LESSON : 1

MEANING, CHARACTERISTICS AND TYPES OF A COMPANY

STRUCTURE

1.0 OBJECTIVE

After reading this lesson, you should be able to:

(a) Define a company and explain its features.

(b) Make a distribution between company and partnership firm.

(c) Explain the various types of companies.

1.1 INTRODUCTION

Industrial has revolution led to the emergence of large scale business organizations. These organization require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of

partnerships of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to

overcome the limitations of partnership business. The Multinational companies like Coca-Cola and, General Motors have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Tubro etc.

1.2 MEANING OF COMPANY

Section 3 (1) (i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1) (ii) Of the act states that "an existing company means a company formed and registered under any of the previous companies laws". This definition does not reveal the distinctive characteristics of a company . According to Chief Justice Marshall of USA, "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 character of its creation of its creation confers upon it either expressly or as incidental to its very existence".

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

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

1.3 CHARACTERISTICS OF A COMPANY

The main characteristics of a company are :

1. **Incorporated association.** A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

For forming a public company at least seven persons and for a private company at least two persons are persons are required. These persons will subscribe their names to the Memorandum of association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability [Sec 12(1)]

2. Artificial legal person. A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. It was rightly pointed out in Bates V Standard Land Co. that : "The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them".

But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and be sued in its own name.

However, it is not a citizen as it cannot enjoy the rights under the Constitution of India or Citizenship Act. In State Trading Corporation of India v C.T.O (1963 SCJ 705), it was held that neither the provisions of the Constitution nor the Citizenship Act apply to it. It should be noted that though a company does not possess fundamental rights, yet it is person in the eyes of law. It can enter into contracts with its Directors, its members, and outsiders.

Justice Hidayatullah once remarked that if all the members are citizens of India, the company does not become a citizen of India.

3. Separate Legal Entity : A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and nor for

the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act. Where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend of income. This proves that a company that a company and its shareholders are two separate entities.

The principal of separate of legal entity was explained and emphasized in the famous case of Salomon v Salomon & Co. Ltd.

The facts of the case are as follows :

Mr. Saloman, the owner of a very prosperous shoe business, sold his business for the sum of $ 39,000 to Saloman and Co. Ltd. which consisted of Saloman himself, his wife, his daughter and his four sons. The purchase consideration was paid by the company by allotment of & 20,000 shares and $ 10,000 debentures and the balance in cash to Mr. Saloman. The debentures carried a floating charge on the assets of the company. One share of $ 1 each was subscribed by the remaining six members of his family. Saloman and his two sons became the directors of this company. Saloman was the managing Director.

After a short duration, the company went into liquidation. At that time the statement of affairs' was like this: Assets :$ 6000, liabilities; Saloman as debenture

holder $ 10,000 and unsecured creditors $ 7,000. Thus its assets were running short of its liabilities b $11,000

The unsecured creditors claimed a priority over the debenture holder on the ground that company and Saloman were one and the same person. But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the assets of the company must be utilized in payment of the debentures first in priority to unsecured creditors.

Saloman's case established beyond doubt that in law a registered company is an entity distinct from its members, even if the person hold all the shares in the company. There is no difference in principle between a company consisting of only two shareholders and a company consisting of two hundred members. In each case the company is a separate legal entity.

The principle established in Saloman's case also been applied in the following: Lee V. Lee's Airforming Ltd. (1961) A.C. 12 Of the 3000 shares in Lee's Air Forming Ltd., Lee held 2999 shares. He voted himself the managing Director and also became Chief Pilot of the company on a salary. He died in an aircrash while working for the company. His wife was granted compensation for the husband in the course of employment. Court held that Lee was a separate person from the company he formed, and compensation was due to the widow. Thus, the rule of corporate personality enabled Lee to be the master and servant at the same time.

The principle of separate legal entity of a company has been, in fact recognized much earlier than in Saloman's case. In Re Kondoi Tea Co Ltd. (1886 ILR 13 Cal 43),

it was held by Calcutta High Court that a company was a separate person, a separate body altogether from its Shareholders. In Re. Sheffield etc. Society - 22 OBD 470), it has been held that a corporation is a legal person, just as much in individual but with no physical existence.

The characteristic of separate corporate personality of a company was also emphasized by Chief Justice Marshall of USA when he defined a company "as a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as accident to its very existence". [Trustees of Darmouth College v woodward (1819) 17 US 518)

4. Perpetual Existence. A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can dissolve it. Members may come and go but the company can go on for ever. "During the war all the member of one private company , while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed i". The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.

5. Common Seal. As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural person who are called its directors. But having a legal personality,

it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company. A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document. If the Articles are silent, the provisions of Table-A (the model set of articles appended to the Companies Act) will apply. As per regulation 84 of Table-A the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose, and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

6. Limited Liability : A company may be company limited by shares or a company limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares. For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs. 7 per share, he can be called upon to pay not more than Rs. 3 per share during the lifetime of the company. In a company limited by guarantee the liability of members is limited to such amount as the member may undertake to contribute to the assets of the company in the event of its being woundup.

7. Transferable Shares. In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision

in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition.

In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

8. Separate Property : As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

9. Delegated Management : A joint stock company is an autonomous, self-governing and self-controlling organization. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, know as directors. They look after the day-to-day working of the company. Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines. Majority decision and centralized management compulsorily bring about unity of action.

1.4 DISTINCTION BETWEEN COMPANY AND PARTNERSHIP

The difference between a company and partnership is as follows:

	Company	Partnership
1. Mode of creation	By Registration by Statute.	By Agreement
2. Legal Statute	Legal entity distinct from members, perpetual succession.	Firm and partners are not separate; no separate entity; uncertain life
3. Liability	Limited liability of members	Unlimited joint and several liability of partners
4. Authority	Divorce between ownership and management Representative Management	Right to share mana gement, common and ownership and Management. Mutual agency - Implied authority.
5. Transfer of shares	Public Co.-freely transferable; transferee gets all the rights of the transferor	Ordinarily no right of transfer of share by a partner-limited rights of transferee

6. Number of members	Private Co-Minimum 2 and Maximum 50 public Co. Minimum7 and Maximum unlimited.	Minimum 2 Maximum 20.
7. Resources	Large and unlimited resources	Personal resources of partners are limited.
8. General powers	Memorandum defines and confines the scope of the company. alteration difficult.	Easy to change the agreement and so also the powers of the partners.
9. Legal formalities	Statutory books, Audit, Publication Registration, filing, etc. lots of legal formalities	No legal formalities Registration not compulsory. No audit, no publication of accounts etc.
10. Dissolution	Only according to the provisions of law- usually by an order of the court. Death of a share-holder does not affect the existence of a company.	Dissolution by agreement by notice, by court. Death of a partner may mean dissolution of partnership

1.5 TYPES OF COMPANY

Joint stock company can be of various types. The following are the important types of company:

1. Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies.

A. Chartered companies. These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charted, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

B. Statutory Companies. These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alternations in the powers of such companies can be brought about by legislative amendments.

The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts [Sec 616 (d)]

These companies are generally formed to meet social needs and not for the purpose of earning profits.

C. Registered or incorporated companies. These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is
the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following.

i) Companies limited by Shares : These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining unpaid on the shares subscribed by him. Such a company is called company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.

ii) Companies Limited by Guarantee : These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company [Sec 13(3)] This amount promised by him is called

'Guarantee'. The Articles of Association of the company state the number of member with which the company is to be registered [Sec 27 (2)]. Such a company is called a company limited by guarantee. Such companies depend for their existence on entrance and subscription fees. They may or may not have a share capital. The liability of the member is limited to the extent of the guarantee and the face value of the shares subscribed by them, if the company has a share capital. If it has a share capital, it may be a public company or a private company.

The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company. Non-

trading or non-profit companies formed to promote culture, art, science, religion, commerce, charity, sports etc. are generally formed as companies limited by guarantee.

iii) **Unlimited Companies :** Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an 'unlimited company' [Sec 12(c)]. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered [Sec 27 (1)]

The articles of an unlimited company shall state the number of member with which the company is to be registered.

II. On the Basis of Number of Members

On the basis of number of members, a company may be :

(1) Private Company, and (2) Public Company.

A. Private Company

According to Sec. 3(1) (iii) of the Indian Companies Act, 1956, a private company is that company which by its articles of association :

i) limits the number of its members to fifty, excluding employees who are members or ex-employees who were and continue to be members;

ii) restricts the right of transfer of shares, if any;

iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

Where two or more persons hold share jointly, they are treated as a single member.

According to Sec 12 of the Companies Act, the minimum number of members to form a private company is two. A private company must use the word "Pvt" after its name.

Characteristics or Features of a Private Company. The main features of a private of a private company are as follows :

i) A private company restricts the right of transfer of its shares. The shares of a private company are not as freely transferable as those of public companies. The articles generally state that whenever a shareholder of a Private Company wants to transfer his shares, he must first offer them to the existing members of the existing members of the company. The price of the shares is determined by the directors. It is done so as to preserve the family nature of the company's shareholders.

ii) It limits the number of its members to fifty excluding members who are employees or ex-employees who were and continue to be the member. Where two or more persons hold share jointly they are treated as a single member. The minimum number of members to form a private company is two.

iii) A private company cannot invite the public to subscribe for its capital or shares of debentures. It has to make its own private arrangement.

B. Public company

According to Section 3 (1) (iv) of Indian Companies Act. 1956 "A public company which is not a Private Company",

If we explain the definition of Indian Companies Act. 1956 in regard to the public company, we note the following :

i) The articles do not restrict the transfer of shares of the company

ii) It imposes no restriction no restriction on the maximum number of the members on the company.

iii) It invites the general public to purchase the shares and debentures of the companies

(Differences between a Public Company and a Private company)

1. **Minimum number :** The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.
2. **Maximum number :** There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.

3. **Number of directors.** A public company must have at least 3 directors whereas a private company must have at least 2 directors (Sec. 252)
4. **Restriction on appointment of directors.** In the case of a public company, the directors must file with the Register a consent to act as directors or sign an undertaking for their qualification shares. The directors or a private company need not do so (Sec 266)
5. **Restriction on invitation to subscribe for shares.** A public company invites the general public to subscribe for shares. A public company invites the general public to subscribe for the shares or the debentures of the company. A private company by its Articles prohibits invitation to public to subscribe for its shares.
6. **Name of the Company :** In a private company, the words "Private Limited" shall be added at the end of its name.
7. **Public subscription :** A private company cannot invite the public to purchase its shares or debentures. A public company may do so.
8. **Issue of prospectus :** Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.
9. **Transferability of Shares.** In a public company, the shares are freely transferable (Sec. 82). In a private company the right to transfer shares is restricted by Articles.
10. **Special Privileges.** A private company enjoys some special privileges. A public company enjoys no such privileges.
11. **Quorum.** If the Articles of a company do not provide for a larger quorum. 5 members personally present in the case of a public company are quorum for a meeting of the company. It is 2 in the case of a private company (Sec. 174)

12. **Managerial remuneration.** Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.

13. **Commencement of business.** A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a "Certificate of Commencement of business".

Special privileges of a Private Company

Unlike a private a public company is subject to a number of regulations and restrictions as per the requirements of Companies Act, 1956. It is done to safeguard the interests of investors/shareholders of the public company. These privileges can be studied as follows:

a) Special privileges of all companies. The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company :

1. A private company may be formed with only two persons as member. [Sec.12(1)]
2. It may commence allotment of shares even before the minimum subscription is subscribed for or paid (Sec. 69).
3. It is not required to either issue a prospectus to the public of file statement in lieu of a prospectus. (Sec 70 (3)]
4. Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. [Sec 81 (3)]

5. Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 14)

6. It need not keep an index of members. (Sec. 115)

7. It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required. [Sec. 149 (7)]

8. It need not hold statutory meeting or file a statutory report [Sec. 165 (10)]

9. Unless the articles provide for a larger number, only two persons personally present shall form the quorum in case of a private company, while at least five member personally present form the quorum in case of a public company (Sec. 174).

10. A director is not required to file consent to act as such with the Registrar. Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private companies [Sec. 266 (5) (b)]

11. Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company on or before 1st April 1952 [Sec. 284 (1)]

12. In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two member if not more than seven member are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up (Sec. 179).

13. It need not have more than two directors, while a public company must have at least three directors (Sec. 252)

b) Privileges available to an independent private company (i.e. one which is not a subsidiary of a public company)

An independent private company is one which is not a subsidiary of a public company. The following special privileges and exemptions are available to an independent private company.

1. It may give financial assistance for purchase of or subscription for shares in the company itself.
2. It need not, like a public company, offer rights shares to the equity shareholders of the company.
3. The provisions of Sec. 85 to 90 as to kinds of share capital, new issues of share capital, voting, issue of shares with disproportionate rights, and termination of disproportionately excessive rights, do not apply to an independent private company.
4. A transfer or transferee of shares in an independent private company has no right of appeal to the Central Government against refusal by the company to register a transfer of its shares.
5. Sections 171 to 186 relating to general meeting are not applicable to an independent private company if it makes its own provisions by the Articles. Some provisions of these Sections are, however made expressly applicable.
6. Many provisions relating to directors of a public company are not applicable to an independent private company, e.g.

a) it need not have more than 2 directors.

b) The provisions relating to the appointment, retirement, reappointment, etc. of directors who are to retire by rotation and the procedure relating, there to are not applicable to it.

c) The provisions requiring the giving of 14 days' notice by new candidates seeking election as directors, as also provisions requiring the Central Government's sanction for increasing the number of directors by amending the Articles or otherwise beyond the maximum fixed in the Articles, are not applicable to it.

d) The provisions relating to the manner of filing up casual vacancies among directors and the duration of the period of office of directors and the requirements that the appointment of directors should be voted on individually and that the consent of each candidate for directorship should be filed with the Registrar, do not apply to it.

e) The provisions requiring the holding of a share qualification by directors and fixing the time within which such qualification is to be acquired and filing with the Registrar of a declaration of share qualification by each director are also not applicable to it.

f) It may, by its Articles, Provide special disqualifications for appointment of directors.

g) It may provide special grounds for vacation of office of a director.

h) Sec. 295 prohibiting loans to directors does not apply to it.

i) An interested director may participate or vote in Board's proceedings relating to his concern of interest in any contract of arrangement.

7. The restrictions as to the number of companies of which a person may be appointed managing director and the prohibition of such appointment for more than 5 years at a time, do not apply to it

8. The provisions prohibiting the subscribing for, or purchasing of, shares or debentures of other companies in the same group do not apply to it.

9. The provisions of Section 409 conferring power on the Central Government to present change in the Board of directors of a company where in the opinion of the Central Government such change will be prejudicial to the interest of the company, do not apply to it.

When a Private company becomes a Public company

A private company shall become a public company in following cases :

i) By default : When it fails to comply with the essential requirements of a private company provided under Section 3 (1) (iii) Default in complying with the said three provisions shall disentitle a private company to enjoy certain privileges (Sec. 43).

ii) A private company which is a subsidiary of another public company shall be deemed to be a public company.

iii) By provisions of law - Section 43-A.

Section 43-A

a) Where not less than 25% of the paid-up share capital of a private company is held by one or more bodies" corporate such a private company shall

become a public company from the data in which such 25% is held by body corporate [Sec. 43-A (1)]

b) Where the average annual turnover of a private company is not less than Rs. 10 crores during the relevant period, such a private company shall become a public company after the expiry of the period of three months from the last day of the relevant period when the accounts show the said average annual turnover [Sec. 43 A (1 A)].

c) When a private company holds not less than 25% of the paid up share capital of a public company the private company shall become a public company from the date on which the private company holds such 25% [Sec. 43A (IB)].

d) Where a private company accepts, after an invitation is made by an advertisement of receiving deposits from the public other than its members, directors or their relatives, such private company shall become a public company [Sec. 43A (IC)].

iv) **By Conversion :** When the private company converts itself into a public company by altering its Articles in such a manner that they no longer include essential requirements of a private company under Section 3 (1) (iii). On the data of such alternations, it shall cease to be private company. It shall comply with the procedure of converting itself into a public company [Sec. 44].

The Articles of Association of such a public company may continue to have the three restrictions and may continue to have two directors and less than seven members.

Within 3 months of such a conversion. Registrar of Companies shall be intimated. The Registrar shall delete the word 'Private' before the words 'Limited' in the name of the company and shall also make necessary alternations in the certificate of incorporation.

III. On the basis of Control

On the basis of control, a company may be classified into :

1. Holding companies, and
2. Subsidiary Company

1. Holding Company [Sec. 4(4)]. A company is known as the holding company of another company if it has control over the other company. According to Sec 4(4) a company is deemed to be the holding company of another if, but only if that other is its subsidiary.

A company may become a holding company of another company in either of the following three ways :-

a) by holding more than fifty per cent of the normal value of issued equity capital of the company; or

b) By holding more than fifty per cent of its voting rights; or

c) by securing to itself the right to appoint, the majority of the directors of the other company , directly or indirectly.

The other company in such a case is known as a "Subsidiary company". Though the two companies remain separate legal entities, yet the affairs of both the companies are managed and controlled by the holding company. A holding company may have any number of subsidiaries. The annual accounts of the holding company are required to disclose full information about the subsidiaries.

2. Subsidiary Company. [Sec. 4 (I)]. A company is know as a subsidiary of another company when its control is exercised by the latter (called holding company) over the

former called a subsidiary company. Where a company (company S) is subsidiary of another company (say Company H), the former (Company S) becomes the subsidiary of the controlling company (company H).

IV. On the basis of Ownership of companies

a) Government Companies. A Company of which not less than 51% of the paid up capital is held by the Central Government of by State Government or Government singly or jointly is known as a Government Company. It includes a company subsidiary to a government company. The share capital of a government company may be wholly or partly owned by the government, but it would not make it the agent of the government . The auditors of the government company are appointed by the government on the advice of the Comptroller and Auditor General of India. The Annual Report along with the auditor's report are placed before both the House of the parliament. Some of the examples of government companies are - Mahanagar Telephone Corporation Ltd., National Thermal Power Corporation Ltd., State Trading Corporation Ltd. Hydroelectric Power Corporation Ltd. Bharat Heavy Electricals Ltd. Hindustan Machine Tools Ltd. etc.

b) Non-Government Companies. All other companies, except the Government Companies, are called non-government companies. They do not satisfy the characteristics of a government company as given above.

V. On the basis of Nationality of the Company

a) Indian Companies : These companies are registered in India under the Companies Act. 1956 and have their registered office in India. Nationality of the members in their case is immaterial.

b) Foreign Companies : It means any company incorporated outside India which has an established place of business in India [Sec. 591 (I)]. A company has an

established place of business in India if it has a specified place at which it carries on business such as an office, store house or other premises with some visible indication premises. Section 592 to 602 of Companies Act, 1956 contain provisions applicable to foreign companies functioning in India.

1.6 SUMMARY

Company may be defined as group of persons associated together to achieve some common objective. A company formed and registered under the Companies Act has certain special features, which reveal the nature of a company. These characteristics are also called he advantages of a company because as compared with other business organizations, these are in fact, beneficial for a company. Companies can be classified into five categories according to the mode of incorporation on the basis of number of members, on the basis of control, on the basis of ownership and on the basis of nationality of the company.

1.7 KEYWORDS

Company: A company means a body of individuals associated together for a common objective, which may be business for profit or for some charitable purposes.

Registered Company: A registered company is one which is formed and registered under the Indian Companies Act, 1956 or under any earlier Companies Act in force in India.

Public Company: A public company means a company which is not a private company. Any seven or more persons can join hands to form a public company.

Holding Company: A company shall be deemed to be the holding company to another if that other is its subsidiary.

Unlimited Company: A company not having any limit on the liability of its member is called an unlimited company.

1.8 SELFASSESSMENT QUESTIONS

1. Define 'Company'. What are its essential characteristics ?
2. Explain the special privileges of a private company as compared to a public company.
3. Bring out the difference between partnership and company form of organization.
4. Write notes on :
   a) Chartered Companies
   b) Government Companies
5. Classify company form of organization on the basis of liability of members.

1.9 SUGGESTED READINGS

P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.

N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.

S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.

S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

INCORPORATION OF COMPANIES; MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

STRUCTURE

2.0 OBJECTIVE

After reading this lesson, you should be able to

(a) Describe the process of formation of a company.

(b) Explain the different clauses of memorandum of association and the alterations thereof.

(c) Discuss the contents of articles of association.

(d) highlight the importance of constructive notice of memorandum and articles of association.

2.1 INTRODUCTION

We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions such as (a) which business they should start, (b) whether they should form a new company or take over he business of some existing company, (c) if new company is to be started, whether they should start a private company or pubic company, (d) what should be the capital of the company etc. After deciding about the formation of the company, the desirous persons take necessary steps, and the company is actually formed. Thereafter, they start their business. Thus, there are various stage in the formation of a company from thinking of starting a business to the actual starting of the business.

2.2 INCORPORATION OF COMPANIES

Company is an artificial person created by following a legal procedure. Before a company is formed, a lot of preliminary work is to be performed. The lengthy process of formation of a company can be divided into four distinct stages : (I) Promotion; (ii) Incorporation or Registration; (iii) Capital subscription; and (iv) Commencement of business. However, a private company can start business as soon as it obtains the certificate of incorporation. It needs to go through first two stages only. The reason is that a private company cannot invite public to subscribe to its share capital. But a public company having a share capital, has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers (Section 149). These four stages are discussed as follow :

2.2.1 Promotion

The term 'promotion' is a term of business and not of law. It is frequently used in business. Haney defines promotion as " the process of organizing and planning the finances of a business enterprise under the corporate form". Gerstenberg has defined promotion as "the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom." First of all the idea of carrying on a business is conceived by promoters. Promoters are persons engaged in, one or the other way; in the formation of a company. Next, the promoters make detailed study to assess the feasibility of the business idea and the amount of financial and other resources required. When the promoters are satisfied about practicability of the business idea , they take necessary steps for assembling the business elements and making provision of the funds required to launch the business enterprise. Law does not require any qualification for the promoters. The promoters stand in a fiduciary position towards the company about to be formed. From the fiduciary position of promoters, the following important results follow:

1. A promoter cannot be allowed to make any secret profits. If any secret profit is made in violation of this rule, the company may, on discovering it, compel the promoter to account for and surrender such profit.
2. The promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If he contracts to sell his own property to the company without making a full disclosure, the companmy may either rescind the sale or affirm the contract and recover the profit made out of it by the promoter.

3. The promoter must not make an unfair or unreasonable use of his position and must take care to avoid anything which has the appearance of undue influence or fraud.

Promoter's Remuneration

A promoter has no right to get compensation from the company for his services in promoting it unless the company, after its incorporation, enters into a contract with him for this purpose. If allowed, remuneration may be paid in cash or partly in cash partly in shares and debentures of the company.

Promoter's Liability

If a promoter does not disclose any profit made out of a transaction to which the company is a party, then the company may sue the promoter and recover the undisclosed profit with interest Otherwise, the company may set aside the transaction i.e., it may restore the property to promoter and recover its money.

Besides, Section 62 (1) holds the promoter liable to pay compensation to every person who subscribes for any share or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. Section 62 also provides certain grounds on which a promoter can avoid his liability. Similarly Section 63 provides for criminal liability for misstatement in the prospectus and a promoter may also become liable under this section.

Promoter's Contracts

Preliminary contracts are contracts made on behalf of a company yet to be incorporated. Following are some of the effects of such contracts;

1. The company, when it comes into existence, is not bound by any contract made on its behalf before its incorporation. A company has no status prior to its incorporation.

2. The company cannot ratify a pre-incorporation contract and hold the other party liable. Like the company, the other party to the contract is also not bound by such a contract.

3. The agents of a proposed company may sometimes incur personal liability under a contract made on behalf of the company yet to be formed.

Kelner v Bexter (1886) L.R. 2 C.P.174. A hotel company was about to be formed and promoters signed an agreement for the purchase of stock on behalf of the proposed company. The company came into existence but, before paying the price, went into liquidation. The promoters were held personally liable to the plaintiff.

Further, an agent himself may not be able to enforce the contract against the other party. So far as ratification of a pre-incorporation contract is concerned, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. The reason is simple, ratification can be done only if an agent contracts for a principal who is in existence and who is competent to contract at the time of the contract by the agent.

2.2.2 Incorporation

This is the second stage of the company formation. It is the registration that brings a company into existence. A company is legally constituted on being duly registered under the Act and after the issue of Certificate of Incorporation by the Registrar of Companies. For the incorporation of a company the promoters take the following preparatory steps:

i) To find out form the Registrar of companies whether the name by which the new company is to be stareted is available or not. To take approval of the name, an application has to be made in the prescribed form along with requisite fee;

ii) To get a letter of Intent under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act.

iii) To get necessary documents i.e. Memorandum and Articles of Association prepared and printed.

iv) to prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

Registration of a company is obtained by filing an application with the Registrar of Companies of the State in which the registered office of the comapany is to be situated. The application should be accompanied by the following documents:

1. Memorandum of association properly stamped, duly signed by the signatories of the memorandum and witnessed.
2. Ariticles of Association, if necessary.
3. A copy of the agreement, if any, which the company proposes to enter into with any individual for his appointment as managing or whole-time director or manager.
4. A written consent of the directors to act in that capacity, if necessary.
5. A statutory declaration stating that all the legal requirements of the Act prior to incorporation have been complied with.

The Registrar will scrutinize these documents. If the Registrar finds the document to be satisfactory, he registers them and enters the name of the company in the Register of Companies and issues a certificate called the certificate of incorporation (Section 34).

The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing in it is conclusive, even if wrong. Further, the

certificate is 'conclusive evidence that all the requirements of this Act in respect of registration and matters precedent and related thereto have been fulfilled and that the association is a company authorized to be registered and duly registered under this Act.

Once the company is created it cannot be got rid off except by resorting to provisions of the Act which provide for the winding up of company. The certificate of incorporation, even if it contains irregularities, cannot be cancelled.

2.2.3 Capital Subscription

A private company can start business immediately after the grant of certificate of incorporation but public limited company has to further go through 'capital subscription stage' and 'commencement of business stage'. In the capital subscription stage, the company makes necessary arrangements for raising the capital of the company. With a view to ensure protection on investors, Securities and Exchange Boar of India (SEBI) has issued 'guidelines for the disclosure and investor protection'. The company making a public issue of share capital must comply with these guidelines before making a public offer for sale of shares and debentures.

If the capital has to be said through a public offer of shares, the directors of the public company will first file a copy of the prospectus with the Registrar of Companies. On the scheduled date the prospectus will be issued to the public. Investors are required to forward their applications for shares along with application money to the company's bankers mentioned in the prospectus. The bankers will then forward all applications to the company and the directors will consider the allotment of shares. If the subscribed capital is at least equal to 90 percent of the capital issue, and other requirements of a valid allotment are fulfilled the directors pass a formal resolution of allotment. However, if the company does not receive applications which can cover the minimum subscription

within 120 days of the issue of prospectus, no allotment can be made and all money received will be refunded.

If a public company having share capital decides to make private placement of shares, then, instead of a 'prospectus' it has to file with the Registrar of Companies a ' statement in lieu of prospectus' at least three days before the directors proceed to pass the first share allotment resolution.

The contents of a prospectus and a statement in lieu of a prospectus are almost alike.

2.2.4 Commencement of Business

A private company can commence business immediately after the grant of certificate of incorporation, but a public limited company will have to undergo some more formalities before it can start business. The certificate for commencement of business is issued by Registrar of Companies, subject to the following conditions.

1. Shares payable in cash must have been allotted upto the amount of minimum subscription
2. Every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others.
3. No money should have become refundable for failure to obtain permission for shares or debentures to be dealt in any recognized stock exchange.
4. A declaration duly verified by one of directors or the secretary that the above requirements have been complied with which is filed with the Registrar.

The certificate to commence business granted by the Registrar is a conclusive evidence of the fact that the company has complied with all legal formalities and it is legally entitled to commence business. It may also be noted that the court has the

power to wind up a company, if it fails to commence business within a year of its incorporation [Sec. 433 (3)]

2.3 MEMORANDUM OF ASSOCIATION

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are :

1. Memorandum of Association
2. Articles of Association

The preparation of Memorandum of Association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. It governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly is its permitted range of activities. It enables these parties to know the purpose, for which their money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

Form of Memorandum (Sec. 14)

Companies Act has given four forms of Memorandum of Association in Schedule I. These are as follows :

Table B	Memorandum of a company limited by shares
Table C	Memorandum of a company limited by guarantee and not having a share capital

Table D Memorandum of company limited by guarantee and having share capital.

Table E Memorandum of an unlimited company

Every company is required to adopt one of these forms or any other form as near there to as circumstances admit.

Printing and signing of Memorandum (Sec. 15).

The memorandum of Association of a company shall be (a) printed, (b) divided into paragraphs numbered consecutively, and (c) signed by prescribed number of subscribers (7 or more in the case of public company, two or more in the case of private company respectively). Each subscriber must sign for his/her name, address, description and occupation in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

Contents of Memorandum

1. Name clause

Promoters of the company have to make an application to the registrar of Companies for the availability of name. The company can adopt any name if :

i) There is no other company registered under the same or under an identical name;

ii) The name should not be considered undesirable and prohibited by the Central Government (Sec. 20). A name which misrepresents the public is prohibited by the Government under the Emblems & Names (Prevention of Improper use) Act, 1950 for example, Indian National Flag, name pictorial representation of Mahatma Gandhi and the Prime Minister of India, name and emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments.

Where the name of the company closely resembles the name of the company already registered, the Court may direct the change of the name of the company.

iii) Once the name has been approved and the company has been registered, then

a) the name of the company with registered office shall be affixed on outside of the business premises;

b) if the liability of the members is limited the words "Limited" or "Private Limited" as the case may be, shall be added to the name; [Sec 13(1) (1)]: Omission of the word 'Limited' makes the name incorrect. Where the word'

Limited" forms part of a company's name, omission of this word shall make the name incorrect. If the company makes a contract without the use of the word "Limited", the officers of the company who make the contract would be deemed to be personally liable [Atkins & Co v Wardle, (1889) 61 LT 23]

The omission to use the word 'Limited' as part of the name of a company must have been deliberate and not merely accidental. Note the following case in this regard:

Dermatine Co. Ltd. v Ashworth, (1905) 21 T.L.R. 510. A bill of exchange drawn upon a limited company in its proper name was duly accepted by 2 directors of the company. The rubber stamp by which the word of acceptance were impressed on the bill was longer that the paper of the bill and hence the word 'Limited' was missed. Held, the company was liable to pay and the directors were not personally liable.

(c) the name and address of the registered office shall be mentioned in all letter- heads, business letters, notices and Common Seal of the Company, etc. (Sec. 147).

In Osborn v The Bank of U. A. E., [9 Wheat (22 US), 738]; it was held that the

name of a company is the symbol of its personal existence. The name should be properly and correctly mentioned. The Central Government may allow a company to drop the word "Limited" from its name.

2. Registered Office Clause

Memorandum of Association must state the name of the State in which the registered office of the companmy is to be situated. It will fix up the domicile of the company. Further, every company must have a registered office either from the day it begins to carry on business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed. Registered Office of a company is the place of its residence for the purpose of delivering or addressing any communication, service of any notice or process of court of law and for determining question of jurisdiction of courts in any action against the company. It is also the place for keeping statutory books of the company.

Notice of the situation of the registered office and every change shall be given to the Registrar within 30 days after the date of incorporation of the company or after the date of change. If default is made in complying with these requirements, the company and every officer of the company who is default shall be punishable with fine which may extend to Rs. 50 per during which the default continues.

3. Object Clause

This is the most important clause in the memorandum because it not only shows the object or objects for which the company is formed but also determines the extent of the powers which the comapany can exercise in order to achieve the object or objects. Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. It is essential that the public who purchase its shares should know clearly what are the objects for which

they are paying.

In the case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act. 1965, the object clause has simply to state the objects of the company. But in the case of a company to be registered after be amendment, the objects clause must state separately.

i) **Main Objects** : This sub-clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects.

ii) **Other objects**: This sub-clause shall state other objects which are not included in the above clause.

Further, in case of a non-trading company, whose objects are not confined to one state, the objects clause must mention specifically the States to whose territories the objects extend. (Sec. 13)

A company, which has a main object together with a number of subsidiary objects, cannot continue to pursue the subsidiary objects after the main object has come to an end.

Crown Bank. Re (1890) 44 Ch D. 634. A company's objects clause enabled it to act as a bank and further to invest in securities land to underwrite issue of securities. The company abandoned its banking business and confined it self to investment and financial speculation. Held, the company was not entitled to do so.

Incidental acts. The powers specified in the Memorandum must not be construed strictly. The company may do anything which is fairly incidental to these powers. Anything reasonable incidental to the attainment or pursuit of any of the express objects of the company will, unless expressly prohibited, be within the implied powers of the

company.

While drafting the objects clause of a company the following points should be kept in mind.

i) The objects of the company must not be illegal, e.g. to carry on lottery business.

ii) The objects of the company must not be against the provisions of the Companies Act such as buying its own shares (Sec. 77), declaring dividend out of capital etc.

iii) The objects must not be against public, e.g. to carry on trade with an enemy country.

iv) The objects must be stated clearly and definitely. An ambiguous statement like "Company may take up any work which it deems profitable" is meaningless.

v) The objects must be quite elaborate also. Note only the main objects but the subsidiary or incidental objects too should be stated.

The narrower the objects expressed in the memorandum, the less is the subscriber's risk, but the wider such objects the greater is the security of those who transact business with the company.

4. Capital Clause

In case of a company having a share capital unless the company is an unlimited company, Memorandum shall also state the amount of share capital with which the company is to be registered and division there of into shares of a fixed amount [Sec. 13 (4)]. The capital with which the company is registered is called the authorized or nominal share capital. The nominal capital is divided into classes of shares and their values are mentioned in the clause. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects

of the company. IN case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less than one share. Each subscriber of the Memorandum shall write against his name the number of shares he takes.

5. Liability Clause

In the case of company limited by shares or by guarantee, Memorandum of Association must have a clause to the effect that the liability of the members is limited. It implies that a shareholder cannot be called upon to pay any time amount more then the unpaid portion on the shares held by him. He will no more be liable if once he has paid the full nominal value of the share.

The Memorandum of Association of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up, while he is a member or within one year after he ceased to be so, towards the debts and liabilities of the company as well as the costs and expenses of winding up and for the adjustment of the rights of the contributories among themselves not exceeding a specified amount.

Any alteration in the memorandum of association compelling a member to take up more shares, or which increases his liability, would be null and void. (Sec 38).

If a company carries on business for more than 6 months while the number of members is less than seven in the case of public company, and less than two in case of a private company, each member aware of this fact, is liable for all the debts contracted by the company after the period of 6 months has elapsed. (Sec. 45).

6. Association or Subscription Clause

In this clause, the subscribers declare that they desire to be formed into a

company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any. This clause generally runs in this form : "we, the several person whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the number of shares in the capital of the company, set opposite of our respective name".

After registration, no subscriber to the memorandum can withdraw his subscription on any ground.

Alteration of Memorandum of Association

Alteration of Memorandum of association involves compliance with detailed formalities and prescribed procedure. Alternations to the extent necessary for simple and fair working of the company would be permitted. Alterations should not be prejudicial to the members or creditors of the comapany and should not have the effect of increasing the liability of the members and the creditors.

Contents of the Memorandum of association can be altered as under :

1. Change of name

A company may change its name by special resolution and with the approval of the Central Government signified in writing . However, no such approval shall be required where the only change in the name of the company is the addition there to or the deletion there from, of the word "Private", consequent on the conversion of a public company into a private company or of a private company into a public company. (Sec. 21)

By ordinary resolution. If through inadvertence or otherwise, a company is registered by a name which, in the opinion of the Central Government, is identical with or too nearly resembles the name of an existing comapany, it may change its name by an ordinary resolution and with the previous approval of the Central Government signified in writing. [Sec. 22(1) (a)].

Registration of change of name. Within 30 days passing of the resolution, a copy of the order of the Central Government's approval shall also be field with the Registrar within 3 months of the order. The Registrar shall enter the new name in the Register of Companies in place of the former name and shall issue a fresh certificate of incorporation with the necessary alterations. The change of name shall be complete and effective only on the issue of such certificate. The Registrar shall also make the necessary alteration in the company's memorandum of association (Sec. 23)

The change of name shall not affect any right or obligations of the company or render defective any legal proceeding by or against it. (Sec. 23).

2. Change of Registered Office

This may involve :

a) Change of registered office from one place to another place in the same city, town or village. In this case, a notices is to be give within 30 days after the date of change to the Registrar who shall record the same.

b) Change of registered office from one town to another town in the same State. In this case, a special resolution is required to be passed at a general meeting of the shareholders and a copy of it is to be filed with the Registrar within 30 days. The within 30 days of the removal of the office. A notice has to be given to the Registrar of the new location of the office.

c) Change of Registered Office from one State to another State to another State.

Section 17 of the Act deals with the change of place of registered office form one State to another State. According to it, a company may alter the provision of its memorandum so as to change the place of its registered office from one State to another State for certain purposes referred to in Sec 17(1) of the Act. In addition the following steps will be taken.

Special Resolution

For effecting this change a special resolution must be passed and a copy there of must be filed with the Registrar within thirty days. Special resolution must be passed in a duly convened meeting.

Confirmation by Central Government

The alteration shall not take effect unless the resolution is confirmed by the Central Government.

The Central Government before confirming or refusing to confirm the change will consider primarily the interests of the company and its shareholders and also whether the change is bonafide and not against the public interest. The Central Government may then issue the confirmation order on such terms and conditions as it may thinkfit.

3. Alteration of the Object Clause

The Company may alter its objects on any of the grounds (I) to (vii) mentioned in Section 17 of the Act.

The alteration shall be effective only after it is approved by special resolution of the members in general meeting with the Companies Amendment Act, 1996, for alteration of the objects clause in Memorandum of Associations sanction of Central Government is dispensed with.

Limits of alteration of the Object Clause

The limits imposed upon the power of alteration are substantive and procedural. Substantive limits are provided by Section 17 which provides that a company may change its objects only in so far as the alteration is necessary for any of the following purposes:

i) to enable the company to carry on its business more economically or more effectively;

ii) to enable the company to attain its main purpose by new or improved means;

iii) to enlarge or change the local area of the company's operation;

iv) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company;

v) to restrict or abandon any of the objects specified in the memorandum

vi) to sell or dispose of the whole, or any part of the undertaking of the company;

vii) to amalgamate with any other company or body of persons.

Alterations in the objects is to be confined within the above limits for otherwise alteration in excess of the above limitations shall be void.

A company shall file with the registrar a special resolution within one month from the date of such resolution together with a printed copy of the memorandum as altered. Registrar shall register the same and certify the registration. [Sec. 18].

Effect of non Registration with Registrar

Any alteration, if not registered shall have no effect. If the documents required to be filed with the Registrar are not filed within one month, such alteration and the order of the Central Government and all proceedings connected therewith shall at the expiry of such period become void and inoperative. The Central Government may, on sufficient cause show, revive the order on application made within a further period of one month [Sec. 19]

4. Alteration of Capital Clause

The procedure for the alteration of share capital and the power to make such alteration are generally provided in the Articles of Association If the procedure and power are not given in the Articles of Associational, the company must change the articles of association by passing a special resolution. If the alteration is authorized by the Articles, the following changes in share capital may take place :

1. Alteration of share capital [Section 94-95]
2. Reduction of capital [Section 100-105]
3. Reserve share capital or reserve liability [Section 99]
4. Variation of the rights of shareholders [Section 106-107]
5. Reorganization of capital [Section 390-391]

5. Alteration of Liability Clause

Ordinarily the liability clause cannot be altered so as to make the liability of members unlimited. Section 38 states that the liability of the members cannot be increased without their consent. It lays down that a member cannot by changing the memorandum or articles, be made to take more shares or to pay more the shares already taken unless he agrees to do so in writing either before or after the change.

A company, if authorized by its Articles, may alter its memorandum to make the liability of its directors or manager unlimited by passing a special resolution. This rule applies to future appointees only. Such alteration will not effect the existing directors and manager unless they have accorded their consent in writing. [Section 323].

Section 32 provides that a company registered as unlimited may register under this Act as a limited company. The registration of an unlimited company as a limited company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into by the company before such registration.

2.4 ARTICLES OFASSOCIATION

Every company is required to file Articles of Association along with the Memorandum of Association with the Registrar at the time of its registration. Companies Act defines 'Articles as Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies Acts. They also include, so far as they apply to the company, those in the Table A in Schedule I annexed to the Act or corresponding provisions in earlier Acts.

Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

In framing Articles of Association care must be taken to see that regulations framed do not go beyond the powers of the company it self as contemplated by the Memorandum of Association nor should they be such as would violate any of the requirements of the companies Act, itself. All clauses in the Articles ultra vires the Memorandum or the Act shall be null and void.

Article of Association are to be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation. Each subscriber shall sign in the presence of at least one witness who shall attest the signatures and also mention his own address and occupation.

Contents of Articles of Association

Articles generally contain provision relating to the following matters; (1) the exclusion, whole or in part of Table A; (ii) share capital different classes of shares of shareholders and variations of these rights (iii) execution or adoption of preliminary agreements, if any; (iv) allotment of shares; (v) lien on shares (vi) calls on shares; (vii)

forfeiture of shares; (viii) issue of share certificates; (ix) issue of share warrants; (x) transfer of shares; (xi) transmission of shares; (xii) alteration of share capital; (xiii) borrowing power of the company; (xiv) rules regarding meetings; (xv) voting rights of members; (xvi) notice to members; (xvii) dividends and reserves; (xviii) accounts and audit; (xix) arbitration provision, if any; (xx) directors, their appointment and remuneration; (xxi) the appointment and reappointment of the managing director, manager and secretary; (xxii) fixing limits of the number of directors (xxiii) payment of interest out of capital; (xxiv) common seal; and (xxv) winding up.

Model form of Articles

Different model forms of memorandum of association and Articles of Association of various types of companies are specified in Schedule I to the Act. The schedule is divided into following tables.

Table A deals with regulations for management of a company limited by shares.

Table B contains a model form of Memorandum of Association of a company limited by shares.

Table C gives model forms of Memorandum and Articles of Association of a company limited by guarantee and not having a share capital.

Table D gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital. The Articles of such a company contain in addition to the information about the number of members with which the company proposes to be registered, all other provisions of Table A.

Table E contains the model forms of memorandum and Articles of Association of an unlimited company.

A Public Company may have its own Article of Association. If it does not

have its own Articles, it may adopt Table A given in Schedule I to the Act.

Adoption and application of Table A (Section 28). There are 3 alternative forms in which a public company may adopt Articles :

1. It may adopt Table A in full
2. It may wholly exclude Table A, and set out its own Articles in full
3. It may frame its own Articles and adopt part of Table A.

In other words, unless the Articles of a public company expressly exclude any or all provisions of Table A shall automatically apply to it.

Alteration of Articles

Section 31 grant power to every company to alter its articles whenever it desires by passing a special resolution and filing a copy of altered Articles with the Registrar. An alteration is not invalid simply because it changes the company's constitution. Thus in Andrews v Gas Meter Co., A company was allowed by changing articles to issue preference shares when its memorandum was silent on the point.

Alteration of articles is much easier than memorandum as it can be altered by special resolution. However, there are various limitations under the Companies Act to the powers of the shareholders to alter the articles.

In case of conversion of a public company into a private company, alteration in the articles would only be effective after approval of the Central Government [Section 31]. The power are now vested with the Registrar of Companies.

Alteration of the articles shall not violate provisions of the Memorandum. It must be made bonafide the benefit of the company. All clauses in the articles ultra vires the Memorandum shall be null and void, and the articles shall be held inoperative. Alteration must not contain anything illegal and shall not constitute fraud on the minority.

Alteration in the articles increasing the liability of the members can be done only with the consent of the members.

The Court may even restrain an alteration where is likely to cause a damage which cannot be adequately compensated in terms of money. Similarly, a company cannot by altering articles, justify a breach of contract. Any alteration so made shall be valid as if originally contained in the articles.

Where a special resolution has been passed altering the articles or an alteration has been approved by the Central Government where required, a printed copy of the articles so altered shall be filed by the company with the Registrar of Companies within one month of the date of the passing of special resolution.

2.5 DISTINCTION BETWEEN ARTICLES OFASSOCIATION AND MEMORANDUM OFASSOCIATION

The difference between memorandum of association and articles of association is as under:

Memorandum of Association	Articles of Association
It is character of company indicating nature of business & capital. It also defines the company's relationship with outside world	1. They are the regulation for the internal management of the company and are subsidiary to the memorandum.
It defines the scope of the activities of the company, or the area beyond which the actions of the company cannot go.	2. They are the rules for carrying out the objects of the company as set out in the Memorandum.
It, being the charter of the	3. They are subordinate to

company, is the supreme document.	the Memorandum. If there is a conflict between the Articles and the Memo- randum, the act of the company
Any act of the company which is ultra vires the Memorandum is wholly void and cannot be ratified even by the whole body of shareholders.	4. Any act of the company which is ultra vires the articles can be confirmed by the share-holders if it is intra vires the memorandum.
Every company must have its own Memorandum	5. A company limited by Shares need not have Articles of its own. In such A case, Table A Applies.
There are strict restrictions on its alteration. Some of the conditions of incorporation contained in it cannot be altered except with the sanction of the Central Government.	6. They can be altered by a special resolution, to any extent, provided they do not conflict with the Memorandum and the Companies Act.

2.6 CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum and Articles of a company are registered with the Registrar. These are the public documents and open to public inspection,. Every person

contracting with the company must acquaint himself with their contents and must make sure that his contract is in accordance with them, otherwise he cannot sue the company.

On registration the memorandum and articles of association become public documents. These documents are available for public inspection either in the office of the company or in the office of the Registrar of Companies on payment of one rupee for each inspection and can be copied (Sec. 610).

Every person who deals with the company, whether shareholder or an outsider is presumed to have read the memorandum and articles of association of the company and is deemed to know the contents of these document. Therefore, the knowledge of these documents and their contents is known as the constructive notice of memorandum and articles of association.

It is presumed that persons dealing with the company have not only read these documents but they have also understood their proper meaning.

Where a person deals with the company in a manner, which is inconsistent with the provisions of memorandum or articles, or enters into a transaction which is beyond the powers of the company, shall be personally liable to bear the consequences regarding such dealings.

2.7 SUMMARY

The whole process of formation of a company can be divided into four distinct stages namely promotion incorporation, capital subscription and commencement of business. However, a private company can start business as soon as it obtains the certificate of information. The memorandum of Association of a company tells us the objects of the company's formation and the utmost possible scope of its

operations beyond which its actions cannot go. The memorandum of association of every clause, objects clause, liability clause, Memorandum of association cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure prescribed in the Companies Act. Articles of association contain the rules and regulations which are granted for the internal management of the company. The company may alter its articles of association any time by following the procedure as prescribed in the Companies Act. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their time perspective. This is known as doctrine of constructive notice.

2.8 KEYWORDS

Promotion: Promotion means the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.

Promoter: A promoter is a person who undertakes to form a company with reference to a given object and brings it into actual existence.

Preliminary Contract: Preliminary contract refers to those agreements or contracts entered into between different parties on behalf and for the benefit of the company prior to its incorporation.

Certificate of Commencement of Business: A public company, having a share capital and issuing a prospectus inviting the public to subscribe for shares, will have to file a few documents with the registrar who shall scrutinize them and if satisfied will issue a certificate to commence business.

Memorandum of Association: It is the document which defines the objects and lays down the fundamental conditions upon which along the company is allowed to be incorporated.

Articles of Association: Articles of association are the rules, regulation and bye-laws for governing the internal affairs of the company.

2.9 SELF ASSESSMENT QUESTIONS

1. Explain the process of formation of a company under the Companies Act, 1956.
2. "A certificate of in corporation is conclusive evidence that all the requirements of the Companies Act have been complied with". Comment.
3. What is a Memorandum of Association ? Discuss its clauses
4. How the alteration in the different clauses of Memorandum of Association can be made?
5. What is Articles of Association ? What are its contents ?
6. Distinguish between Memorandum of Association and Articles of Association.

2.10 SUGGESTED READINGS

S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

R.H. Pandia, Priciples of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

LESSON : 3

PROSPECTUS AND COMMENCEMENT OF BUSINESS

STRUCTURE

3.0 OBJECTIVE

After reading this lesson, you should be able to:

(a) Define a prospectus and explain the requirement regarding issue of pro- spectus.

(b) Describe the contents of the prospectus.

(c) Explain the civil and criminal liabilities for mis-statement in prospectus.

(d) Discuss the conditions to be fulfilled by a public company to get certifi- cate of commencement of business.

3.1 INTRODUCTION

The promoters of a public company will have to take steps to raise the necessary capital for the company, after having obtained the Certificate of Incor- poration. A public company may invite the public to subscribe to its shares or debentures. Prospectuses are to be issued for this purpose. To issue a prospectus is very essential for a public company. If the promoters of the company are confident of raising the required capital privately from their friend or relatives, they need not issue a prospectus. In such a case, a statement in lieu of prospectus must be filed with the Registrar. A private company is not allowed to issue a prospectus since it cannot invite the general public to subscribe to its shares and debentures. It is not required to file a statement in lieu of prospectus.

3.2 DEFINITION OF PROSPECTUS

Section 2(36) defines a prospectus an "any document described as issued as a prospectus and includes any notice, circular, advertisement or other docu- ment inviting deposits from the public or inviting orders from the public for the subscription or purchase of any share in, or debentures of, a body corporate". In simple words, a prospectus may be defined as an invitation to the public to subscribe to a company's shares or debentures. By virtue of the Amendment Act of 1974, any document inviting deposits from the public shall also come within the definition of prospectus. The word "Prospectus" means a document which invites deposits from the public or invites offers from the public to buy shares or debentures of the company.

A document will be treated as a prospectus only when it invites offers from a public. According to Section 67 the term “public” is defined as, “It in- cludes any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the pro- spectus or in any other manner”. It further provides that no offer of invitation shall be treated as mode to the public if, (i) the same is not calculated to result in the shares or debentures becoming available other than those receiving the offer or invitation; (ii) it appears to be a domestic concern of the person making and receiving the offer or invitation. The ‘public’ is a general word. No particular numbers are prescribed. The point is that the offer makes the shares and deben- tures available for subscription to any one who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication does not satisfy the above point.

Where directors make an offer to a few of their friends, relatives or customers by sending them a copy of the prospectus marked “not for publica- tion” it is not considered an offer to the public.

The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued to the public. Issued means issued to the public. Whether the prospectus has been issued to the public or not is a matter of fact. The leading case of this point is Nash v Lynde (1929) A.C. 158. In this case the managing director of a company prepared a document that was marked “strictly private and confidential” and did not contain the particulars required to be dis- closed in a prospectus. A copy of the document along with application forms was

sent to a solicitor who in turn sent it to the plaintiff. The document was held not be prospectus and as such the claim of the plaintiff for compensation was dis- missed.

In the case Re South of England Natural Gas and Petroleum Co. Ltd. (1911) 1 Ch. 573, the distribution of 3,000 copies of a prospectus among the members of certain gas companies was held to be an offer to the public because person other than those receiving the offer could also accept it. One may note that under Section 67 an offer or invitation to any section of the public, whether selected as members or debenture holders of the company or as clients of the person making the invitation, will be deemed to be an invitation to the public.

The term "subscription of purchase of shares" means taking or agreeing to take shares for cash. Any document to be called a prospectus must have the following ingredients :

I. There must be an invitation offering to the public;

II. The invitation must be or on behalf of the company or in relation to an intended company;

III. The invitation must be to subscribe or purchase.

IV. The invitation must relate to shares or debentures.

3.3 OBJECTS OF PROSPECTUS

The main objects of a prospectus are as follows :

1. To bring to the notice of public that a new company has been formed.

2. To preserve an authentic record of the terms of allotment on which the public have been invited to but its shares or debentures.

3. The secure that the directors of the company accept responsibility of the statement in the prospectus.

3.4 REQUIREMENTS REGARDING ISSUE OF PROSPECTUS

The relevant requirements regarding issue of prospectus are given below:

1. Issue after Incorporation

Section 55 of the Act permits the issue of prospectus in relation to an intended company. A prospectus may be issued by or on behalf of the company.

a) by a person interested or engaged in the formation company or

b) through an offer for sale by a person to whom the company has allotted shares.

2. Dating of Prospectus

A prospectus issued by a company shall be dated and that date shall be taken as the date of publication of the prospectus (Section 55). Date of issue of the prospectus may be different from the date of publication.

3. Registration of Prospectus

A copy of every prospectus must be delivered to the Registrar for regis- tration before it is issued to the public. Registration must be made on or before the date of its publication. The copy sent for registration must be signed by every person who is named in the prospectus as a director or proposed director of the

company or by his agent authorized in writing. Where the prospectus is issued in more than one language, a copy of its as issued in each language should be delivered to the registrar. This copy must be accompanied with the following documents:

a) If the report of an expert is to be published, his written consent to such publication;

b) a copy of every contract relating to the appointment and remuneration of managerial personnel;

c) a copy of every material contract unless it is entered in the ordinary course of business or two years before the date of the issue of prospectus;

d) a written statement relating to adjustments; if any, made by the auditors or accountants in their reports relating to profits and losses, assets and li- abilities or the rates of dividends, etc.; and

e) written consent of auditors, legal advisers, attorney, solicitor, banker or broker of the company to act in that capacity.

A copy of the prospectus along with specific documents must been field with the Registrar. The prospectus must be issued within ninety days of its reg- istration. A prospectus issued after the said period shall be deemed to be a prospectus, a copy of which has not been delivered to the Registrar for registra- tion. The company and every person who is knowingly a party to the issue of prospectus without registration shall be punishable with fine which may extend to five thousand rupees (Section 60).

4. Expert to be unconnected with the Formation of the Company

A prospectus must not include a statement purporting to be made by an expert such as an engineer, valuer, accountant etc. unless the expert is a person who has never been engaged or interested in the formation or promotion as in the management of the company (Section 57).

A statement of an expert cannot be include in the prospectus without his written consent and this fact should be mentioned in the prospectus. Further, this consent should not be withdrawn before delivery of the prospectus for registra- tion Section (58).

5. Terms of the contract not to be varied

The terms of any contract stated in the prospectus or statement in lieu of prospectus cannot be varied after registration of the prospectus except with the approval of the members in the general meeting (Section 61).

6. Application Forms to be Accompanied with the Copy of Prospectus

Every from of application for subscribing the shares or debentures of a com- pany shall not be issued unless it is accompanied by a copy of prospectus except when it is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures or in relation to shares or debentures which were not offered to the public [(Section 56(3)].

Section 56(5) provides that the prospectus need not contain all the details required by the Act where the offer is made to exiting members or debenture holders of the company or if such shares or debentures are in all respect uniform with shares or debentures already issued and quoted on a recognize stock ex-

change.

7. Personation for Acquisition etc. of Shares

The provision, consequences of applying for shares in fictitious names to be prominently displayed must be reproduced in every prospectus and every application form issued by the company to any person.

A person who makes in a fictitious name to a company for acquiring shares or subscribing any shares or subscribing any shares shall be liable to imprisonment which may extend to five years similarly, a person who induces a company to allot any shares or to register any transfer of shares in a fictitious name is also liable to the same punishment. [Section 68(a)].

8. Contents as per Schedule II

Every prospectus must disclose the matters as required in Schedule II of the Act. It is to be noted that if any condition binding on the applicant for shares or debentures in a company to waive compliance with any requirements of the Act as to disclosure in the prospectus or purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus shall be void [Section 56(2)].

If a prospectus is issued without a copy thereof, the necessary documents or the consent of the experts the company and every person, who is knowingly a part to the issue of the prospectus, shall be punishable with fine which may extend to Rs. 5,000/- .

3.5 CONTENTS OF PROSPECTUS

We know that a prospectus is issued to the public to purchase the shares or debentures of the company. Every person wants to invest his money in some sound undertaking. The soundness of a company can be known from the prospec- tus of a company. Thus, the prospectus must disclose the true nature of company's activities which enable the public to decide whether or not to invest money in the company. In fact, the public invest money in the company on the faith of the representation contained in the prospectus. Therefore, everything should be stated with strict accuracy, and the complete and true position of the company should be disclosed to the public.

Section 56 lays down that every prospectus issued (a) by or on behalf of a company, or (b) by on behalf of any person engaged or interested in the for- mation of a company, shall :

1. State the matters specified in Part I of Schedule II, and.
2. Set out the reports specified in Part II or Schedule II both Part I and II shall have effect subject to the provisions contained in Part III of that Schedule II.

Part I of Schedule II

1. The main objects of the company with names, descriptions, occupations and addresses of the signatories to the Memorandum of association, and number of shares subscriber by them.
2. The number and classes of shares, and the nature and extent of the inter- ests of the shareholders in the property and profits of the company.
3. The number of redeemable preference shares intended to be issued with

particulars as regards their redemption.

4. The number of shares fixed by the articles of company as the qualification of a director.

5. The names, addresses, description and occupation of directors, managing director or manager or any of those proposed person.

6. Any provisions in the articles or any contract relating to appointment, remuneration and compensation for loss of office of directors, managing director or manager.

7. The amount of minimum subscription.

8. The time of the opening of the subscription list cannot be earlier than the beginning of the fifth day after the publication of prospectus.

9. Amount payable on application and allotment on each share shall be stated. If any allotment was previously made within two preceding years, the details of the shares allotted and the amount; if any, paid thereon.

10. Particulars about any option or preferential right to be given to any person to subscribe for shares or debentures of the company.

11. The number, description and amount of shares and debentures which, within the last two years, have been issued or agreed to be issued as fully or partly paid up than in cash.

12. The amount paid or payable as a premium, if any, on such share issued within two years preceding the date of the prospectus or is to be issued

stating the necessary particulars.

13. The names of the underwriters of shares or debentures, if any, and the opinion of the directors that the resources of the underwriters are suffi- cient to discharge their obligations.

14. The names or addresses description and occupations of the vendors from whom the property has been purchased or is to be purchased, and the amount paid or payable in cash, shares or debentures respectively.

15. The amount of underwriting commission paid within two preceding years or payable to any person for subscribing or procuring subscription for any shares or debentures of the company.

16. Any benefit given to any promoter or officer in preceding two years and the consideration for giving of the benefit.

17. Particulars as to the date, parties and general nature of every contract appointing or fixing the remuneration of managing director or manager, whenever entered into.

18. Particulars of every material contract not entered into in the ordinary course of business carried on or intended to be carried on by the company or a contract entered into more than two years before the date of the prospectus.

19. Names and addresses of the auditors of the company.

20. Full particulars of the nature and extent of interested of the directors or promoter in the promotion of the company or in the property acquired by

the company within two years of the issue of the prospectus.

21. If the share capital of the company is divided into different classes of shares, the rights of voting at meeting of the company and the rights in respect of capital and the dividends attached to several classes of shares respectively.

22. Where the articles of the company impose any restriction upon the mem- bers of the company in respect of the rights to attend, speak or vote at meetings of the company or the rights to transfer shares or on the direc- tors of the company in respect of their powers of management, the nature and extent of these restrictions.

23. Where the company carries on business, the length of time during which it has been carried on. If the company proposes to acquire a business which has been carried on for less than three years, the length of time during which the business had been conducted.

24. If any reserves or profits of the company or any of its subsidiaries have been capitalized, particulars of the capitalization and particulars of the surplus arising from any revaluation on the assets of the company.

25. A reasonable time and place at which copies of all balance sheets and profits and loss accounts, if any, on which the report of the auditors under part II below is based, may be inspected.

Part II of Schedule II

I General Information

1. Names and address of the Company Secretary, Legal Adviser, Lead Man-

agers, Co-managers, Auditors, Bankers to the company. Bankers to the issue and Brokers to the issue.

2. Consent of Directors, Auditors, Solicitors/Advocates, Managers to issue, Registrar of Issue, Bankers to the company, Bankers to the issue and Experts.

3. Expert's opinion obtained, if any.

4. Change, if any, in directors and auditors during the last 3 years, and rea- sons thereof.

5. Authority for the issue and details of resolution passed for the issue.

6. Procedure and time schedule for allotment and issue of certificates.

II. Financial Information

1. Report by the Auditors

A report by the auditors of the company as regards (a) its profits and losses and assets and liabilities of the company and (b) the rates of dividend, if paid by the company during the preceding 5 financial years.

If no accounts have been made up in respect of any part of the period of 5 years ending on a date 3 months before the issue of the prospectus, the report shall, in addition, deal with either the combined profits and losses and assets and liabilities of its subsidiaries or each of the subsidiary, so far as they concern the members of the company.

2. Reports by the Accountants

(a) A report by the accountants on the profits or losses of the business for the preceding 5 financial years, and on the assets and liabilities of the busi- ness on a date which shall not be more than 120 days before the date of the issue of the prospectus. This report is required to be given, if the proceeds of the issue of the shares or debentures are to be applied di- rectly on the purchase of any business.

(b) A similar report on the account of a body corporate by an accountant if the proceeds of the issue are to be applied in the purchase of shares of a body corporate so that body corporate becomes a subsidiary of the acquiring company.

(c) Principal terms of loans and assets charged as security.

3. Statutory and other Information

Statutory and other information minimum subscription, underwriting com- mission and brokerage; date of allotment, closing date, date of refund, option to subscribe, material contracts and inspection of documents, etc. are required to set out in the prospectus.

Part III of Schedule II

Part III of the schedule consists of provisions applying to Part I and II of the said schedule.

A. Every person shall, for the purpose of this schedule, be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase of any property to be acquired by the company, in any case where (a) the purchase money is not fully paid at the date of the issue

of the prospectus (b) the purchase money is to be paid or satisfied, wholly or in part, out of the proceeds of the issue offered for subscription by the prospectus; (c) the contract depends for its validity or fulfillment on the result of that issue.

B. In the case of a company which has been carrying on business for less than 5 financial years, reference to 5 financial years means reference to that number of financial years for which business has been carried on.

C. Reasonable time and place at which copies of all balance sheets and profit and loss accounts on which the report of the auditors is based, and mate- rial contracts and other documents may be respected.

"Term year" wherever used herein earlier means financial year.

Declaration

That all the relevant provision of the Companies Act, 1956 and the guide lines issued by the Government have been complied with and no statement made in the prospectus is contrary to the provisions of the Companies Act, 1956 and rules thereunder. The prospectus shall be dated and signed by the directors.

Statement by Experts

1. Experts to be unconnected with formation or management of company (Section 57). Where a prospectus includes a statement made by an expert, he shall not be engaged or interested in the formation, promotion or man- agement of the company. The expression 'expert' includes an engineer, accountant, a valor and, any other person whose profession gives authority

to a statement made by him.

2. Expert's consent to issue of prospectus containing statement by him (Sec- tion 58). A prospectus including a statement made by an expert shall not be issued, unless (a) he has given his written consent to be issued of the prospectus with the statement included in the form and context in which it is included and; (b) statement that he has given and has not withdrawn his consent as aforesaid appears in a prospectus.

A wholesome rule intended to protect intending investors by making the expert a party to the issue of the prospectus and making him liable for untrue statements (Section 58). Penalty [Section 59 (1)], if any, prospec- tus is issued in contravention of Section 57 or 58, the company, and every person who is knowingly a party to the issue thereof, shall be punishable with fine which may extent to Rs. 5,000/-

3.6 MIS-STATEMENT IN THE PROSPECTUS

A prospectus is an invitation to the public to subscribe to the shares or debentures of a company. Every person authorizing the issue of prospectus has a primary responsibility to seed that the prospectus contains the true state of affairs of the company and does not give any fraudulent picture to the public. People invest in the company on the basis of the information published in the prospectus. They have to be safeguarded against all wrongs or false statements in prospectus. Prospectus must give a full, accurate and a fair picture of material facts without concealing or omitting any relevant fact. This is known as the 'Golden Rule' for framing prospectus as laid down in New Brunswick etc. Co. V.

Muggeridge [(1860) 3 LT 651]. The true nature of company's venture should be disclosed. The statements which do not qualify to the particulars mentioned in the prospectus or any information is intentionally and willfully concealed by the directors of the company, would be considered as mis-statement.

Thus, the term 'venture statement' as 'mis-statement' is used in a broader sense. It includes not only false statements which produce a impression of actual facts. Concealment of a material fact also comes within the category of mis- statement.

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 in- cluded; and
- the omission from a prospectus of any matter is calculated to mislead (Section 65).

If there is any misstatement of a material fact in a prospectus as if the prospectus is wanting in any material fact, this may arise-

1. Civil Liability
2. Criminal Liability

1. Civil Liability

A person who has induced to subscribe for shares (or debentures) on the faith of a misleading prospects has remedies against the company, directors,

promoters, and experts. Every person who is a director and promoter of the company, and who has authorized the issue of the prospectus [Section (2)].

a) Compensation

The above persons shall be liable to pay compensation to every person who subscribes for any shares or debentures for any loss or damage sustained by him by reason of any untrue statement included therein [Section 62(1)].

In McConnel V. Wright (1903 1 Ch 5460 it has been held that the measure of the damages is the loss suffered by reason of the untrue statement, omissions, etc. the difference between the value which the shares would have had and the true value of the shares at the time of the allotment.

b) Recession of the Contract for Misrepresentation

Avoiding the contract is recession. Any person can apply to the court for recession of the contract if the statements on which he has taken the shares are false or caused by misrepresentation whether innocent or fraudulent.

The contract can be rescinded if the following conditions are satisfied:

1) The statement must b a material misrepresentation of fact

2) It must have induced the shareholder to take the shares.

3) The deceived shareholder is an allottee and he must have relied on the statement in the prospectus.

4) The omission of material fact must be misleading before recession is granted.

5) The proceedings for recession must be started as soon as the allottee comes to know of a misleading statement.

c) Damages for Deceit as Fraud

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

Fraud occurs when any statement is made without belief in the truth or carelessly. A statement made with knowledge that it is false, will constitute fraud or deceit. In the leading case on the point - Derry V. Peek (1889 14 AG 337). It has been held that if the person making the statement honesty believes it to be true, he is not guilty of fraud even if the statement is not true. The facts of this

case were:

The Tramway company had power by special Act to make tramways and to use steam power with the consent of the Board of Trade. The plants of the company are approved honesty. The directors of the company believed that since the plans were approved, permission to use steam power from Board of Trade was only a formality and would be granted. Prospectus was issued wherein the directors stated that the consent to use steam power was obtained by the com- pany. Subsequently, the consent was refused and company had to be wound up. On the action by plaintiffs for deceit it was held that the directors were not liable for fraud as they honesty believed that the consent would be obtained, though the statement was untrue.

d) Liability for non-compliance

A director or other person responsible shall be liable for damage for non-compliance with or contravention of any of the matters to be stated and reports to be set out in the prospectus as provided [by Section 56(41)].

e) Damages for Fraud under General Law

Any person responsible for the issue of prospectus may be held liable under the general law or under the Act for misstatements or fraud.

f) Penalty for Contravening Section 57 & 58

If any prospectus is issued is contravention of Section 57, (experts to be unconnected with formation or management of company), or Section 58 (expert's consent to issue of prospectus containing statement by him) the company and every person who is knowingly party to the issue thereof, shall be punishable

with fine which may extend to Rs. 5,000/-.

g) Penalty for issuing the Prospectus without Registration

If a prospectus is issued without a copy of thereof being delivered to the Registrar, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extent to Rs 5,000 [Sec- tion 60(5)].

Defence against Civil Liability

Every person made liable to pay compensation for any loss or damages may escape such liability by proving that :

I. Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus and that it was issued without

his authority or consent.

II. The prospectus was issued without his knowledge or consent and that on becoming aware of its issue he forth with gave reasonable public notice that it was issued without his knowledge or consent.

III. After the issue of prospectus, and before allotment thereunder he, on becoming aware of any untrue statement therein withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal.

IV. If a director, etc., has reasonable ground to believe that the statement was true and he, in fact, believed it to be true up to the time of allotment, he is not liable. But it is not enough for a director to say that he was honest, he has to show that his honest belief was based on reasonable grounds.

V. If statement is a correct and fair representation or extract or copy of the statement made by an expert who is competent to make it and had given his consent and had not withdrawn it, the director, etc., is not liable. Like- wise, if the statement is a correct and fair representation or extract or copy of an official document or is based on the authority of an official person, no liability attaches to the director etc.

2. Criminal Liability

Every person who authorized the issue of prospectus shall be punishable for untrue statement with imprisonment for a term which may extend to 2 years or with fine which may extend to Rs. 5,000/- or with both [Section 63(1)].

Penalty for Fraudulently inducing Persons to Invest Money [Section 68]

Any person who either knowingly or recklessly makes any statement, prom-

ises 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;

- Any agreement with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures;
- An agreement to secure to any of the parties from the yield of shares or debentures; or by reference to fluctuation in the value of shares or deben- tures; shall be punishable for a term which may extend to 5 years of with fine which may extend to Rs. 10,000/- or with both.

Defence against Criminal Liability

Any person made criminally liable can escape the same as proving that

- the statement was true [Section 63(i)]. statement was immaterial; or
- he had a reasonable ground to believe and did upto the time of the issue of prospectus that the statement was true [Section 63(i)].

3.7 STATEMENT IN LIEU OF PROSPECTUS (SECTION 70)

A company having a share capital which does not issue a prospectus or which has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or deben- tures, unless at least three days before the allotment of shares or debentures, this has been delivered to the Registrar for registration a 'statement in lieu of pro- spectus' signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing, in the form and

containing the particulars set out in Part I of Schedule III and setting out the reports specified in Part II of Schedule III subject to the provisions contained in Part III of that Schedule (Section 70).

A private company on becoming a public company shall deliver to the Registrar a statement in lieu of prospectus in the form containing the particulars specified in Part I of Schedule IV with report set out in Part II of Schedule IV subject to the provisions contained in Part III of that Schedule [Section 44(2) (b)].

If the company acts in contravention of the provisions, the company and every director who is at fault shall be punishable with fine which may extent to Rs. 1,000/-.

If the 'statement in lieu of prospectus' include any untrue statement, any person who authorized the delivery of the statement in lieu of prospectus shall be, punishable with imprisonment up to two years or with fine which may extent to Rs. 5,000/- or with both. He can avoid liability if he proves either that the statement was immaterial or that he had reasonable ground to believe that the statement was immaterial or that he had reasonable ground to believe that the statement was true. The civil and criminal liability for mis-statements or misrep- resentations is the same as in the case of a prospectus [Section 70(5)].

3.8 MINIMUM SUBSCRIPTION (SECTION 69)

When shares are offered to the public the amount of minimum subscrip- tion has to be mentioned in the prospectus. It means the amount which, in the opinion of the directors, is enough to meet the purchase price of any property,

preliminary expenses and working capital. No allotment shall be made until at least so much amount has been subscribed for. If the minimum subscription has not been received within 120 days, of the issue of the prospectus, the money received from the applicants must be repaid without interest. If the money is not paid back within 130 days, the directors become personally liable to pay it with interest, unless they can show that default was not due to any negligence or misconduct or their part.

3.9 COMMENCEMENT OF BUSINESS

A private company can commence business immediately on its incorpora- tion. A public company has to, however, comply with certain additional formali- ties before it can commence its business. This can be grouped under the follow- ing three heads.

1. Public Company Issuing a Prospectus

No public company having a share capital and issuing a prospectus inviting the public to subscribe for its shares, shall commence business or borrow unless it has obtained 'certificate of commencement of business' from the Registrar of Companies. The certificate of commencement of business will be issued after the following formalities are complied with -

a) At least minimum subscription has been raised;

b) every director of the company has paid to the company, on each of the shares taken by him or agree to be taken by him the amount payable by him on application and allotment of the shares;

c) Obtain or apply for permission for dealing of the shares or debentures on the recognized stock exchange so that no money is repayable to applica- tion for an shares of debentures offered for public subscription by reason of any failure to apply for, or to obtain stock exchange permission;

d) A duly verified declaration has been filed with the Registrar by one of the director or the secretary or of the secretary in whole time practice that the above provisions have been complied with [Section 149(1)].

2. Public Company Not Issuing a Prospectus

Where a company having a share capital has not issued a prospectus invit- ing the public subscribe for its shares, it can commence business or exercise any borrowing powers if the following conditions are fulfilled:

- A statement in lieu of prospectus has been filled in the Registrar.
- Every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him for cash, the application and allotment money.
- There has been filed with the Registrar a duly verified declaration by one of the directors or the secretary, a secretary in whole time practice, in the prescribed form, that the above provisions have been complied with.

When the company fulfils the above conditions, the Registrar shall certify that it is entitled to commerce business and that the certificate shall be conclu- sive evidence that the company is so entitled [Section 149(3)].

Any contract made by a public company after incorporation but before the

date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificates is obtained [Section 149(4)].

Thus where goods are supplied to the company which never become en- titled to commence business not one can sue the company for the price of goods supplied to it.

3. Failure to Commence business

It may also be noted that the court has the power to wind up a company, if it does not commence its business within a year of its incorporation [Section 433(3).

3.10 SUMMARY

A prospectus means any invitation issued to the public inviting it to de- posit money with the company or to take share or debentures of the company such invitation may be in the form of a document or a notice, circular, advertise- ment etc. Section 55 states that every prospectus must be dated, and that date is deemed to be the date of publications of the prospectus, prospectus should nei- ther contain any mis-statement i.e. untrue or misleading nor omit to disclose any material fact. It there is any mis-statement or omission of material facts, then the directions promoters, the persons responsible for the issue of prospectus, and the company incur a liability for the same. The company can also allot shares or

debentures without issuing the prospectus. However, in such a case, a statement known as 'Statement in lieu of Prospectus' is required to be prepared and field with the Registrar of Companies.

3.11 KEYWORDS

Prospectus: A document inviting offers from the public for the subscription of shares in on debentures of a company is known as a prospectus.

Minimum Subscription: Minimum subscription is the amount which, in the opinion of the board of directors, must be raised by the issue of share capital.

Statement in lieu of Prospectus: If a public company makes a private arrange- ment for raising capital then it must file a statement in lieu of prospectus with the Registrar three days before any allotment of shares or debentures can be made.

Civil Liability: It means the liability to pay damages or compensation.

Criminal Liability: Criminal liability means the liability which improve pun- ishment of imprisonment or fine or both.

3.12 SELF ASSESSMENT QUESTIONS

1. What is a prospectus? Explain the requirements regarding issue of pro- spectus.
2. Is it compulsory for a company to issue prospectus?
3. Explain the civil and criminal liabilities for misstatement in the prospec- tus of a company.

4. Write short notes on the following:

   A) Minimum subscription

   B) Statement in lieu of prospectus

5. Explain the conditions that a public company is required to fulfil in order to obtain a certificate of commencement of business.

3.13 SUGGESTED READINGS

S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.eeh

S.S. Gulshan & G.K. Kapoor, Business Law, New Age International Publishers, New Delhi.

S.C. Kuchhal, Mercantile Law, Vikas Publishing House, New Delhi.

Nirmal Singh, Business Law, Deep and Deep Publication Pvt. Ltd., New Delhi.

M.C. Kuchhal, Mercentile Law, Vikas Publishing House Pvt. Ltd., New Delhi.

LESSON -4
ALLOTMENT OF SHARES AND DEBENTURES; TRANSFER AND TRANSMISSION OF SHARES; SHARE WARRANT AND SHARE CERTIFICATE

STRUCTURE

4.0 OBJECTIVE

After reading this lesson, you will be conversant with

a) General principles regarding allotment.

b) Rules of allotment of shares and debentures.

c) Procedure for transfer of shares and powers of directors to refuse transfer.

d) Transmission of shares.

e) Procedure for issuing share warrant and share certificate.

4.1 INTRODUCTION

When a company issue a prospectus inviting the public to subscribe for the shares of a company, it is merely an invitation rather than

an offer. An application for shares is an offer by the prospective shareholders to take the shares of the company. Such offers are made on application forms supplied by the company. When an application is accepted, it is called allotment. Allotment is the acceptance by the company of the offer made by the applicant. Allotment results in a binding contract between the parties. The term allotment has not been defined in the Companies Act.

In *Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd., (1963),* allotment of shares was explained by the Supreme Court as "the appropriation, out of the previously unappropriated capital of the company, of a certain number of shares to a person. It is only after allotment that shares come into existence. Reissue of forfeited shares is not an allotment'.

4.2 GENERAL PRINCIPLES REGARDING ALLOTMENT

The provisions of the law of contract regarding the acceptance of an offer apply to the allotment of shares by a company. The general principles relating to the allotment of shares are as follows :

1. Proper Authority

Allotment must be made by a resolution of the Board of Directors or by a committee authorised to allot shares on behalf of the Board if permitted by the articles.

2. Absolute and unconditional

The allotment must be absolute and unconditional. If an application for shares in made subject to a condition, then that condition has to be fulfilled in order to make the allotment effective. In case that condition is not fulfilled, the applicant is not bound to take the shares.

3. Within a reasonable time

The allotment must be made within a reasonable time after the receipt of the application. Otherwise the applicant shall not be bound to accept it.

In *Ramasgate Victoria Hotel Co. v. Monterfiore*, Monterfiore applied for shares on June 28. But allotment was made on November 23 and he refused to take the shares. In this case it was held that the offer had lapsed and the applicant was not liable to pay for the allotment.

4. Must be communicated

The allotment must be communicated to the person making the application so that it is legally complete. Communication need not be in a particular form unless the articles of the company provide otherwise. Whatever is the mode of communication, it must be made to the applicant or his agent who is duly authorised to receive it. In case of postal communication, allotment is complete as soon as the letter of allotment is posted even though it is never received (Household Fire Insurance Co. v. Grant).

5. Revocation of the offer

An offer to take shares can be revoked at any time before the allotment is communicated.

H applied for shares in a company which were allotted to him. The letter of allotment was sent by the company's agent to be delivered by hand to H. Before the delivery of the letter of allotment, H withdrew his application. It was held that H was not a shareholder of the company. [*Re National Savings Bank Association (1867) L.R. 4E9.9]*

In the same way, the allotment can be withdrawn by the company before it is communicated completely to the applicant.

4.3 RULES OF ALLOTMENT

The Companies Act, 1956 does not prescribe any restriction as to the allotment of shares and debentures when issued by private companies. However, the Companies Act prescribes certain restrictions regarding the allotment of shares and debentures by public companies. Such restriction may be discussed under the following two heads :

(A) When no public offer is made.

(B) When public offer is made.

(A) When no public offer is made

A public company having share capital, which does not issue a prospectus or has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or debentures unless a statement in lieu of prospectus has been delivered to the Registrar at least three days before the first allotment of shares or debentures. The statement must be signed by every person who is a director or proposed director of the company or by his agent authorised in writing. (Section 70 (1)]

If the company contravenes the above provision, the allotment shall be irregular and voidable at the option of the allottee. Further, the company, and every director of the company who willfully authorises or permits the contravention, shall be punishable with fine which may extend to Rs. 1000. [Section 70(4)]

(B) When public offer is made

In the case of public company offering shares or debentures to the public for subscription, the provisions relating to allotment may be discussed under the following three heads :

1. First allotment of shares.
2. Subsequent allotment of shares.
3. Allotment of debentures.

1. First allotment of shares

The Companies Act, 1956 imposes the following restrictions which must be complied with by a public company which offers shares to the public for the first time :

(i) Registration of prospectus : The company must deliver a copy of the prospectus to the Registrar for registration on or before the date of its publication. It must be signed by every director or proposed director of the company or by his agent authorised in writing. [Sec. 60(1)]

(ii) Minimum subscription : No allotment shall be made of any share capital of the company offered to the public for subscription unless the amount stated in the prospectus as the minimum amount has been subscribed and the sum payable on application for such amount has been paid to or received by the company. [Sec.69(1)]

The amount stated in the prospectus shall be reckoned exclusively of any amount payable otherwise than in cash. [Sec.69(2)]

A company making any rights or public issue of shares, debentures etc. must receive a minimum of 90 per cent subscription against the entire issue before making an allotment of shares or debentures to the

public. If the amount of minimum subscription is not received within 120 days of the issue of the prospectus, all amounts received from the applicants shall be refunded to them immediately without interest. However, if the refund is not made within 130 days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay the money with interest @ 6% p.a. for the delayed period.

(iii) Application money : The amount payable on application for each share shall not be less than 5% of the nominal amount of the share [Sec.69(3)]. SEBI guidelines prescribe that in the case of mega issues (exceeding Rs. 500 crore), the amount payable with the application on allotment or any one call should not exceed 25% of the value of shares.

All moneys received from the applicants for shares shall be deposited and kept deposited in a scheduled bank :

(a) until the certificate of commencement of business is obtained, or

(b) where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription has been received by the company. [Sec. 69 (4)]

If the conditions aforesaid have not been complied with, all moneys received from the applicants for shares shall be forthwith repaid to them without interest. If any such money is not so repaid within one hundred and thirty days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of 6% p.a. from the expiry of 130 days. A director shall not be liable if he proves that default in the repayment of the money was not due to any misconduct or negligence on his part. [Sec. 69 (4)]

Any condition which requires or binds any applicant for shares not to comply with any requirement of Section 69 shall be void. [Sec. 69(6]

(iv) Subscription list : No allotment shall be made until the beginning of the 5th day after a date on which the prospectus is issued or such later time as may be specified in the prospectus. This day is known as the 'opening of the subscription list'.

Where after the issue of the prospectus, a public notice is given by some responsible person, disclaiming his responsibility for the issue of the prospectus, no allotment shall be made until the beginning of the fifth day after that on which such public notice is first given [Sec. 72(1)]

A company may proceed to allot shares soon after the opening of the subscription list. In case of listed shares, however, the subscription list must be kept open for at least 3 days under the rules of recognised stock exchanges. The prospectus generally states the time when the subscription lists will be closed. The allotment of shares in contravention of these provisions is valid. But the company and every officer who is in default shall be liable to a fine upto Rs. 5,000 [Section 72(3)].

An application for shares shall not be revocable until after the expiry of the fifth day after the opening of the subscription list. [Section 72 (5)]. The object of these provisions is to discourage the activities of stags.

(v) Shares and debentures to be dealt on a stock exchange : Where a prospectus states that an application has been, or will be, made for permission for the shares or debentures offered thereby to be dealt in one or more recognised stock exchanges, the allotment made under such prospectus be void :

(i) if the permission has not been applied for before the 10th day after the issue of the prospectus, or

(ii) if permission has not been granted by the stock exchange, as the case may be, before the expiry of 10 weeks from the date of the closing of the subscription list.

If the allotment becomes void, the company must forthwith repay without interest all moneys received from applicants in pursuance of the prospectus and if any such money is not repaid within 8 days after the company becomes liable to repay it, the directors shall be jointly and severally liable to repay that money with interest between 4 to 15% per annum from the expiry of the eighth day [Sec. 73(2)].

Return of excess money where permission is granted

Where permission has been granted by the recognised stock exchange or stock exchanges for dealing in any shares or debentures and moneys received from the applicants for shares or debentures are in excess of the aggregate of the application moneys relating to the shares or debentures in respect of which allotments have been made, the company shall repay the moneys to the extent of such excess forthwith without interest. If such money is not repaid within eight days from the day the company becomes liable to repay it, the company and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at such rate, not less than 4% and not more than 15%, as may be prescribed, having regard to the length of the period of delay in making the repayment of such money. [Sec. 73(2A)]

If default is made in complying with the provisions of Section 73(2A), the company and every officer of the company who is in default

shall be punishable with fine which may extend to Rs. 5000 and where the repayment is not made within 6 months from the expiry of the eight day, also with imprisonment for a term which may extend to one year. [73(2B)]

All moneys to be kept in a separate bank account in a scheduled bank

Where a prospectus states that an application has been made to stock exchange for permission for the shares to be dealt in on the stock exchange, all moneys received shall be kept in a separate bank account maintained with a Scheduled Bank until the permission has been granted and where an appeal has been preferred against the refusal to grant such permission, until the disposal of the appeal. Where the permission has not been applied for or has not been granted, the moneys shall be repaid within the time and in the manner specified in Section 73(2). If default is made in complying with this Section, the company and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5000. [Sec. 73(3)]

2. Subsequent allotment of shares

In case of subsequent allotment of shares all the 'statutory provisions' regarding 'first allotment of shares' apply equally, except :

(a) minimum subscription [Sec. 69 (1)]; and

(b) application money must be deposited in a scheduled bank. [Sec69(4)]

3. Allotment of debentures

In case of issue of debentures all the statutory provisions regarding 'first allotment of shares' apply equally, except :

(a) minimum subscription [Sec. 69(1)];

(b) the amount payable on application; [Sec.69(3)] and

(c) application money must be deposited in a scheduled bank. [Sec.69(4)]

4.4 TRANSFER AND TRANSMISSION OF SHARES

A. Transfer of Shares

The shares in a company are movable property and they can be transferred in the manner provided by the articles of the company. A private company with a share capital, by its very nature as provided by Section 3(1)(iii) of the Act restricts the right of transfer in shares by its articles. Transfer of shares is less strict in a public company.

In a public company, every shareholder has right to transfer his shares to any person without the consent of other shareholders subject to such express restrictions as are found in the articles of the company. A restriction on transfer of shares which is not specified in the articles is not binding on the company or the shareholders. A transfer of share is valid if it is not forbidden under the articles of the company, even if it has been made with the object of escaping liability on the shares.

Procedure for Transfer of Shares

Ordinarily, shares can be transferred by a person whose name appears in the register of members and who is the holder thereof. As per Section 109, a legal representative of a deceased member, although not a member at the time of transfer, can also transfer shares.

Shares may be transferred by executing an instrument of transfer (called the 'transfer deed'). The instrument of transfer must be in the prescribed form. Before it is signed by or on behalf of the transferor and before any entry is made therein, it shall be presented to the prescribed authority which shall stamp or otherwise endorse on it the date of presentation.

The instrument of transfer shall then be executed by the transferor and the transferee and completed in all respects. Thereafter, it shall be presented to the company for registration within the following time limits :

(i) Where the shares of the company are listed/dealt in/quoted on a recognised stock exchange, the instrument of transfer must be presented for registration at any time before the register of members is closed for the first time after the date of presentation of the instrument to the prescribed authority or within 12 months thereof, whichever is later.

(ii) In any other case, the instrument of transfer shall be presented to the company within 2 months of the date of presentation to the prescribed authority. [Section 108 (1A)]

The Central Government may, however, on application extend the period by such further time as it may think fit to avoid any hardship [Section 108 (1-D)]

When a duly executed and stamped transfer deed is delivered to the company within the prescribed time, the transfer is complete irrespective of whether the company registers it or not. But the transferee becomes a member only when the transfer is registered. Pending registration, the transferor is a trustee of the shares for the transferee. The transferor continues to be the holder of the shares until his name is struck off the register and that of the transferee substituted in its place. The transferor must pay over to the transferee any dividends or other rights which he may receive from the company after the date of the transfer deed.

The application for transfer of shares may be made either by the transferor or the transferee. In case any application is made by the

transferor and relates to partly paid shares, the transfer shall not be registered unless the company gives notice of application to the transferee and the later raises no objection to the transfer within two weeks from the receipt of such notice. No such notice needs to be given where fully paid shares are transferred or where the application for the registration of transfer is made by the transferee.

In case a company refuses to register the transfer of shares, it must give notice to the transferor and the transferee within 2 months from the date of which the instrument of transfer was delivered, giving reasons for such refusal.

The transferor or the transferee may prefer an appeal to the Central Government within 2 months of the receipt of such notice of refusal. In case the notice of refusal has not been given by the company, the appeal must be filed within 4 months from the date on which the instrument of transfer was delivered to the company. On its appeal, the Central Government must give an opportunity to the company, the transferor and the transferee to make their representation before issuing any order. If the refusal of the company seems to be unjustified, the Central Government may issue an order to the company to register the transfer.

Issue of new share certificate (Sec. 113)

On the approval of the transfer, the company shall cancel the old share certificate and issue a new one made out in the name of the transferee. Normally, it is done by making an endorsement on the back of the share certificate.

The transfer when registered has retrospective effect from the time when the transfer was first made. It should be noted that the seller

of the shares is not bound to procure registration. He will simply hand over to the transferee a duly executed transfer form and the share certificate or the letter of allotment.

Power of Directors to refuse transfer

Where the articles do not contain any clause, allowing the directors to reject the transfer, the shareholder may freely transfer his share and can compel the directors for registering of shares. On the other hand, if the articles contain a clause empowering the directors to reject the transfer, the directors can reject such transfer but subject to the following conditions :

(a) Power must be exercised by the directors in the interest of the company as a whole and not in the interest of a section of shareholders.

(b) For rejection, the conditions given in the articles must be followed.

(c) Refusal must be exercised within a reasonable time.

(d) Refusal must be exercised by the board and not by one of the directors.

(e) The court cannot compel the directors to supply the reasons of rejection but if supplied can examine and if inadequate can reject the order of the directors.

The following are the grounds on which the board may refuse registration of transfer :

(a) If partly paid up shares are being transferred and transferee is known to be financially incapable of paying balance calls.

(b) Where partly paid up shares are being transferred to a minor incapable of entering into a contract.

(c) When the transferor is a debtor of the company and the company has lien on such shares.

(d) When the transferor has not paid the due call money.

(e) Where the instrument of transfer is incomplete, irregular and defective and not properly stamped.

(f) On any other reasons which are just and equitable and are in the general interest of the company.

Grounds on which the company may refuse to register transfer in the case of the listed companies

The Companies Act does not specify the grounds on which the board of directors may refuse to register a transfer of shares. But after the insertion of Section 22-A in the Securities Contract (Regulation) Act, 1956, the Board of Directors of a company, the shares of which are listed on a stock exchange, can refuse to register a transfer on only one or more of the four grounds provided for in Section 22-A (3).

Thus in the case of listed securities, the absolute powers with the directors to refuse registration of transfer are no longer available. There are now only four grounds (and no other) on which transfer can be refused in the case of listed shares. The four grounds under Sec. 22-A (3) are :

(a) Where there are defects or deficiencies in the transfer deed, i.e., instrument of transfer is not proper or the certificate relating to the securities has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with. This is a technical ground on which

transfer of shares can be refused.

(b) The transfer of shares is likely to result in such a change in the composition of the Board of Directors as would be prejudicial to the interests of the company or to the public interest.

(c) The transfer of shares is in contravention of any law.

(d) The transfer of shares is prohibited by any court, tribunal or other authority under any law for the time being in force.

Certification of transfer

Where a person purchases a number of shares, only one certificate of shares is issued in respect of the whole lot of shares so that when he desires to transfer a part of his shares, he is required to produce before the company his certificate of shares along with the instrument of transfer for the purpose of certification. The company then endorses on the instrument of the transfer the fact of the certificate having been lodged with the company. The company will cancel the old certificate and prepare two new share certificates to be delivered to the transferor and the transferee. This is known as the certification of transfer and is provided for in Section 112 of the Companies Act.

The certification of shares amounts to a representation by the company that the document which evidences the title to the transferor has been produced to the company. It gives neither warranty of the transferor's title nor any guarantee on the part of the company.

Forged Transfer

A forged document never has any legal effect. If a forged transfer is lodged with the company for registration, the position of the parties affected is as follows :

(i) If the true owner has been removed from the register, he can compel the company to replace him.

(ii) If the company has issued a new certificate to the so called transferee, it can not deny his title to the shares, the certificate stops it (the company) from doing so.

(iii) The person lodging the transfer must indemnify the company against loss by forgery.

Companies normally notify the transferor of the transfer so that he can object if he wishes. The transferor is, however, under no legal obligation to reply and therefore no estoppel can be raised against the owner on his failure to reply.

Blank Transfer

A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee is not filled.

Since the name of the transferee is not filled, the shares in such cases may further be transferred merely by delivering the blank instrument of transfer. Thus, stamp duty and registration fee is saved. Only the last transferee has to bear these expenses. The results are :

(i) this helps in avoiding or reducing liability of tax thereon; and

(ii) these may act as clear security for creditors.

But blank transfer does not confer the ownership of shares on the transferee. If he wants to retain the shares, he can fill in his name and date in the transfer deed and get himself registered as shareholder. Until such registration, the original transferor continues to be the owner and remains liable for any amount remaining unpaid on the shares. Morally, he is a trustee for the dividends declared and received. But it does not confer

any right on the transferee to prefer any claim against the company in the event of the transferor's failure to pay him the dividends etc.

A blank transfer, however, can remain in circulation only for 12 months after its signing by the prescribed authority or up to the time of closure of the register of members by the company, whichever is later. This provision has been made to curb the abuse of this system.

B. Transmission of shares

When a registered shareholder dies or becomes bankrupt his share are transmitted to his legal representative or the Official Assignee or Receiver, This is called transmission of shares. It takes place when a registered shareholder (a) dies or (b) becomes bankrupt.

Transmission of death : When a registered shareholder dies, his shares vest in his legal representative. If they wish, they may ask the company to register them as the holder of these shares and for this purpose no instrument of transfer is required and the company is bound to accept the probate of will or letters of administration as sufficient evidence of the title to those shares. When they are registered as the holder of these shares and their names are put on the company's register of members, they become personally liable on the shares. Thus if the shares are not fully paid, they will be liable to pay the unpaid value of the shares.

However, if the legal representatives do not wish to be registered as the holder of the shares, they may transfer them without being so registered. Section 109 enables the legal representative to transfer the shares even if he is not himself a member of the company. Thus the transfer of shares of a deceased member made by his legal representative, although the legal representative does not get himself registered as the holder of

these shares, (i.e., the member of the company) is perfectly valid and the transferee acquires a good title to the shares.

Transmission on bankruptcy : If a registered shareholder is adjudged an insolvent, his shares vest in the Official Assignee or Receiver who may either get himself registered as the holder of the these shares or transfer them to another person. The Official Assignee or Receiver can also disclaim the shares if they contain liability. Usually the articles of the company contain provisions relating to the transmission of shares. Clauses 25 to 28 of Table A in Schedule I contain regulation governing the transmission of shares. If the transmission is not accepted by the company, the same remedies are available against the company as in the case of the refusal of a transfer of shares.

Distinction Between Transfer And Transmission of Shares

The following are the points of difference between transfer and transmission of shares :

(a) A transfer is a deliberate act of the holder, while transmission results by operation of law.

(b) A transfer requires an execution of an instrument of transfer, while transmission requires evidence showing the entitlement of the transferee.

(c) For the execution of transfer, stamp duty is payable, while no stamp duty is payable in case of transmission.

(d) The company charges for registering a transfer, while no charges are levied for registering a transmission.

(e) In case of transfer, the liability of the transferor ceases as soon as the transfer is complete, while in transmission, the shares continue to be subject to original liabilities.

4.5 SHARE WARRANT AND SHARE CERTIFICATE

A. Share Warrants

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

(i) if it is authroised by its articles ;

(ii) shares are fully paid up ; and

(iii) previous approval of the Central Government is obtained.

A share warrant is a document which shows that the bearer of the warrant is entitled to the shares specified therein. It is a substitute for the share certificate. A shares warrant may have coupons attached to it to provide for the payment of future dividends on the shares specified in the warrant. A shares warrant shall entitle the bearer thereof to the shares specified therein. The shares may be transferred by delivery of the warrant.

On issue of a share warrant, the company shall strike out of its register the name of the member then entered therein as holding the shares specified in the warrant as if he had ceased to be a member. The following particulars shall be entered in the register :

(i) the fact of the issue of the warrant ;

(ii) a statement of the shares specified in the warrant, distinguishing each share by its number ; and

(iii) the date of the issue of the warrant.

The bearer of a share warrant shall subject to the articles of the company be entitled to have his name entered as a member in the register of members on surrendering the warrant for cancellation and paying such fee to the company as the Board of Directors may from time to time determine.

The bearer of the share warrant may, if the articles of the company so provide, be deemed to be a member of the company.

B. Share Certificate

The holder of share or shares is issued a share certificate by the company. A certificate under the common seal of the company, signed by one or more of directors, specifying shares held by the member and the amount paid up on the shares shall be prima facie evidence of the title of the member to such share or shares.

Every company shall deliver the certificates to the allottee within three months from the date of allotment and to the transferee within two months of making of the application for the registration of the transfer of shares, debentures or debenture stock.

If default is made, the company and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000/- for every day during which the default continues. The person may make an application to the court if default is not made good by the company within 10 days after the service of the notice. The court may order the company and any officer of the company to make good the default.

Objects and Advantages : Since a share certificate is prima facie evidence of title, a shareholder is able to show his title to the shares by producing his share certificate. Thus it is very easy for a shareholder to sell his shares in the market by producing a share certificate showing his title to these shares. Besides it would be very easy for a lender to lend money to the shareholder taking the possession of his share certificate by way of security.

Duplicate Certificate

Section 84(2) provides that a company may renew or issue a

duplicate certificate if it is proved to have been lost or destroyed or having been defaced, mutilated or torn; is surrendered to the company. The articles may provide other terms and conditions like requiring the allottee to give an indemnity bond (Clause 89 Table A).

If a company with the intent to defraud renews a certificate or issues a duplicate thereof, the company shall be punishable with fine which may extend to Rs. 10,000 and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to Rs. 10000 or with both [Sec.84(3)].

The Central Government may prescribe rules regarding the issue or renewal of certificates and duplicates, fees, etc. (Sec. 84(4)). The rules so made override the provisions in the articles.

4.6 DIFFERENCE BETWEEN A SHARE CERTIFICATE AND A SHARE WARRANT

1. The holder of a share certificate is a registered member of the company whereas the bearer of a share warrant is not. The bearer of a share warrant can be a member only when the Articles so provide and only for the purposes defined in the Articles.
2. A share certificate may be issued in respect of partly or fully paid shares, whereas a share warrant can be issued only when shares are fully paid up.
3. Only public companies are authorised to issue share warrants but share certificates are issued by both public and private companies.
4. A share warrant is transferable by delivery only and no transfer deed and registration of transfer with the company is required. But a share certificate is transferred only in pursuance of a transfer deed along

with the delivery of the share certificate. The transfer of a share certificate must be registered with the company.

5. A share warrant is a negotiable instrument as it is transferable by delivery only. But a share certificate is not a negotiable instrument.

6. Stamp duty is payable for the transfer of a share certificate but no stamp duty is payable in the case of transfer of a share warrant.

7. The permission of the Central Government is not necessary for the issue of share certificates but share warrants can be issued only if allowed by the Articles and with the prior permission of the Central Government.

8. The holder of a share warrant does not qualify to become a director of the company (where qualification share are required for directorship). But the holder of a share certificate is so qualified.

9. The petition for the winding up of the company can be presented by the holders of share certificates only. Holders of shares warrants cannot do so.

10. Payment of dividend on a share warrant is made by way of coupons attached with it. But in the case of share certificates, the company issues dividend warrants to the holders by name.

4.7 SUMMARY

Allotment means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares of different persons. An allotment is the acceptance of an offer in purchase relating to valid acceptance of an offer must be followed. The shares can be transferred by any person who is the holder of shares and whose name appears in the Register of Members or by

anyone with his authority. However, the legal representative of a deceased member can validly transfer the shares even if he is not the member. The transmission of shares takes place on the death or insolvency of the shareholder. Every person whose name is entered as a member in the register of members, is entitled to receive share certificate from the company. A share warrant is a document specifying certain shares and stating that the bearer of the document is entitled to the shares specified in it.

4.8 KEYWORDS

Share Warrant: Share warrant is a document which shows that the bearer of the warrant is entitled to the shares specified therein.

Share Certificate: As soon as a shareholder is allotted shares, he must be issued a share certificate by the company within the specified time.

Allotment: Allotment is the acceptance by the company of the offer made by the applicant.

Application Money: The amount payable on application for each share is known as application money.

Transmission of Shares: When a registered shareholder dies or becomes bankrupt, his shares are transmitted to his legal representative or the official assignee or receivers, and this is called transmission of shares.

4.9 SELF ASSESSMENT QUESTIONS

1. What restrictions have been imposed by the Companies Act, 1956 on the allotment of shares ? What is the effect of irregular allotment?
2. What is a share certificate ? What is the object and effect of the share certificate ? When can a company renew a share certificate or issue a duplicate ?

3. What is a share warrant ? Distinguish between a share certificate and a share warrant. What legal formalities are to be complied with for the issue of a share warrant ?

4. How is the transfer of shares effected ? What course is open to a transferee if the company refuses to register a transfer ?

5. What is a forged transfer ? If a forged document is lodged with a company, what is the position of the affected parties ?

4.10 SUGGESTED READINGS

Nirmal Singh, Business Law, Deep and Deep Publication Pvt. Ltd., New Delhi.

M.C. Kuchhal, Mercentile Law, Vikas Publishing House Pvt. Ltd., New Delhi.

Avtar Singh, The Priciples of Mercantile Law, Eastern Book Co., Lucknow.

M.C. Shukla, A Manual of Mercantile Law, S. Chand & Co., New Delhi.

R.S.N. Pillai and Bagavathi, Business Law, S. Chand & Co., New Delhi.

LESSON : 5

MEMBERSHIP OF COMPANIES; BORROWING POWERS

STRUCTURE

5.0 OBJECTIVE

By reading this lesson, you would know about

(a) Who is a member and who may become member ?

(b) Modes of acquiring membership.

(c) Rights, duties and liabilities of members.

(d) The borrowing powers of Board of Directors and their limitations

(e) Lender's rights when borrowing is ultra vires the company

(f) Charges requiring registration and effect of non-registration

5.1 INTRODUCTION

A company is composed of certain persons who constitute it as a corporate body. However, the identity of the company is different from the persons composing it. The persons composing the company are the 'members' or 'shareholders' of the company. A member is a person who has signed company's memorandum of association. Any other person who agrees in writing to become a member and whose name is entered in company's register of members is also a member of the company [Section 41].

It is important to note here that the terms 'member' and 'shareholder' are used inter-changeably in the Companies Act. A shareholder means a person who holds the shares of the company. A part from a few exceptional cases, the terms member and shareholder are synonymous. In these exceptional cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member. In the following cases, a person is a member, but not a shareholder:

(a) A person who signs company's memorandum of association, immediately becomes the member on registration of the memorandum before any shares are allotted to him.

(b) A person who transfers his shares, continues to be the member of the company until his name is replaced by the name of the transferee. But he is no more a shareholder.

(c) A person who has ceased to be a shareholder by reason of forfeiture, surrender or transfer of shares, may be held liable as member, for the payment of unpaid amount on shares in case of default by the present shareholder.

(d) A company limited by guarantee or an unlimited company having no share capital will have only members but no shareholders.

In the following cases, a person is a shareholder, but not a member:

1. A person having a share warrant is a shareholder but he is not a member [Section 115 (1)]. However, he may be treated as member for specific purpose if company's articles so provide.

2. A legal representative of a deceased shareholder is the shareholder even if his name is not entered in the register of members. He becomes a member only when his name is entered in the register.

Note: The Depositories Act, 1996 has further widened the definition of a member by inserting a new Sub-section 41 (3). This sub-section provides that every person holding equity share capital of the company and whose name is entered as beneficial owner in the record of the depository, shall be deemed to be a member of the company.

5.2 DIFFERENCE BETWEEN MEMBERS AND SHAREHOLDERS

The terms 'member' and 'shareholder' have been used interchangeably in the Companies Act. The word 'shareholder' is used in relation to a company having a share capital and there can be no membership except through the medium of shareholding. A holder of shares becomes a member only when his name is entered on the register of members. But the term 'member' is wider in scope and may be used in relation to all types of company. A person may become a member of a company without holding any shares. Companies limited by guarantee or unlimited companies having no share capital can have no shareholders but do have members.

The following are the points of distinction between members and shareholders :

1. A holder of a share warrant is a shareholder but not a member as his name is struck off the register of members immediately after the issue of such share warrant.

2. Every registered shareholder is a member but every registered member may not be a shareholder because the company may or may not have share capital.

3. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed as shareholder.

4. Similarly, a shareholder by transfer is not a member until his name is entered in the company's register of members.

5. A person who mispresents himself to be a member is estopped from denying his position subsequently. He is said to have become a member by estoppel.

6. A person may become a member by an order or decree of a court.

5.3 CAPACITY OF A MEMBER

We know that the capacity means the competency of a person to enter into a contract. A contract to purchase shares in a company is like any other contract. Therefore, the membership of a company is open to any person who is competent to enter into a valid contract. The Companies Act does not prescribe any qualifications for becoming a member of a company. However, only such a person who is competent to contract as per the Indian Contract Act, 1872 may become a member. This is, however, subject to the provisions of the memorandum and articles of the company. The articles may provide that certain persons cannot become members of the company. The membership rights of certain persons and organisations are discussed hereunder :

1. Minor

Under the English Law, a minor can be a member of the company because a contract with a minor is voidable and not void. But under the Indian Law, a minor being incompetent to contract can not become a member of a company because a contract with a minor is absolutely void here. A minor in India may apply for and receive an allotment of shares subject to a right to repudiate liability on them before or within a reasonable time after attaining full age.

In the case of *Palaniappa Mudliar v. Official Liquidator, Pasupathi Bank Ltd., A.I.R. (1942) Mad. 470.,* an application for shares in a company was made by a father as a guardian of his minor daughter. The company allotted the shares in the name of the daughter described as a minor. Subsequently, the company went into liquidation and the liquidator placed the father's name in the list of contributories. It was held that the transaction was void ab-initio and neither the minor nor her guardian could be placed on the list of contributories.

2. Company

Since a company is a legal person, it can become a member of another company, provided it is so authorised by its memorandum, by investing in the shares of that company.

3. Partnership Firm

Since a partnership firm has no legal personality, it cannot purchase shares in a company in its own name.

4. Person taking shares in fictitious names

A person who takes shares in the name of a fictitious person will be liable as a member in respect of those shares and his name shall be

entered in the register of members. Besides, such a person can be punished for impersonation under Section 68-A.

5. Hindu Undivided Family

It can have shares in the name of its karta.

6. Foreigners/Non-Residents

Foreigners can become members of companies registered in India but permission of the Reserve Bank of India under FERA, 1973 has to be obtained for this purpose. This right of the foreigner as a member will be suspended if he becomes an alien enemy.

7. Insolvent

An insolvent being incompetent to contract can not become a member of a company. But if a person is a member of a company and afterwards he is declared insolvent, he will be regarded as a member so long as his name appears in the register of members and he will be entitled to vote but the beneficial interest in the shares will be vested in the official assignee or receiver and any dividend on shares will be received by the assignee.

8. Pawnee

In case of a pledge, the ownership remains with the pawner and the possession with the pawnee. So the pawnee does not become the member of the company. The pawner continues to be the member and he can exercise the rights of a member.

5.4 MODES OF ACQUIRING MEMBERSHIP

A person may become a member in a company in any of the following ways :

1. Membership by Subscribing to Memorandum (Section 41)

All the subscribers to the memorandum are deemed to have agreed to become members of the company and on the registration of the company their names are automatically entered as members in the company's register of members. Thus, the signatories to the memorandum become members of the company simply by reason of their having signed the memorandum. Neither an application form nor allotment of shares is necessary for becoming a member in their case. A person who signs the memorandum enters into a contract with the company to take the number of shares written opposite his name and be cannot repudiate his contract on the ground of misrepresentation.

In the case of *Metal Constituents Co., (1902) 1.Ch. 707,* a subscriber agreed to take 350 shares. Then, he wanted to rescind the contract on the ground of misrepresentation on the part of the promoters. Held that the subscriber by signing the Memorandum becomes liable to other members in the company brought into existence by his own act. So he can not rescind the contract.

2. Membership by Qualification shares

Before a person can be appointed a director of a public company, he must take, or sign an undertaking to take and pay for the qualification shares. He thus becomes a member and is in the same position as a subscriber to the memorandum of the company is.

3. Membership by Application and Allotment

A person may become a member of a company by an application for shares subject to formal acceptance by the company. The ordinary law of contracts applies to the agreement to take shares in a company. An

application for shares may be absolute or conditional. If it is absolute, a simple allotment and notice thereof to the applicant will constitute the agreement. If it is conditional, the allotment must be made on the basis of the conditions specified. Where there is a conditional application for shares and an unconditional allotment, there is no contract constituted.

R agreed to take shares in a company provided he was appointed local manager of the company. Shares were allotted to him but he was not given the appointment. R refused to take the shares. It was held that R was not a member as his application was conditional and allotment was unconditional. [Roger's case (1868) L.R. 3Ch. 633].

4. Membership by Transfer

Where a transfer of share is made and the transfer is registered with the company, the transferee becomes entitled to be placed on the company's register of members in the place of the transferor in respect of the shares so transferred.

5. Membership by Transmission

On the death of a member his shares rest with his legal representative. The legal representative is entitled to be registered as the holder of the shares and to get his name entered as member in the register of members provided there is no provision in the articles of the company and for the purpose no instrument of transfer is required to be delivered by him to the company.

If a company unduly refuses to accept a transmission, the same remedies are available to the legal representative as in the case of transfer.

In the case of *Indian Chemical Products V. State of Orissa, AIR (1967) SC 253,* by devolution, the state of Orissa had become entitled

to the shares of the Maharajas. But the company refused to register the shares in the name of state's representative. It was held that the company was bound to register the shares in favour of the state's representative because it was a case of transmission. And the state became entitled to the shares due to the operation of law.

6. Membership by Estoppel

If a person holds himself out in writing or allows his name to be on the register of members, he is deemed to be a member of the company. Thus if a persons's name is improperly placed on the register of members, and he knows and assents to it, he cannot afterwards say that he is not a member. Estoppel is simply a rule of evidence which prevents a person from denying the legal implications of his conduct.

5.5 CESSATION OFMEMBERSHIP

A person may cease to be a member of a company :

(a) if he transfers his shares to another person.

(b) by the sale of his shares by the company in exercise of right of lien over his shares.

(c) by forfeiture of his shares;

(d) by a valid surrender of his shares.

(e) by the death of a member. The estate of the deceased remains liable until the shares are registered in the name of his legal representative.

(f) by his insolvency.

(g) by his rescission of contract to take shares on the ground of misrepresentation or fraud.

(h) by the winding-up of the company, of course he remains liable as a contributory.

(i) by redemption of redeemable preference shares.

(j) by issue of share warrants to him in exchange of fully paid shares.

5.6 DUTIES AND LIABILITIES OF MEMBERS

Duties

It is the duty of a shareholder :

(a) as a subscriber of the memorandum, to take the share written opposite his name direct from the company and pay for them ;

(b) to take shares when they are duly allotted to him and pay for them according to the terms of issue of the shares ;

(c) to pay all valid calls as and when they are made;

(d) to abide by the decisions of the majority of members unless the majority acts vindictively, oppressively, mala fide or fraudulently;

(e) to contribute to the asset of the company when it goes into liquidation.

Liability

The liability of the members of a company depends upon the nature of the company.

Company limited by shares. In the case of a company limited by shares, the liability of a member of company is the amount, if any unpaid on his shares. If his shares are fully paid, his liability is nil for all purposes.

Company limited by guarantee. The liability of the members of a company limited by guarantee is limited to the amount they undertook to contribute to the assets of the company in the event of winding up.

*Company with unlimited liability***.** Every member of an unlimited company is liable in full for all debts contracted by the company during the period he was a member.

5.7 RIGHTS OF MEMBERS

When a person becomes a member of a company he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Act. The rights of a member can be classified under the following heads :

(A) Statutory Rights

Statutory rights are those which are given to the members by the statute, i.e. the Companies Act, 1956. No document of the company can take away or modify such rights. Such rights, for example, are :

1. Right to receive copies of the Balance Sheet and Profit and Loss Account of the company along with the auditor's report.
2. Right to obtain a copy of the contract for the appointment of managing directors/managers of the company.
3. Right to receive notice of the general meetings of the company.
4. Right to get the copies of the Memorandum and the Articles of the company on payment of the prescribed fees.
5. Right to inspect the register of members, and debentureholders and index registers, annual returns etc. and get copies thereof on payment of the prescribed fee.
6. Right to inspect the debenture trust deed and get copies thereof on payment of the prescribed fees.

7. Right to inspect the register of charges and get copies thereof on payment of the prescribed fees.

8. Right to receive a copy of the statutory report.

9. Right to apply to the Central Government to call the annual general meeting when default is made by the company in holding annual general meeting (AGM).

10. Right to attend the AGM.

11. Right to appoint a proxy to attend the AGM and vote in his place and right to inspect the proxy register.

12. Right to receive a share certificate in respect of his share holding and a certificate of stock within a prescribed time.

13. Right to transfer shares.

14. Right to receive dividend when declared by the company.

15. Preemptive right i.e. right to have the rights shares on any further issue of shares.

16. Right of participation in the appointment the directors who are to retire by rotation by taking part in the AGM.

17. Right of participation in appointing the auditors and fixing their remuneration.

18. Right to have a share in the surplus of assets, if any, on the winding up of the company.

19. Right of dissident shareholders to apply to the court to have any variation of their rights cancelled.

20. Right to have notice of any resolution requiring a special notice in the meeting.

21. Right to inspect the shareholders' minutes book and get copies thereof on payment of the prescribed fees.

(B) Documentary Rights

There rights are the rights given by the two basic documents i.e. memorandum of association and articles of association. The company may also give certain rights to its members by expressly providing for them in the memorandum or the articles of the company.

(C) Legal Rights

These rights are given to members under general law. For example, a person who has taken shares of a company on the faith of a misleading prospectus can avoid the contract and claim damages under the general law.

5.8 REGISTER OF MEMBERS (SEC. 150)

It is the statutory obligation of every company to maintain a register of its members containing the following particulars :

(a) The name and address and the occupation, if any, of each member ;

(b) In the case of a company having share capital, the shares held by each member and the amount paid or agreed to be considered as paid on those shares;

(c) The date on which each person was entered in the register as a member;

(d) The date on which any person ceased to be a member.

(e) Where the company has converted any of its shares into stock and given notice of conversion to the Registrar, the register shall show the amount of the stock held by each of the members concerned instead of the shares so converted which were previously held by him.

If default is made in complying with these provisions, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

5.9 INDEX OF MEMBERS (SEC. 151)

Every company having more than fifty members must keep an index of members, unless the register is already in the form of an index. Any alteration in the register of members must be noted in the index within 14 days of alteration. The index must, in respect of each member, contain a sufficient indication to enable the entries relating to that member in the register to be readily found. The index must always be kept at the same place as the register of members.

Inspection : The register of members and the index must be open for inspection, except when closed under the provisions of the Act, by members and debenture-holders free and by other persons on payment of such sum as may be prescribed. The company is also bound to supply a copy of the register on demand on payment.

Closure of Register of Members : As per Sec. 154, a company may, after giving not less than seven days' previous notice by advertisement in a local daily, close the register of members, for a period not exceeding 45 days in a year, but not exceeding 30 days at any one time.

The closure of the register of members is necessary whenever any general meeting of the shareholders is to be held or interim dividend is to be declared or a call is made. During the period of closure, no transfer of shares can take place and therefore, the company may determine its membership and may send notices of general meetings and calls made and also the dividend warrants to is members.

5.10 ANNUAL RETURNS

Every company is required to file with the Registrar an annual return containing certain particulars relating to the company. The object of filing the annual return is to enable the Registrar to record the changes that have occurred in the constitution of the company during the years. The particulars to be stated in the annual return are different for the companies having a share capital, and for the companies having no share capital. The returns for these companies, are, therefore, discussed separately:

I) By Company having a Share Capital (Sec.159)

Every company having a share capital shall within 60 days from the day on which each of the annual general meetings is held, prepare and file with the Registrar a return containing the particulars specified in parts I and II of Schedule V, as they stood on that day regarding its :

1. Registered office.
2. Register of members.
3. Register of debenture-holders.
4. Shares and debentures.
5. Indebtedness.
6. Members and debenture-holders, past and present; and
7. Its directors, managing directors, managers and secretary, past and present.

8. Names and addresses of and number of equity shares held by each of the following, namely :

(a) Foreign holdings;

(b) Government-sponsored financial institutions;

(c) Bodies corporates (not covered under (a) and (b) above);

(d) Directors and their relatives, their shareholdings and directorships ;

II) By Company not having Share Capital (Sec. 160)

Every company not having a share capital shall within 60 days from the day on which each of the annual general meetings is held, prepare and file with the Registrar a return stating the following particulars as they stood on that day :

(a) Registered office.

(b) Name of members and respective dates on which they became members.

(c) Names of persons who ceased to be members since the date of the annual general meeting of the immediately preceding year, and the dates on which they so ceased.

(d) Particulars regarding its directors, managers and its secretary.

Other provisions regarding annual return (Sec.161)

The copy of the annual return filed with the Registrar under Section 159 or 160 shall be signed both by a director and by the manager or secretary of the company. Where there is no manager or secretary, it shall be signed by two directors of the company, one of whom shall be the managing director, where there is one. The annual return is also required to

be signed by a secretary in whole time practice, in the case of a company whose shares are listed on a recognised stock exchange.

Penalty: In case of non compliance with any of the provisions contained in Sections 159, 160 or 161 the company and every officer who is in default shall be punishable with fine upto Rs. 50 for every day during which the default continues. (Section 162).

5.11 BORROWING POWERS

Capital is necessary for the establishment and development of a business and borrowing is one of the most important source of the capital, but unfortunately there is no express provision in the Companies Act as to the borrowing powers of the company. Every trading company, unless prohibited by its memorandum or articles, has an implied power to borrow money for the purpose of its business, and to give security for the loan by creating a mortgage or charge on its property even though such power is not expressed in the memorandum of the company. On the other hand, a non-trading company has no implied power to borrow money and, therefore, it cannot borrow unless such power is expressly provided in the memorandum. If the memorandum does not contain such a power, the memorandum have to be amended before the company can exercise its borrowing powers. Again a public company having a share capital cannot exercise the borrowing powers unless a certificate of commencement of business has been obtained by it (Section 149).

In General Auction Estate and Monetary Co. v. Smith (1891) 3ch. 432 case the company had among its objects the sale and purchase of estates and property, loans on deposits of securities and discounting of bills. The Memorandum of the company did not expressly give it anypower

to borrow money. The company borrowed money from one of the directors on the security of some of its estates to pay off some depositors and creditors. The company was wound up within six months. The liquidator wanted to set aside the security as it was beyond the powers of the company. Held, being a trading company, it had an implied power to borrow money for its business and to give security to the person making the advance (loan). Where a company has express or implied power to borrow it can raise, borrow or secure the payment of any sum of money for the purposes of business subject to the limits set by its Memorandum or Articles.

The Board's Powers

The borrowing power is exercised by the board of directors subject to the provisions in the memorandum and articles of the company. The memorandum or articles generally specify the maximum limit of borrowing power allowed to the Board of Directors and may impose restrictions upon the exercise of such power. Section 293(1)(d) also limits the directors' power to borrow. It provides that the Board of Directors of a public company or of a private company which is a subsidiary of a public company, shall not except with the consent of such public company or its subsidiary in a general meeting borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the company (apart from the temporary loans obtained from the company's bankers in the ordinary course of business) will exceed the aggregate of paid-up capital of the company and its free reserves (that is to say, reserves not set apart for any specific purpose). Thus, the power of directors to borrow is subject to two main limitation :

1. Statutory limitations and
2. Limitations enumerated in the memorandum and articles.

5.12 ULTRA VIRES BORROWINGS

Ultra vires borrowings mean borrowings which are beyond the powers of the company or the directors. Borrowing by a company may be :

1. Ultra vires of the company, or
2. Intra vires of the company but ultra vires of the directors.

1. Borrowing which is ultra vires of the company

Where a company borrows money in excess of its powers, the borrowing would be ultra vires the company. In such a case, the contract is void and the lender cannot sue the company for the return of the loan. The securities given for such ultra vires borrowings are also void and inoperative, and no ratification can render the debt valid.

In the case of *Introduction Ltd. v. National Provincial Bank Ltd. (1970) Ch. 199,* a company was formed with the main object of providing information and facilities to the overseas visitors to the Festival of Britain in 1950. The company later engaged in pig breeding as its sole activity. For this purpose, it borrowed money from a bank which took debentures as a security. The bank was given a copy of the Memorandum and it knew that the only business being carried on by the company was pig breeding. Held, the loan was for a purpose known to be ultra vires and therefore, the debentures were sold.

The lender has, however, the following remedies :

(a) Injunction

If the money lent to the company has not been spent, the lender can get an injunction to prevent the company from parting with it.

(b) Subrogation

If the money borrowed has been used by company in paying off its lawful debts, the lender will rank as a creditor upto the amount so used, and can recover it from the company. He can sue the company by virtue of principle of subrogation. But the lender will have no priority over other creditors even though the debts paid off had priority.

Example : A company had exhausted its borrowing powers by issuing three different series of debentures A, B and C. A had priority over B and B had priority over C. The company took a loan from the plaintiff to pay interest on A debentures. The borrowing by the company was ultra vires. It was held that plaintiff was a legal creditor of the company to the extent his loan was used to pay-off legal debts, but he was not entitled to the priority of A debentures. (Re Wrexham Mold C. Ltd. (1899) 1 Ch. 440).

(c) Tracing

If the lender is in a position to trace the property purchased with his money, he can get a tracing order from the court and follow the property. If traced, the company will be deemed as a trustee for the property on behalf of the lender.

In the case of *Sinclair v. Broughham, (1914) A.c. 398,* the Memorandum of a building society empowered it to borrow or to lend on the security of land. But the building society also developed a large banking business which was ultravires of the society. The company was wound up and the company's assets were composed partly of the shareholder's money (i.e. the money of the members of the society) and partly of the depositors money (i.e. the money of the ultravires lenders). The company had to pay the outside creditors, the shareholders of the society (i.e. members) and the depositors of money. The outside creditors were paid in-full with the

consent of the shareholders and the depositors. The remaining assets were not capable of being identified; nor were they sufficient to pay both the shareholders and the depositors in full. Held the remainder of the assets should be apportioned between the shareholders and the ultravires depositors in proportion to the amount paid by them.

(d) Recovery of damages

The ultra vires lender has a right to sue the directors for the breach of warranty of authority and recover the damages. e.g. if the directors knowingly misrepresent their authority, the lender can claim the money back fromthem.

Example : Under the authority of an investment trust company, its managing director borrowed large sums of money. He utilised large sums of such borrowed money for the purpose of gambling in shares differences and also misappropriated some money. It was held that the company was liable. [V.K.R.S.T. Firm v. Oriental Investment Trust Ltd. AIR 1944 Mad 532]

2. Borrowing intra vires of the company but ultra vires of the directors

In this case, the borrowings is within the powers of the company but restrictions have been placed on the authority of the directors to borrow. Borrowing ultra vires the directors, but within the power conferred by the memorandum, is voidable only and may be ratified by the company. If the borrowing is ratified, the company becomes liable to repay the money. Whereas such borrowing is not ratified by the company, the remedies available to lender are :

(i) Doctrine of indoor management. By relying on the rule of indoor management he can recover the amount of loan from the company provided the borrowing was due to non-compliance with some internal regulations of the company.

(ii) No notice for unauthorised business. A lender is deemed to have notice of the limitations imposed by the memorandum and articles on the borrowing powers of the directors. A company can avoid the liability on the ground that borrowing was known or deemed to be known to be ultra vires. But if restrictions on the director's authority are secret or not obvious from these documents, or otherwise the lender does not know of it from some other source, the company will be bound.

Further, the company shall not be liable for the unauthorised borrowings of its directors if it can establish that the borrowing was neither necessary not 'bonafide' or for the benefit of the company but if a loan has not been taken in the name of the company it will not be liable even if it has received some benefit.

In Equity Insurance Co. Ltd v. Dinshaw & Co., AIR 1940 outh 202 case, it was held- "Where the managing agent of a company who is not authorised to borrow has borrowed money which is not necessary, neither bonafide, nor for the benefit of the company, the company is not liable for the amount borrowed.".

But if a loan has not been obtained in the name of the company, it will not be liable even though such amount has been used for the benefit of the company.

5.13 CHARGES SECURINGDEBENTURES

A company can issue debentures either secured or unsecured by a charge on its property. Such charge may :

1. Fixed charge (or specific charge)
2. Floating charge

Fixed charge

A fixed charge or specific charge is one which is created on some ascertained and definite property of the company such as building or machinery, etc.

The effect of such a charge is that the company cannot deal with such property freely, i.e. it cannot sell without the consent of the holder. Again in the winding up of the company, the holder of a debenture secured by a fixed charge ranks as a secured creditor in respect of debt due to him on the debenture.

Floating charge

When a charge is created on property which is not fixed but changing or unstable, it is known as floating charge. For example, where a debenture is secured by creating a charge on stock-in-trade, the charge will be valid as a floating charge.

Lord Macnaghten remarks, "A floating charge is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying conditions in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created intervenes. [*Government Stock Investment Co. Ltd. v. Manila Rly Company Ltd.(1897) A.C.]*

The chief characteristics of a floating charge have been summed up by Justice Romer in Re *Uorkshire Woolcomber's Association Lt.* His Lordship said that mortgage or charge will be treated as a floating charge, if :

1. It is a charge upon a class of assets both present and future.
2. The class of assets upon which the charge has been created must be one which in the ordinary course of the business of the company would be changing from time to time, and
3. It has been contemplated by the charge that until some step is taken by the mortgagee, the company can use the assets comprised in the charge in the ordinary course of business.

Crystallisation of a Floating Charge

Crystallisation is the conversion of a floating charge into a fixed charge on the assets in the class charged at the moment of crystallisation A floating charge crystallises and becomes fixed in the circumstances given below :

1. When the company goes into liquidation, or
2. When the company ceases to carry on business, or
3. When the debenture-holders take steps to enforce their security, e.g. by appointing a receiver.

Effects

In the case of floating charge

1. The company has a free hand to deal with the property charged in the ordinary course of business in any way authorised by its memorandum or articles so long as the company remains a going concern or so long as the charge does not become a fixed charge.
2. Unless otherwise agreed, a floating charge leaves the company at liberty to create a specific mortgage on the property subject to the floating charge ranking in priority in such floating charge.

3. The company can sell the whole of its undertaking if that is one of its objects specified in the memorandum, in spite of a floating charge on the undertaking.

Invalidity of Floating Charge

A floating charge created within 12 months of the commencement of the winding up of a company will be invalid unless it is proved that the company immediately after the creation of the charge was solvent. Even a charge created within twelve months of the commencement of the winding up of the company is valid to the extent of the cash paid or to be paid to the company in consideration for such charge, together with interest on that amount at the rate of 5% per annum or such other rate as may for the time being be notified by the Central Government in this behalf in the official Gazette (Sec. 534).

5.14 CHARGES REQUIRING REGISTRATION

All charges are not required to be registered. Only nine types of charges need compulsory registration under Section 125 with the Registrar of Companies within 30 days of their creation. They are :

1. A charge for the purpose of securing any issue of debentures
2. A charge on uncalled share capital of the company
3. A charge on any immovable property
4. A charge on any book debts of the company
5. A charge not being a pledge on any movable property of the company
6. A floating charge on the undertaking or any property of the company including stock in trade.

7. A charge on calls made but not paid

8. A charge on a ship or any share in a ship

9. A charge on goodwill, on a patent or a licence under a patent, on a trade mark, or on a copyright or a licence under a copyright

It is the duty of the company to send the above particulars to the Registrar within 30 days of charge or extended period which cannot be more than seven days, but registration may also be effected on the application of the creditor. The creditor may in such a case recover the registration fee from the company (Sec.134).

5.15 CONSEQUENCES OF NON-REGISTRATION OF CHARGES

If any charge which is required to be registered under Sec. 125 is not registered, the consequences will be as follows :

1. The charge becomes void as against the liquidators (if the company goes into liquidation) and against the creditors.

2. The charge is good against the company and may be enforced until the company goes into liquidation.

3. Money secured by the charge becomes immediately payable.

4. A subsequent registered charge will have priority over a prior unregistered charge even if the subsequent creditor has notice of the prior mortgage or charge.

5. The holder of an equitable charge whose charge is void for non-registration, has no lien on the title deeds or documents deposited with him as they are only ancillary to the void charge.

6. At the time of liquidation of the company, the creditor having an unregistered charge becomes an unsecured creditor of the company

as the charge is void against the liquidator and the creditors.

7. If default is made in filing the particulars of charges, the company and every officer of the company or any other person who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues. A further fine of upto Rs. 1000 may be imposed on the company and every officer of the company for other defaults relating to the registration of charges (Sec. 142).

The Company's Register of Charges (Sec. 143)

Every company has to keep at its registered office a register of charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case :

(a) a short description of the property charged ;

(b) the amount of charge ; and

(c) the names of the persons entitled to charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the above entries, he shall be punishable with fine which may extend to Rs. 500.

Further, under Sec. 136, every company must keep at its registered office a copy of every instrument creating any charge requiring registration. But in the case of a series of uniform debentures , a copy of only one debenture of the series is sufficient. The register of charges and the documents must be open for inspection by any person.

Register of Charges to be kept by the Registrar (Sec. 130)

The Registrar must also keep, with respect to each company, a register of all the charges requiring registration. He must, on payment of the prescribed fee, enter in the register, with respect to every charge, the following particulars :

(a) the date of the creation of the charge (if the charge is a charge created by the company), or the date of the acquisition of the property (if the charge was a charge existing on property acquired by the company);

(b) the amount secured by the charge ;

(c) short particulars of the property charged ; and

(d) the persons entitled to the charge

5.16 SUMMARY

There are two important elements which must be present to make one a member of a company (a) these must be an agreement to become a member and (b) the name must be entered in the register of member of the company. Companies Act does not prescribe any qualifications for the members of a company but as regards the competency of a member, the provisions of the Indian Contract Act shall apply. There are different modes of acquiring membership- Companies Act confers a number of rights on the members of a company. The liability of the members of the company depends upon the nature of company. Every company is bound to keep the register of its members. But when the number of company's members is more than fifty, it must also keep an index of the names of its member.

Every trading company, unless prohibited by its memorandum or articles, has an implied power to borrow money for the purpose of its business, and to give security for the loan by creating a mortgage or charge

on its property even though such power is not expressed in the memorandum of the company, whom borrowings are beyond the powers of the company or the directors, it is ultra vires borrowings. In case of borrowing which is ultra vires of the company, the lender has no right for the recovery of his loan, yet he has the right of injunction, subrogation, identification and tracing, and recovery of damages against the company. The charges which a company may create on its assets are of two kinds namely fixed charge and floating charge. The effect of non-registration of a charge is that the security created by the charge becomes void as against the liquidator and other creditors.

5.17 KEYWORDS

Member: Member refers to a person whose name appears on the register of members.

Shareholders: The term shareholder as refers to the person who holds the share in a company.

Insolvent: An insolvent is a person who has been declared by the court as unable to pay his debts.

Ultra Vires Borrowing: Where a company borrows money in excess of its powers, the borrowing would be ultra-vires the company.

Injuction: Injuction means a court order restraining a person from doing a particular thing.

Subrogation: Subrogation means the substitution of one person for another.

Fixed Charge: It is the charge which is created on the definite and ascertained assets of the company.

Floating Charge: It is the charge which is created on the class of property which is constantly changing.

5.18 SELF ASSESSMENT QUESTIONS

1. 'Members include shareholders while shareholders does not include members'. Comment.
2. Who may become a member of a company ? How to become member of a company? What are the ways of cessation of membership ? Discuss in detail.
3. What are the duties and liabilities of members ? Discuss.
4. Discuss the borrowing powers of a company. What are the restrictions on its borrowing powers ?
5. Define a floating charge and distinguish it from a fixed charge. When does a floating charge become a fixed charge ?
6. Enumerate the charges that require registration. Discuss the consequences of non-registration.

5.19 SUGGESTED READINGS

P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.

N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.

S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.

S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

R.H. Pandia, Priciples of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

LESSON : 6

MEETINGS; MANAGERIAL REMUNERATION

STRUCTURE

6.0 OBJECTIVE

After reading this lesson, you should be able to-

(a) Define a meeting and explain the kinds of meeting.
(b) Discuss the statutory provision regarding the various types of meeting of shareholders.
(c) Explain the requisites of a valid meeting.
(d) Describe the provisions regarding voting and poll, proxies and resolutions.
(e) Discuss the statutory provisions regarding payment of management remuneration.

6.1 INTRODUCTION

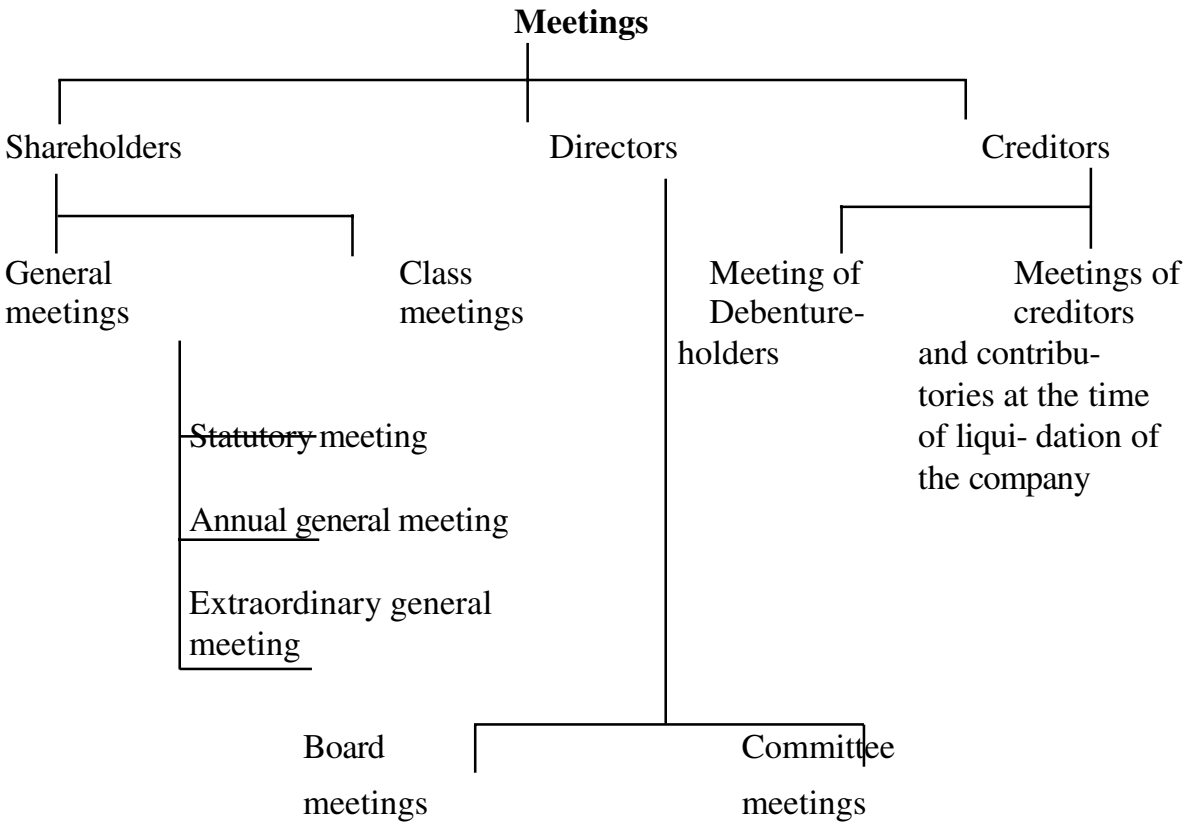
The company is an artificial person created by law having a separate entity distinct from its members. Being an artificial person, it cannot take decisions on its own. It has to take decisions on matters relating to its well being by way of resolutions passed at properly constituted and convened meetings of its shareholders or directors. The decisions about a company's management are taken by the directors in their meetings and they are to be ratified in the general meetings of the company by the shareholders.

There in an old proverb that "Two heads are always better than one". When two or more than two persons come together to discuss matters of common interest, there is said to be a meeting. It follows that to constitute a meeting there must be two or more persons. Generally, the purpose of a meeting is to consider issues of common interests to its attendants.

6.2 KINDS OFMEETINGS

The meetings of a company are of three kinds :

1. Meetings of the shareholders
   - (i) General meetings
   - (ii) Class meetings
2. Meetings of the Directors
3. Meetings of the Creditors



In this lesson, the discussion will be confined to the meetings of the shareholders.

6.3 STATUTORYMEETING

Every public company limited by shares and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date on which the company is entitled to commence business hold a general meeting of the members of the company. This meeting is called 'the statutory meeting'. [Sec. 165 (1)]

A meeting held prior to the statutory period of one month from the date of entitlement of a company to commence business can not be called the statutory meeting. The notice for such a meeting should state it

to be statutory. The statutory meeting is held only once in the life time of a company.

Private companies, public companies limited by guarantee and not having a share capital and unlimited companies are not required to hold the statutory meeting. However, a private company which becomes a public company by the application of Sec. 43 will have to comply with the provisions of the Act which are applicable to public limited companies from the date of its becoming a public limited company. A private company can commence business on the date of its incorporation. If the date of its becoming a public company is within 6 months of its incorporation, it must hold a statutory meeting in accordance with the provision of Section 165 (1). If it becomes a public company after 6 months of its incorporation, it is not required to hold the statutory meeting.

Notice

The company must give notice to its members 21 days before the holding of the statutory meeting. The notice convening the statutory meeting must specifically state that the meeting is the statutory meeting. The time, date and place of the meeting must be mentioned in the notice. However, a shorter notice may be sufficient if consent is accorded by the members of the company :

(a) If the company has a share capital, holding not less than 95% of such part of the paid up share capital of the company as gives a right to vote at the meeting.

(b) If the company has no share capital, holding not less than 95% of the total voting power exercisable at the meeting.

Statutory Report

The Board of Directors is required to prepare a report which is known as the 'statutory report" and must send this report to the members at least 21 days before the day on which the meeting is to be held [Section 165(2)]. If the report is sent later than is required, it will be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting. Thus the delay in sending the report can be condoned by unanimous consent of all the members present at the meeting. The statutory report is required to be certified as correct by at least two directors of the company, one of whom must be a Managing Director, if there is any. Thereafter the auditor must certify the report to be correct in so far as it relates to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company [Section 165(4)]. A copy of the report must be sent to the Registrar also [Section 165(5)].

Contents of Statutory Report

The statutory report shall set out :

(a) The total number of shares allotted, distinguishing those allotted as fully or partly paid-up otherwise than in cash, the extent to which they are partly paid up and the consideration for which they have been allotted.

(b) The total amount of cash received by the company in respect of all the shares allotted.

(c) An abstract of the receipts and payments made thereout up to a date within 7 days of the date of the report.

(d) The name, address and occupations of the directors of the company and of its auditors and also if there be any, of its manager and secretary.

(e) The particulars of any contract which , or the modification or the proposed modification of which is to be submitted to the meeting for its approval.

(f) The extent to which each underwriting contract (if any) has not been carried out and the reason therefor.

(g) The arrears due on cash from every director and from the manager.

(h) Particulars of any commission or brokerage paid or to be paid in connection with the issue or sale of shares or debentures to any director.

Procedure at the meeting

A list showing the names, addresses and occupation of the members of the company and the number of shares held by them must be produced by the Board of Directors at the commencement of the statutory meeting. The list is to remain open and accessible to any member of the company during the continuance of the meeting [Section 165 (6)].

It is to be noted that the members of the company present at the meeting are at liberty to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice has been given or not but one resolution may be passed of which notice has not been given in accordance with the provisions of Companies Act. [Sec. 165 (7)]

Adjournment of Statutory Meeting

The meeting may adjourn from time to time and at any adjourned meeting any resolution of which notice has been given in accordance with the provisions of the Companies Act may be passed and the adjourned meeting will have the same power as an original meeting. [Sec. 165(8)]

Penalty

If any default is made in complying with the above provisions, every director or other officer of the company who is in default shall be liable to a fine which may extend to Rs. 500. Besides, if default is made in delivering the statutory report to the Registrar or in holding the statutory meeting, the Court may order the compulsory winding up of the company. [Sec. 433 (b)]

Objects

The obvious purpose of the statutory meeting with its preliminary report is to put the shareholders of the company as early as possible in possession of all the important facts relating to the new company what shares have been taken up, what moneys received, what contracts entered into, what sums spent on preliminary expenses, etc. Furnished with these particulars the shareholders are to have an opportunity of meeting and discussing the whole situation in the management methods and prospects of the company. If the shareholders fails to do so, they have only themselves to blame.

6.4 ANNUAL GENERAL MEETING

Every company must in each year hold in addition to any other meeting a general meeting, as its annual general meeting and must specify the meeting as such in the notices calling it [Section 166 (1)]. The annual

general meeting is to be held in addition to any other general meeting that might have been held in a year. It appears that holding of an annual general meeting in every calender year is a statutory necessity. Calender year is to be calculated from Ist January to 31st December and not twelve months from the date of incorporation of the company.

First annual general meeting

A company must hold its first annual general meeting within a period of not more than 18 months from the date of its incorporation and if such general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year [Section 166(1)]. For example a company is incorporated in October 1994. Its first annual general meeting is required to be held within 18 months from the incorporation, i.e. up to March 1996 and if such a meeting is held within this period, no other meeting will be necessary either for 1995 or 1996.

Subsequent annual general meeting

As already discussed a company is required to hold an annual general meeting in each year. Where a meeting called and held on a day in one year is adjourned to a date in the next year and held on that date, the meeting held on the latter date is not a different meeting and does not comply with the requirements of Section 166. However, the gap between one annual general meting and the next should not be more than fifteen months.

In the case of Shree Meenakshi Mills Company Limited v. Astt. Registrar of Joint Stock Companies Madurai AIR 1938 Mad. 640, the annual general meeting of a company called in December 1934 was adjourned and held in March 1935. The next annual general meeting was held in January,

1936, no other meting being held in 1935. The company was prosecuted for failure to call the annual general meeting in 1935. It was held that there should be one meeting per year and as many meetings as there are years.

The Registrar can, for any special reason, extend the time within which any annual general meeting is required to be held by a period not exceeding 3 months but the time for holding the first annual general meeting cannot be so extended. [Sec. 166(1)]

Power to convene an annual general meeting

The proper authority to convene an annual general meeting is the Board of Directors, and if the managing director, manager, secretary or other officer calls a meting without such authority, it will not be effectual unless the Board ratifies the act before the meeting is held.

Notice

A public company must give at least 21 days notice for convening any general meeting including annual general meeting. Annual general meeting may be called after giving a shorter notice than 21 days if it is so agreed by all the members entitled to vote in the meeting (Section 171). In calculating 21 days, the date on which the notice is served and the day of the meeting are excluded.

Date, time and place of holding the annual general meeting

Every annual general meeting shall be called at any time during the business hours, on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated [Section 166(2)]. The Central Government may exempt any class of companies from the provisions of Sec. 166 subject to such conditions as it may impose.

(a) A public company or a private company which is a subsidiary of a public company, may by its Articles fix the time for its annual general meetings and may also by a resolution passed in preceding annual general meeting fix the time for its subsequent annual general meetings and

(b) A private company which is not a subsidiary of a public company may in like manner and also by a resolution agreed to by all the members thereof, fix the time as well as the place for its annual general meetings [Sec. 166(2)]

Adjournment

Where an annual general meeting is held but adjourned, the adjourned meeting is nothing but continuance of the earlier meeting and therefore if in the adjourned meeting the Balance Sheet and the Profit and Loss Account of the company are laid and adopted and thereafter sent to the Registrar, Section 220(I) is not violated.

Holding of annual general meeting where the annual accounts are not ready

According to Central Government instructions, in case the annual accounts are not ready for laying at the appropriate annual general meeting, the company must hold the annual general meeting within the time limit, transact all business other than the consideration of the accounts, announce when the accounts are expected to be ready for laying and pass a suitable resolution adjourning the said annual general meeting to a specific date or to a date to be specified later on. Thus the company cannot take the plea that the annual general meeting was not held because the accounts were not ready.

Power of Central Government to call annual general meeting

The Central Government may, on the application of any member of the company, call or direct the calling of a general meeting of the company. However, it is to be noted that the Court has no power to call such meeting. A general meeting held in pursuance of this order will be deemed to be an annual general meeting of the company.

The Central Government may direct that only one member of the company present in person or by proxy shall be deemed to constitute a meeting. [Section 167]

Penalty

If a default is made in holding an annual general meeting in accordance with the above provisions or in complying with the directions given by the Central Government, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 5000 and in the case of a continuing default, with a further fine which may extend to Rs. 250 for every day after the first during which the default continues. (Section 168)

Importance

It is the annual general meeting at which the shareholders can exercise control over the affairs of the company. At this meeting some directors retire and come up for re-election and thereby the shareholders find an opportunity to refuse to re-elect a director of whose action and policy they disapprove. Appointment of auditors is also made at this meeting.

Annual accounts are presented at this meeting for the consideration of the shareholders and the shareholders can ask any question relating to the account. It is at this meeting that dividends are declared. At

this meeting the shareholders can discuss any other matters relating to the company's business.

6.5 EXTRA ORDINARY GENERAL MEETING

Regulation 47 of the Table A provides that all general meetings other than annual general meetings shall be called extraordinary general meetings. An extraordinary general meeting is called to consider those transactions or business which cannot be postponed till the next annual general meeting. Hence, it is a meeting of a company which is held between two consecutive annual general meetings for transacting some urgent or special business. An extraordinary general meeting may be convened :

1. By the Board of Directors on its own or on the resolution of members; or
2. By the requisitionists themselves on the failure of the Board to call the meeting ; or
3. By the Central Government.

1 Extraordinary meeting convened by the Board of Directors

(A) On its own

Regulation 48(1) of Table A provides that the board may, whenever it thinks fit, call an extraordinary general meeting. An extraordinary general meeting may be convened by the Board of Directors if some business of special importance requires the approval of the members and which in the opinion of the Board of Directors can not be postponed till the next annual general meeting. The directors can call an extraordinary general meeting by passing a resolution in a properly convened board meeting or by a circular resolution. Regulation 48(2) of Table A

provides that "If at any time, they are not present within India, the number of directors capable of acting and forming a quorum, any director or any two members of the company may call an extraordinary general meeting in the same manner, as nearly as possible, as that in which such a meeting may be called by the Board".

(B) On the requisition of members

The directors are bound to call an extraordinary general meeting of the company if the requisition is made :

(i) in the case of a company having a share capital, by the holders of at least one-tenth paid up capital having the right to vote on the matter of requisition ; or

(ii) in the case of a company not having a share capital, by members representing not less than one-tenth of the total voting power in regard to the matter of requisition.

The Board of Directors is under a legal obligation to proceed within 21 days of the deposit of the requisition to call a meeting. The meeting shall be held within 45 days of such deposit of the requisition with the company [Sec. 169(6)]. On receipt of the requisition, the Board shall send out notices for the meeting giving not less that 21 days' time.

3. Extraordinary meeting covered by the Central Government

If due to any reason it is impracticable to call or conduct an extraordinary general meeting, the Central Government may, either on its own or on the application of any director or any member who would be entitled to vote, order a meeting to be called, held and conducted in such manner as the Central Government thinks fit and may give such directions as it thinks expedient, including a direction that one member present in person or by proxy shall be deemed to constitute a meeting.

Any meeting called, held and conducted in accordance with any such order of the Central Government will, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

The word 'impracticable' may be taken to mean impossible to hold a peaceful or useful meeting. It has been held that the word 'impracticable' should be taken to mean impractical from a reasonable point of view.

In Opera Photographic Ltd. Re; 1989 BCL [763 (1989)] case, there were only two directors and one of them who was holding 51% of the shares wanted to remove his fellow director. The Articles required the quorum of two. The fellow director did not attend the meeting to frustrate him. The Central Government ordered a meeting to be called with the presence of one as a sufficient quorum.

6.6 CLASS MEETINGS

Class meetings are the meetings of the shareholders and the creditors. Class meetings are held to pass resolutions which will bind only the members of the particular class concerned. According to regulation 3(1), if the rights attached to any class of shares are to be varied, it can be done with the consent of the holders of 3/4 of the issued shares of that class in a separate meeting of that class of holders. Similarly, under Sec. 394, where a scheme of arrangement or compromise is proposed, the meetings of several classes of shareholders and creditors are required to be held. Class meetings can only be attended by the members of that class. Whenever it is necessary to alter or change the rights or privileges of a class as provided by the Articles, a class meeting must be called.

6.7 REQUISITES OF A VALID MEETING

A meeting to be in order must fulfil certain requirements.

1. Proper Authority

The Board of Directors is the proper authority to convene a general meeting of a company and for this purpose the board should pass a resolution at a duly convened meeting of the board. However, if the board fails to call a general meeting of the company, the members or the Central Government or the Central Government may call such a meeting. Some defects in appointment or qualification of the directors present at the meeting of the board will not necessarily be fatal to the validity of the resolution passed at the meeting provided the board has acted bonafide.

2. Notice of Meetings (Sec. 171)

A proper notice of the meetings must be given to the members of the company. The notice must be given 21 days before the date of the meeting. The period of 21 days excludes the day of service of the notice and also the day on which the meeting is to be held.

The length of the notice may be waived :

(a) in the case of an annual general meeting by the consent of all members;

(b) in the case of any other meeting by the consent of the holders of not less than 95% of the paid-up share capital or the total voting power where the company has no share capital.

Notice to whom (Sec. 172)

The notice is required to be given to

(a) all the members of the company who are entitled to vote on the

matters which are proposed to be dealt with at the meeting ;

(b) all the persons who are entitled to a share in consequences of the death and insolvency of a member ;

(c) the auditor or auditors of the company. Deliberate omission to give notice of the meeting to members or to a single member will make the meeting invalid, but an accidental omission to give notice to or the non-receipt of notice by any member will not invalidate the proceedings at the meeting [Sec. 172 (3)].

Contents of Notice

Every notice of a meeting is required to specify the place and the day and hours of the meeting and must contain a statement of the business to be transacted at the meeting. If the time of holding meeting and other essential particulars are not specified in the notice, the meeting will be invalid and all resolutions passed at the meeting will be of no effect.

The notice of general meeting must contain a statement of the business to be transacted at the general meeting of the company. The business to be transacted at a meeting may be general business or special business.

Section 173 provides (a) in the case of an annual general meeting, all business to be transacted at the meeting will be deemed special except the business relating to the consideration of accounts, Balance Sheet and reports of the Board of Directors and auditors, the declaration of dividends, the appointment of directors in the place of those retiring and the appointment of and the fixing of the remuneration of the auditors and
(b) in the case of any other meeting, all business will be deemed special.

If any special business is to be transacted at an annual general meeting a statement to that effect must be annexed to the notice of the

meeting. The statement must set out all material facts concerning each item of business including in particular the nature of the concern or interest therein of every director or other managerial personnel. Thus every notice calling a meeting is required to specify the business to be transacted at the meeting.

A notice of meeting must give a sufficiently full and frank disclosure to the members of the fact upon which they are asked to vote otherwise the resolution passed at the meeting will be invalid.

In Kaye v. Croydon Tramways Co., there was a provisional agreement between two companies for the sale of the undertaking of the one company to the other. Under the agreement the buying company agreed to pay, in addition to the sum payable to the selling company, certain amount to the directors of the selling company as compensation for the loss of office. The notice calling the meeting of the shareholders to consider the agreement for sale of the undertaking did not disclose that there was a provision in the agreement for the payment of compensation to the directors. The Court held that the notice could not make the full and fair disclosure of all the material facts to the considered and voted upon at the meeting and therefore the resolutions passed at the meting were invalid and ineffective.

3. Quorum

Quorum means the minimum number of members that must be present at the meeting. The quorum is generally fixed by the company's article. Unless the articles provide for a large number, five members personally present in the case of a public company (other than a public company which has become such by virtue of Section 43-A) and two members personally present in the case of any other company will be the

quorum for a meeting of the company. If within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting will stand dissolved if it was called upon the requisition of members but in any other case it stands adjourned to the same day in the next week, at the same time and place or to such other day as the Board may determine. If at a adjourn meeting also the quorum is not present within half an hour from time appointed for holding the meeting the members present sufficient will be quorum [Section 174(5)].

Section 174 clearly indicate that the meeting must be attended by more than one member so as to constitute it as a meeting. But a few exceptions to this general rule may also be noted :

(a) Under Section 167, the Central Government may, on the application of any member of the company, call a general meeting of the company and may direct that even one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(b) Under Section 186, the Central Government may call a meeting of the company other than an annual general meeting and may give direction that even one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(c) In *East v. Bennet Bros. Ltd.,* one shareholder held all these preference shares in the company. A meeting of preference shareholders attended by him only was held to be a valid meeting.

4. Chairman of meeting

Before a meeting of a company can start its business, it is required to have a Chairman. It is the Chairman who is to preside at the meeting of the company. He is to conduct the meeting and to maintain the

order. It is the Chairman who is to put up the resolution, count the votes and declare the result. Usually the articles provide for the appointment of a Chairman but if there is no provision in the articles to this effect, the members present in the meeting shall elect one of themselves to be the Chairman of such meeting on a show of hands [Section 175(1)]. If a poll is demanded on the election of the Chairman, it shall be taken forthwith [Section 175(2)] and in such a case the Chairman elected on the show of hands will exercise all the powers of the Chairman. If some other person is elected Chairman as a result of the poll, he will be the Chairman for the rest of the meeting [Section 175(3)]. He can adjourn the meeting in the event of disorder but he should do so only as a last resort, if his attempts to restore order have failed.

A Chairman is not entitled to close the meeting prematurely and if he does so, a new Chairman may be elected and the meeting of the company may be continued. However, it is to be noted that where a meeting is called but it is not held due to pandemonium and confusion and a note to this effect is made in the minute book by the Chairman, the shareholders cannot elect a new Chairman because in such a case no meeting has actually been commenced and consequently no question of dissolving the meeting permanently by the Chairman arises.

Duties of the Chairman

(a) He must take care that the minority is not oppressed in any way.

(b) He must give the members who are present a reasonable opportunity to discuss any proposed resolution and it must be ensured that all the views are adequately aired. But at the expiry of a reasonable time, if he thinks fit, he should stop the discussion on any resolution.

(c) He must see that the meting is properly convened and constituted i.e. proper notice was given to every person entitled to attend the meeting and his own appointment is in order. It is the Chairman who is to see whether a quorum is present before proceeding with the business.

(d) The Chairman must conduct the proceedings in accordance with the provisions of the Act, the companies Articles of Association or Table A or in the absence thereof, the common law relating to the meetings.

(e) He should adjourn the meeting when it is impossible, by reason of disorder or other like cause, to conduct the meeting and complete its business. He must not use this power in a malafide manner.

(f) He must take care that the opinion of the meeting is properly ascertained with regard to the questions before it. He must do so by putting the resolution in a proper form before the members and then declaring the result.

(g) He must keep order in the meeting. He must decide all questions which arise at the meeting and which require decision at the time.

(h) He should exercise his casting vote, if any, provided by the articles for the benefit of the company.

(i) The minutes of the meeting should be properly recorded and signed by the chairman.

5. Minutes of the meeting :

Every company must keep a record of all proceedings of every general meeting and of all proceedings of every meeting of its Board of Directors and of every committee of the board.

These records are known as minutes and the books in which these records are written are called 'minute books'.

Rules of Keeping Minutes (Sec. 193-196)

(a) Within 30 days of every such meeting, entries of the proceedings must be made in the books kept for that purpose. [Sec. 193 (1-A)]

(b) Each page of minutes book which records proceedings of a board meeting must be initialled or signed by the Chairman of the same meeting or the next succeeding meeting. In the case of minutes of proceedings of a general meeting, each page of the minute book must be initialled or signed by the Chairman of the same meeting.

(c) The minutes of each meeting must contain a fair and correct summary of the proceedings at the meeting.

(d) All the appointments of officers made at any of the meetings aforesaid must be included in the minutes. In the case of a meeting of the Board of Directors or of a committee of the board, the minutes must contain the names of the directors present at the meeting and the names of the directors dissenting from or not concurring in the resolution passed at the meeting [Sec. 193 (4)].

(e) The Chairman may exclude from the minutes, matters which are defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of the company. Minutes of meetings kept in accordance with the above provisions are evidence of the proceedings recorded therein.

(f) The minutes books must be kept (i) at the registered office of the company; and (ii) be open during business hours to the inspection of any member without charge subject to reasonable restrictions but at least two hours each day must be allowed for inspection.

Penalty

If default is made in complying with the provision of Section 193 in respect of any meeting, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 50.

6.8 VOTING AND ROLL

A vote is the formal expression of the will of the members of the house either for or against a proposal. The matters proposed and duly recommended in a general meeting of the company are decided by the voting of the members of the company.

The procedure of voting is regulated by the Articles subject to the provisions of the Act. Members holding any share capital of the company have the right to vote on every motion placed before the company. However, the members holding preference shares can vote only on those motions which affect the rights attached to their capital. Share warrant holders, executors of a deceased member, receiver of an insolvent member can not exercise any voting right unless registered as members. The voting rights of an equity shareholder at a poll are in proportion to his share of the paid up equity capital.

Voting may take place in either of the following two ways :

1. Voting by a show of hands

At any general meeting, unless the Articles otherwise provide, a resolution put to the vote is in the first instance decided by a show of hands except when a poll is demanded [Sec. 177]. While voting by a show of hands, one member has one vote irrespective of the shares held by him. Proxies can not be counted unless the Articles otherwise provide. The

Chairman will count the hands raised and will declare the result accordingly. Chairman's declaration of the result of voting by the show of hands to be conclusive evidence [Sec. 178].

2. Voting by poll [Sec. 179]

If there is dissatisfaction among the members about the result of voting by the show of hands, they can demand a poll. 'Poll' means counting the number of votes cast for and against a motion. The voting rights of a member on a poll shall be in proportion to his share of the paid-up equity capital of the company. Before or on the declaration of the result of voting on any resolution by a show of hands, a poll may be ordered to be taken by the Chairman of the meeting of his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the person or persons specified below :

(a) In the case of a public company having a share capital, by any member or members present in person or by proxy and holding shares in the company:

(i) which confer a power to vote on the resolution not being less than one tenth of the total voting power in respect of the resolution, or

(ii) on which an aggregate sum of not less than fifty thousand rupees has been paid-up,

(b) In the case of a private company having a share capital, by one member having the right to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy, if more than seven such members are personally present,

(c) In the case of any other company, by any member or members present in person or by proxy and having not less than one tenth of the total voting power in respect of the resolution [Sec. 179(1)].

The demand for a poll may be withdrawn at any time by the person or persons who made the demand. [Sec. 179(2)]. The provisions of Section 179 apply to a private company, which is not a subsidiary of a public company unless the articles provide otherwise.

A poll demanded on the question of adjournment or the election of the Chairman shall be taken forth with. A poll demanded on any other question shall be taken at such time not being later than forty eight hours from the time when the demand was made, as the Chairman may direct. Where a poll is taken, the meeting will be deemed to continue until the ascertainment of the result of the poll. Even a voter who was not present at the meeting when the poll was demanded to be taken, may vote personally in a poll held on the next day.

The Chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken [Sec. 185(1)]. Where a poll is to be taken, the Chairman of the meeting shall appoint two scrutiniser to scrutinise the votes given on the poll and to report thereon to him [Sec. 184 (1)]. Of the two scrutiniser, one shall always be a member present at the meeting, provided such a member is available and willing to the appointed [Sec.184 (3)].

The Articles of a company may provide that no member shall exercise any voting right in respect of any shares registered in his name on which calls or other sums presently payable by him have not been paid (Sec. 181).

Proxies

A meeting has right to vote either in person or by proxy. Any member of a company who is entitled to attend and vote at a meeting of the company can appoint another person (whether a member or not) as his proxy to attend and vote instead of himself but a proxy so appointed will have no right to speak at the meeting. Unless the articles otherwise provide, a proxy will not be allowed to vote except on a poll. A member of a private company, unless the articles provide otherwise is not entitled to appoint more than one proxy to attend on the same occasion. Besides unless the articles provide otherwise a member of a company not having a share capital is not entitled to appoint a proxy. The instrument appointing a proxy is required to be in writing and signed by the appointor or his attorney duly authorised in writing. A proxy is revocable but it should be revoked before the proxy has voted. If the member who has appointed a proxy personally attends and votes at the meeting, the proxy is revoked by such conduct of the member [Section 189]. Death of the member who has appointed a proxy revokes the authority of his proxy but if the company has no notice of such death, then the vote given by the proxy will be valid.

6.9 RESOLUTIONS

The decisions of a meeting take the form of resolutions carried by a majority of votes. A question on which a vote is proposed to be taken is called a 'motion'. Once a 'motion' has been put to the members and they have opted in favour of it, it becomes a resolution. A resolution may, thus, be defined as the formal decision of a meeting on a particular proposal before it.

Types of Resolutions

Resolutions are of the following types :

1. Ordinary Resolutions ;
2. Special Resolutions ; and
3. Resolutions requiring special notice.

Ordinary Resolution

At a general meeting of which notice has been given, if votes cast in favour of the resolution by members exceed the votes, if any, cast against the resolution by members, the resolution so passed is an ordinary resolution [Sec. 189(1)]

Unless the Companies Act or the memorandum or the articles expressly require a special resolution or resolution requiring special notice, an ordinary resolution is sufficient to carry out any matter.

Transactions where ordinary resolution is required

Important maters for which an ordinary resolution is enough are as follows :

(i) Issue of shares at a discount (Sec. 79)

(ii) Alteration of the share capital (Sec. 94)

(iii) Approval of the statutory report (Sec.165)

(iv) The consideration of accounts, the Balance Sheet and the report of the Board of Directors and of the auditors (Sec. 210)

(v) Appointment of auditors and fixation of their remuneration [Sec. 224(1)].

(vi) Appointment of the first directors who are to retire by rotation [Sec. 255(1)].

(vii) Increase or decrease in the number of directors within the limits prescribed by the Articles [Sec. 258].

(viii) Adoption of the appointment of sole selling agents [Sec. 294].

(ix) Removal of a director and appointment of another director in his place [Sec. 284(1)].

(x) Declaration of dividend [Sec. 205].

(xi) Appointment of liquidator in case of voluntary winding up and fixing his remuneration [Sec. 490(1)].

(xii) To rectify the name of company [Sec. 22].

(xiii) To cancel or redeem debentures [Sec. 21].

(xiv) To cancel directors by rotation [Sec. 256].

(xv) To approve the remuneration of directors [Sec. 309].

(xvi) To fill the vacancy in the office of Liquidator [Sec. 492].

Special Resolution

The resolution is a special resolution, if

(i) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting ;

(ii) the notice required has been duly given of the general meeting; and

(iii) the votes cast in favour of the resolution by members are three times the number of the votes, if any, cast against the resolution by the members [Sec. 189 (2)].

A copy of the special resolution must be filed with the Registrar within 30 days of its passing.

Special Resolution Matters

In addition to the matters given in the articles of the company, the Companies Act specifies certain matters for which a special resolution must be passed ; for example,

(i) to alter the memorandum of the company [Sec. 17];

(ii) to alter the articles of the company [Sec. 31];

(iii) to issue further shares without pre-emptive rights [Sec. 81];

(iv) for creation of a reserve capital [Sec. 99];

(v) to reduce the share capital [Sec. 100];

(vi) to pay interest out of the capital to members [Sec. 208],

(vii) for authorising a director to hold an office or place of profit [Sec. 314];

(viii) for voluntary winding-up of a company [Sec. 484].

Resolutions Requiring Special Notice

A resolution requiring special notice is not an independent class of resolutions. It is a kind of ordinary resolution, with the only difference that here the mover of the proposed resolution is required to give a special notice of 14 days to the company before moving the resolution, and the company shall then immediately give its members notice of the resolution in the same manner as it gives notice of the meeting. If that is not practicable, the company shall give not less than seven days notice before the meeting either by advertisement in a newspaper or in any other mode allowed by the articles (Sec. 190).

In addition to the purposes enumerated in the articles requiring special notice, under the Act, special notice has to be given for the following matters :

(a) for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor and for a resolution providing expressly that a retiring auditor shall not be re-appointed (Sec. 225).

(b) for certain persons who shall not be eligible for appointment as directors whose period of office is liable to determination by retirement of directors by rotation (Sec. 261).

(c) for removing a director before the expiry of his period of office; and

(d) of any resolution to appoint a director in place of a director so removed (Sec. 284).

6.10 MANAGERIAL REMUNERATION

Directors have no right to claim remuneration for their services unless there is a specific provision to that effect in the Articles or the company resolves for the same in a general meeting as per the provisions of Section 309. The resolution may be ordinary or special as the Articles may require.

As per Section 198, the total managerial remuneration payable by a public company or a private company which is a subsidiary of a public company, to its directors and its managing agent, secretaries and treasurer or manager in respect of any financial year shall not exceed 11% of the net profit of that company for that financial year. This percentage shall be exclusive of the fees payable to the directors under Section 309.

If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay any remuneration to its directors except with the previous approval of the Central Government. The word remuneration shall include the following :

(i) any expenditure incurred on providing free accommodation and other amenities connected therewith ;

(ii) any expenditure incurred on providing any other amenity either absolutely free or at a concessional rate ;

(iii) any expenditure incurred in providing any obligation or service which in the absence of provision by the company would have to be borne by that person ;

(iv) any expenditure incurred in providing life insurance, pension, annuity or gratuity to such person or his spouse or child.

According to Section 249, in computing the net profits of a company in any financial year for the purpose of Section 348, credit shall be given for bounties and subsidies received from any government, or any public authority constituted or authorised in this behalf, by any government, unless and except in so far as the Central Government otherwise directs.

However credit shall not be given for the following sums :

(i) Profits, by way of premium, on the shares or debentures of the company, which are issued or sold by the company,

(ii) Profits on the sales by the company of the forfeited shares;

(iii) Profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof ;

(iv) Profits from the sales of any immovable property or fixed assets of a capital nature comprising in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets.

In making the aforesaid computation, the following sums shall be deducted :

(i) all the usual working charges ;

(ii) director's remunerations ;

(iii) bonus or commission paid or payable to any employees of the company whether on a whole time or on a part time basis ;

(iv) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;

(v) any tax on business profits imposed for special reasons or in special circumstances;

(vi) interest on debentures issued by the company ;

(vii) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets ;

(viii) interest on unsecured loans and advances ;

(ix) expenses on repairs to immovable or movable property provided the repairs are not of a capital nature ;

(x) contributions to charitable and other funds ;

(xi) depreciation to the extent specified in Section 350;

(xii) past losses arising after Ist April, 1956 to the extent not already deducted in any year preceding that in which net profits have to be ascertained ;

(xiii) any compensation or damages under a legal liability or arising from breach of contract ;

(xiv) any sum paid by way of insurance against the risk of meeting any liability as specified in clause (iii) above ; and

(xv) bad debts written off or adjusted during the year of account.

The following sums shall not be deducted in computing the profits :

(i) Income tax and super tax payable by the company or any other tax on the income of the company not falling under clauses (d) and (e) of Section 399 (4);

(ii) any compensation, damages or payments made voluntarily ; and

(iii) loss of a capital nature.

It is pertinent to note that according to Section 309, a whole time director or managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company, or partly by one way and partly by the other. Except with the approval of the Central Government, such remuneration shall not exceed 5 per cent of the net profits for one such director, or 10 per cent for all of them in case there are more than one such director.

A part time director may be paid remuneration either by way of a monthly, quarterly, or annual payment with the approval of the Central Government, or by way of commission if the company by a special resolution authorises such payment with the approval of the Central Government, or by a special resolution authorises such payment.

The remuneration paid to part time directors shall not exceed per cent of the net profits of the company if the company has a managing or whole time director or a manager and 3 per cent of the profits in any other case. However, the company in a general meeting may, with the approval of the Central Government, increase these rates of remuneration.

6.11 SUMMARY

A meeting is a gathering or assembly of a number of persons for transacting any lawful business. But every gathering of persons does not constitute a meeting. A meeting would be valid if it is held by following the prescribed rules and regulations. The meetings of a company are of three kinds namely meetings of shareholders directors and creditors. Statutory meeting is the first meeting of the members of the company after its incorporations and must be held within six months from the date at which the company is entitled to start business. Annual general meeting is the regular meeting of the members of the company and the purpose of this meeting is to provide an opportunity to the members of the company express their views on the management of company's affairs. Any meeting other than the statutory and the annual general meeting of the company is known as extra-ordinary general meeting, class meeting is the meeting of a particular class of shareholders. The business of the meeting is conducted in the form of resolutions passed at the meeting and the resolutions proposed in the meeting are decided on the votes of the members of the company. The remuneration payable to directors is determined by the articles of association of the company, or by a resolution of the company passed in its general meeting. The overall maximum limit of management remuneration in fixed by Section 198 of the Companies Act.

6.11 KEYWORDS

Meeting: A meeting may be defined as gathering or assembly of a number of persons for transacting any lawful business.

Statutory Meeting: Every public company limited by shares and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date on which the company is entitled to commence business hold a general meeting of the members of the company. This meeting is called the statutory meeting.

Annual General Meeting: Every company must in each year hold in addition to any other meeting, a general meeting as its annual general meeting.

Extra Ordinary General Meeting: Any meeting other than a statutory and an annual general meeting is called an Extra Ordinary General Meeting.

Class Meeting: Class meetings are separate meetings of holders of different classes of shares. They are held in cases where their rights are sought to be affected.

Quorum: It means the minimum number of members that must be present at the meeting.

Vote: A vote is the formal expression of the will of the members of the house either for or against a proposal.

Ordinary Resolution: It is the resolution which is passed, at a valid meeting by simple majority of the members, i.e., where the votes cast in favour of resolution exceed the votes cast against it.

Managerial Remuneration: The total managerial remuneration payable by a public company or a private company which is a subsidiary of a public company to its directors, managing agent, secretaries and treasurer or

manager in respect of any financial year shall not exceed 11% of the net profit of that company for that financial year.

6.13 SELF ASSESSMENT QUESTIONS

1. What is a statutory meeting ? When and how is it held ? What are the objects of such a meeting ? What business is transacted at such meetings ?
2. What are the statutory provisions regarding the holding of an annual general meeting ? What types of business are transacted in such meetings ?
3. What are the requisites of a valid meeting ? Discuss in detail
4. What is a quorum ? What happens if there is no quorum at ameeting?
5. What are different types of resolutions which must be passed in the meeting of shareholders ?
6. Discuss the statutory provisions relating to payment of managerial remuneration of a public limited company.

6.14 SUGGESTED READINGS

S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

S.S. Gulshan & G.K. Kapoor, Business Law, New Age International Publishers, New Delhi.

S.C. Kuchhal, Mercantile Law, Vikas Publishing House, New Delhi.

Nirmal Singh, Business Law, Deep and Deep Publication Pvt. Ltd., New Delhi.

LESSON : 7

WINDING UP OF A COMPANY

STRUCTURE

7.0 OBJECTIVE

This lesson is intended to familiarize you with

a) The concept of winding up.
b) Different modes of winding up of a public company.
c) Persons entitled to apply for winding up.
d) Consequences of winding up.

7.1 INTRODUCTION

Winding up (which is more commonly called liquidation in Scotland) is proceeding for the realisation of the assets, the payment of creditors, and the distribution of the surplus, if any, among the shareholders, so that the company may be finally dissolved. Professor Gover in his book *Principles of Modern Company Law* has described the winding up of a company in the following words :

''Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator called a liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.''

Thus winding up is the last stage in the life of a company. It means a proceeding by which a company is dissolved.

Winding up should not be taken as if it is dissolution of a company. The winding up of a company precedes its dissolution. Prior to dissolution and after winding up, the legal entity of the company remains and it can be sued in a Court of law. On dissolution the company ceases to exist, its name is actually struck off from the Register of Companies by the Registrar and the fact is published in the official Gazette.

7.2 MODES OF WINDING UP

A company can be wound up in three ways :

1. Compulsory winding up by the Court;
2. Voluntary winding up : (i) Members' voluntary winding up; (ii) Creditors' voluntary winding up;

3. Voluntary winding up subject to the supervision of the Court [Sec. 425].

7.3 WINDING UP BY THE COURT

A company may be wound up by an order of the Court. This is called compulsory winding up or winding up by the Court. Section 433 lays down the following grounds where a company may be wound up by the Court.

A petition for winding up may be presented to the Court on any of the grounds stated below :

1. Special resolution

A company may be wound up by the Court if it has, by a special resolution, resolved that it be wound up by the Court. But it is to be noted that the Court is not bound to order for winding up merely because the company by a special resolution has so resolved. Even in such a case it is the discretion of the Court to order for winding up or not.

2. Default in filing statutory report or holding statutory meeting

If a company has made a default in delivering the statutory report to the Registrar or in holding the statutory meeting, a petition for winding up of the company may be presented to the Court. A petition on this ground may be presented to the Court by a member or Registrar (with the previous sanction of the Central Government) or a creditor. The power of the Court is discretionary and generally it does not order for winding up in first instance. The Court may, instead of making an order for winding up, direct the company to file the statutory report or to hold the statutory meeting but if the company fails to comply with the order, the Court will wind up the company.

3. Failure to commence business within one year or suspension of business for a whole year

Where a company does not commence its business within one year from its incorporation or suspends its business for a whole year, a winding up petition may be presented to the Court. Even if the business is suspended for a whole year, this by itself does not entitle the petitioner to get the company wound up as a matter of right but the question whether the company should be wound up or not in such a circumstances entirely in the discretion of the Court depending upon the facts and circumstances of each case. Even if the work of all the units of the company has been suspended then too it will still be open to the Court to examine as to whether it will be possible for the company to continue its business. Before the order of winding up on this ground the Court is required to see what are the possibilities of resumption of the business of the company. The suspension of the business, for this purpose, must be the entire business of the company and not a part of it.

The Court will not order for winding up on the grounds, if :

(a) suspension of business is due to temporary causes ; and

(b) there are reasonable prospects for starting of business within a reasonable time.

4. Reduction of membership below the minimum

When the number of members is reduced, in the case of a public company, below 7 and in the case of a private company, below 2, a petition for winding up of the company may be presented to the Court.

5. Company's inability to pay its debts

A winding up petition may be presented if the company is unable

to pay its debt. 'Debt' means definite sum of money payable immediately or at future date. A company will be deemed to be unable to pay its loan in the following conditions (Section 434) :

(a) a creditor of more than Rs. 500 has served, on the company at its registered office, a demand under his hand requiring payment and the company has for three weeks thereafter neglected to pay or secure or compound the sum to the reasonable satisfaction of the creditor ; or

(b) execution or other process issued on a judgement or order in favour of a creditor of the company is returned unsatisfied in whole or in part ; or

(c) it is proved to the satisfaction of the Court that the company is unable to pay its debts, taking into account its contingent and prospective liabilities, i.e. whether its assets are sufficient to meet its liabilities.

6. Just and Equitable [Sec. 433(f)]

The Court may also order to wind up of a company if it is of opinion that it has just and equitable that the company should be wound up. What is 'just and equitable' depends on the facts of each case. The words 'just and equitable' are of wide connotation and it is entirely discretionary on the part of the Court to order winding up or not on this ground.

Thus the Court itself works out the principles on which the order for winding up under the section is to be made.

Winding up by the Court on 'just and equitable' grounds may be ordered in the cases given below :

(a) When the substratum of the company has gone : In the words of Shah, J. in *Seth Moham Lal v. Grain Chambers Ltd.* the "substratum of the

company is said to have disappeared when the object for which it was incorporated has substantially failed, or when it is impossible to carry on the business of the company except at a loss, or the existing and possible assets are insufficient to meet the existing liabilities.

The substratum of a company will be deemed to have gone when

(i) The object for which it was incorporated has substantially failed or has become impossible or (ii) it is impossible to carry on business except at a loss or (iii) the existing and possible assets are insufficient to meet the existing liabilities of the company.

(b) When there is oppression by the majority shareholders on the minority, or there is mismanagement.

(c) When the company is formed for fraudulent or illegal objects or when the business of the company becomes illegal.

(d) When there is a deadlock in the management of the company. When there is a complete deadlock in the management of the company, it will be wound up even if it is making good profits. In *Re Yenidjee Tobacco Co. Ltd.* A and B the only sharehodlers and directors of a private limited company became so hostile to each other that neither of them would speak to the other except through the secretary. Held, there was a complete deadlock and consequently the company be wound up.

(e) When the company is a 'bubble', i.e. it never had any real business.

7.4 PERSONS ENTITLED TO APPLY FOR WINDING UP

The Court does not choose to wind up a company at its own motion. It has to be petitioned. Section 439 of the Companies Act enumerates the persons those can file a petition to the Court for the winding

up of a company. The petition for winding up may be brought by any one of the following :

1. Petition by Company

A company can make a petition only when it has passed a special resolution to that effect. However, it has been held that where the company is found by the directors to be insolvent due to circumstances which ought to be investigated by the Court, the directors may apply to the Court for an order of winding up of the company even without obtaining the sanction of the general meeting of the company.

2. Petition by Creditors

The word 'creditor' includes secured creditor, debentureholder and a trustee for debentureholder. A contingent or prospective creditor (such as the holder of a bill of exchange not yet matured or of debentures not yet payable) is also entitled to petition for a winding up of the company.

Before a petition for winding up of a company presented by a contingent or prospective creditors is admitted, the leave of the Court must be obtained for the admission of the petition. Such leave is not granted (a) unless, in the opinion of the Court, there is a prima facie case for winding up the company; and (b) until reasonable security for costs has been given.

Notice that a creditor has a right to winding up order if he can prove that he claims an undisputed debt and that the company has failed to discharge it. When a creditors' petition is opposed by other creditors, the Court may ascertain the wishes of the majority of creditors.

3. Contributory Petition

The term 'contributory' means every person who is liable to contribute to the assets of the company in the event of its being wound up.

Section 428 makes it clear that it includes the holder of fully-paid shares. A fully-paid shareholder will not, however, be placed on the list of contributors, as he is not liable to pay any contribution to the assets, except in cases where surplus assets are likely to be available for distribution.

A contributory is entitled to present a petition for winding up a company if :

(a) the number is reduced, in the case of a public company below seven and in the case of private company below two; and

(b) the shares in respects of which he is a contributory either were originally allotted to him or have been held by him; and

(c) the shares have been registered in his name, for at least six months during the period of 18 months immediately before the commencement of the winding up; and

(d) the shares have been devolved on him during the death of a former holder [Sec. 439(4)].

4. Registrar's Petition

The Registrar can present a petition for winding up a company only on the following grounds, viz.,

(a) if a default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;

(b) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year ;

(c) if the number of members is reduced, in the case of a public company below seven and in the case of a private company below two ;

(d) if the company is unable to pay its debts; and

(e) if the Court is of opinion that it is just and equitable that the company should be wound up.

Note that the Registrar can file a petition for winding up only with prior approval of the Central Government. The Central Government before sanctioning approval must give an opportunity to the company for making its represent actions, if any.

Again a petition on the ground of default in delivering the statutory report or holding the statutory meeting cannot be presented before the expiration of 14 days after the last day on which the statutory meeting ought to have been held.

5. Petition by any Person Authorised by the Central Government

If it appears to the Central Government from any report of the inspectors appointed to investigate the affairs of the company, that it is expedient to wind up the company because its business is being conducted with intent to defraud creditors, members or any other person, or its business is being conducted for a fraudulent or unlawful purpose, or the management is guilty of fraud, misfeasance or other misconduct, the Central Government may authorise any person to present to the Court a petition for winding up of the company that is just and equitable that the company should be wound up.

7.5 COMMENCEMENT OF WINDING UP (SECTION 441)

Where before the presentation of a petition for the winding up of a company by the Court, a resolution has been passed by the company for voluntary winding up, the winding up of the company will be deemed to have commenced from the date of the resolution. In all other cases (i.e. where the company has not previously passed a resolution for voluntary

winding up), the winding up will be deemed to commence from the time of the presentation of the petition for the winding up.

The Court may dismiss or allow the petition for winding up and also can adjourn its hearing or pass conditional order of winding up. In the case of *Misrilal Dharamchand Ltd. v. B. Patnaik Mines Ltd. (1978)* the Court ordered for winding up but stayed the operation of the order for six months so as to enable the company to pay the petitioner, if it could do so within this period and in case of failure the order was to come in force.

Powers of the Court

On hearing a winding up petition, the Court may dismiss it or adjourn the hearing or make interim orders or make an order for winding up the company, with or without costs or any other order that it thinks fit (Section 443).

Consequences of winding up

(i) Where the Court makes an order for winding up of company, the Court must forthwith cause intimation thereof to be sent to the Official Liquidators and the Registrar (Section 444).

(ii) On the making of a winding up order it is the duty of the petitioner in the winding up proceedings and of the company to file with the Registrar a copy of the order of the Court within 30 days from the date of the making of the order [Section 445(1)].

(iii) The winding up order is deemed to be notice of discharge to the officers and employees of the company, except when the business of the company is continued [Section 445(3)].

(iv) When a winding up order has been made, no suit or other legal proceedings can be commenced against the company except with the

leave of the Court. Suits pending at the date of the winding up order cannot be further proceeded without the leave of the Court. According to sub-section (2) of Section 446 the Court which is winding up the company has jurisdiction to entertain or dispose of (a) any suit or proceeding by or against the company; (b) any claim made by or against the company; (c) any application made under Section 391 by or in respect of the company ; (d) any question of priorities or any other question whatsoever which may relate to or arise in course of the winding up of the company.

(v) An order for winding up operates in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of a contributory (Section 447).

(vi) According to Section 536 any disposition of the property (including actionable claims) of the company, any transfer of shares in the company or alteration in the status of its members, made after the commencement of the winding up shall be void, unless the Court otherwise orders.

Thus the Court can direct that any such disposition of property or actionable claims or transfer of shares or alteration of status of the members will be valid. But unless the Court so directs, such disposition, transfer or alteration will be void.

(vii) Section 537 declares that any attachment and sale of the estate or effects of the company, after the commencement of the winding up, will be void. In the case of winding up by the Court any attachment, distress or execution put in force, without leave of the Court, against the estate or effects of the company after the commencement of the winding up will be void. Similarly any sale held , without leave of the

Court, of any of the properties or effects of the company after the commencement of the winding up will be void. With leave of the Court, attachment and sale of the properties of the company will be valid even if such attachment and sale are made after the commencement of the winding up of the company. Besides this section does not apply to any proceedings for the recovery of any tax imposed or any dues payable to the Government. Thus I.T.O. can commence assessment proceedings without leave of the Court.

(viii) It is to be noted that winding up order does not bring the business of the company to an end. The corporate existence of the company continues through winding up till the company is dissolved. Thus the company continues to have corporate personality during winding up. Its corporate existence come to an end only when it is dissolved.

(ix) An order for winding up operates in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of contributory.

(x) On a winding up order being made in respect of a company, the Official Liquidator, by virtue of the office, becomes the liquidator of the company (Section 449).

7.6 OFFICIAL LIQUIDATORS

Under the present Act, the only person who is competent to act as the liquidator in a winding up is the official liquidator. For the purpose of winding up, there shall be attached to each high Court an official liquidator appointed by the Central Government, who may be either a whole time or part time officer depending upon the volume of work. In district courts the official receiver will be the official liquidator. The Central

Government may appoint one or more deputy or assistant official liquidators to assist the official liquidator in the discharge of his functions. There is no provision in the Act, for the removal of the official liquidator [Sec. 448(1) & (1-A)].

Liquidator

On a winding up order being made, the official liquidator, by virtue of his office, becomes the liquidator of the company (Sec. 449). Where the official liquidator becomes or acts as liquidator, there shall be paid to the Central Government out of the assets of the company such fees as may be prescribed.

A liquidator shall be described by the style of "The official liquidator" of the particular company in respect of which he acts and not by individual name [Sec. 452].

Provisional Liquidator

The Court may appoint the official liquidator to be the liquidator provisionally at any time after the presentation of the petition for winding up and before making winding up order [Sec. 450 (1)]. Before making such an appointment notice must be given to the company and a reasonable opportunity must be given to it to make representation. The Court may dispense with such notice where there are special reasons. Such reasons must be recorded in writing. A provisional liquidator is as much liquidator as a liquidator in the winding up of a company. But where a provisional liquidator is appointed by the Court, the Court may limit and restrict his powers. On a winding up order being made, the official liquidator shall cease to be provisional liquidator and shall become liquidator of the company.

General provisions for liquidators

The liquidator shall conduct the proceedings in winding up the company and perform such duties as the Court may impose. The official liquidator gets his remuneration from the Central Government and as such he is not entitled to any further remuneration. For the services rendered by the official liquidator to the company, the Central Government shall pay such fees out of the assets of the company as may be prescribed.

The acts of a liquidator shall be valid, notwithstanding any defect that may afterwards be discovered in his appointment or qualification. But his acts shall not be valid if they are done after it has been shown that his appointment was invalid [Sec. 451].

Statement of Affairs [Sec. 454]

The company must make out and submit to the official liquidator a statement as to the affairs of the company in the prescribed form verified by an affidavit and containing the following particulars :

(a) The assets of the company, stating separately the cash balance in hand and at the bank and the negotiable securities held by the company;

(b) Its debts and liabilities;

(c) Names, residences and occupation of its creditors, stating separately the amount of secured and unsecured debts;

(d) In the case of secured debts, particulars of securities given, their value and the dates on which they were given;

(e) The debts due to the company and the names, residences and occupations of the persons from whom they are due and the amount likely to be realised on account thereof; and

(f) Such further or other information as may be prescribed or as the official liquidator may require.

Note that the statement must be submitted and verified by one or more of the directors and by the manager, secretary or other chief officer of the company and it must be submitted within 21 days from the relevant date or within such extended time not exceeding three months [Sec. 454 (3)].

Duties of the Liquidator

They may be summarised as under :

(i) He must conduct equitably and impartially all proceedings in the winding up according to the provisions of the law.

(ii) He must submit a preliminary report to the Court as to :

(a) the amount of capital issued, subscribed and paid up and the estimated amount of assets and liabilities, giving separately, under the heading of assets such as (i) cash and negotiable securities; (ii) debts due from contributories; (iii) debts due to the company and securities, if any available in respect thereof ; (iv) immovable and movable properties belonging to the company; and (v) unpaid calls.

(b) if the company has failed, as to the causes of the failure; and

(c) whether in his opinion further inquiry is desirable as to any matter relating to the promotion, formation or failure of the company or the conduct of the business thereof.

Note that the Court may extend the period of six months for the submission of the above report by the official liquidator. The Court may also order that no such statement need be submitted.

(iii) The official liquidator may, if he thinks fit, make further reports, stating the manner in which the company was promoted or formed. He may state in the reports whether in his opinion any fraud has been committed by any person in its promotion or formation, or since the formation thereof. He may also state any other matters which, in his opinion, it is desirable to bring to the notice of the Court [Sec. 455(2)].

(iv) He must take into his custody and control the property of the company.

Notice that so long as there is no liquidator, all the property and effects of the company are deemed to be in the custody of the Court [Sec. 456(2)].

(v) Control of powers : The liquidator must in the administration of the assets of the company and the distribution thereof among its creditors have regard to any directions which may be given by a resolution of the creditors or contributories at any general meeting or by the committee of inspection [Sec. 460(1)]. Any directions given by the creditors or contributories at any general meeting override any directions given by the committee of inspection.

(vi) To Summon Meetings of Creditors and Contributories : He may summon general meetings of the creditors or contributories for the purpose of ascertaining their wishes. But he shall be bound to summon such meetings, at such times, as the creditors or contributories may, by resolution, direct, or whenever requested in writing to do so by not less than one tenth in value of the creditors or contributories, as the case may be [Sec. 460 (3)].

(vii) Proper Books : The liquidator must keep proper books for making entries or recording minutes of proceedings at meetings and of such other matters as may be prescribed. Any creditor or contributory may, subject to the control of the Court, inspect any such books, personally or through his agent [Sec. 461].

(viii) He must, at least twice in each year, present to the Court an account of his receipts and payments as liquidator. The account must be in the prescribed form and must be made in duplicate. The Court gets the account audited, keeps one copy thereof in its records and delivers the other copy to the Registrar for filling. Each copy shall, however, be open to the inspection of any creditor, contributory or person interested. The liquidator must also send a printed copy of the accounts so audited by post to every creditor and to every contributory.

(ix) Within two months from the date of the direction of the Court, the liquidator must call a meeting of the creditors for determining the persons who are to be members of the committee of inspection, if such committee is to be appointed. Within 14 days of the meeting of the creditors, the liquidator must call a meeting of the contributories to consider the decision of the creditors.

(x) Within two months of the expiry of each year from the commencement of winding up, the liquidator must file a statement duly audited, by a qualified auditor with respect to the proceedings in, and position of, the liquidation.

The statement must be filed :

(a) in the case of a winding up by or subject to the supervision of the Court, in the Court ; and

(b) in the case of voluntary winding up, with the Registrar.

Note that when the statement is filed in the Court, a copy must simultaneously be filed with the Registrar and must be kept by him along with the other records of the company [Sec. 551].

Powers of The Liquidator

A liquidator has two types of powers under the Act :

(a) Powers exercisable with the sanction of the Court ; and

(b) Powers exercisable without the sanction of the Court.

Powers with the Sanction of the Court

(a) to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, on behalf of the company ;

(b) to carry on the business of the company for the beneficial winding up of the company ;

(c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract ;

(d) to raise any money required on the security of the assets of the company ;

(e) to appoint an advocate, attorney or pleader to assist him in the performance of his duties ;

(f) to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

Note that the Court may by order provide that the liquidator may exercise any of the above powers without the sanction of the Court [Sec. 458).

Powers Without the Sanction of the Court

The liquidator may exercise the following powers without the sanction of the Court, namely, powers :

(a) to execute documents and deeds on behalf of the company and use, when necessary, the company's seal ;

(b) to inspect the records and returns of the company or the files of the Registrar without payment of any fee ;

(c) to draw, accept, make and endorse any bills of exchange, hundis or promissory notes with the same effect as if drawn, accepted, made, or endorsed by the company in the course of its business ;

(d) to prove, rank and claim in the insolvency of any contributory for any balance against his estate and to receive dividends in respect thereof;

(e) to take out, in his official name, letters of administration to any deceased contributory ;

(f) to appoint an agent to do any business which he is unable to do himself [Sec. 457(2)]. For example, he can appoint any advocate, attorney or pleader entitled to appear before the Court to assist him in the performance of his duties [Sec. 459], but with the sanction of the Court.

Supervision and control over liquidators

1 Control by contributories and creditors

The contributories and creditors exercise control over the liquidator in the performance of his duties through the medium of the meetings which it is his duty to call from time to time. Any creditor or

contributory may, subject to the control of the Court inspect the books which are maintained by the liquidator. The liquidator is also required to print and send a copy of the audited accounts to each creditor and contributory.

2. Control by Court

The liquidator shall apply to the Court for directions in relation to any matter arising in the winding up. The Court has the power to confirm, reserve or modify any act or decision of the liquidator if complained by any aggrieved person. The Court has the power to cause the accounts of the liquidator to be audited in such manner as it thinks fit.

3. Supervision by committee of inspection

The committee of inspection can inspect the accounts of the liquidator at all reasonable times. The liquidator is under an obligation to have directions from the committee of inspection.

4. Control by Central Government

Section 463 seeks to bring the conduct of the liquidators of companies under the control and scrutiny of the Central Government. Where a liquidator does not faithfully perform his duties and duly observe all the requirements imposed upon him by the Act or the rules thereunder with respect to the performance of his duties, or if any complaint is made to the Central Government by any creditor or contributory in regard thereto, the Central Government shall enquire into the matter, and take such action thereon as it may think fit . The power includes the power to remove the liquidator from office.

The Central Government may at any time require any liquidator of a company which is being wound up by the Court to answer any inquiry in

relation to any winding up in which he is engaged. It may also, if it thinks fit, apply to the Court to examine him or any other person on oath concerning the winding up. The Central Government may also direct a local investigation to be made of the books and vouchers of the liquidator.

The provisions of this section do not apply where the winding up has been completed after dissolution.

Committee of Inspection (Sections 464, 465)

The Court may, at the time of making an order for the winding up or at any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator. Where such a direction is given by the Court, the liquidator is required to convene, within 2 months from the date of the direction, a meeting of the creditors to determine who are to be the members of the committee, within 14 days from the date of the creditors' meeting, the liquidator must call a meeting of the contributories to consider the creditors' decision with respect to the membership of the committee. Contributories may accept the decision of the creditors with or without modification or reject it. If the contributories at their meeting do not accept the creditors' decision in its entirely, the liquidator shall apply to the Court for directions as to what the composition of the committee should be and who shall be its members. The committee shall consist of not more than 12 members, being creditors or contributories of the company in such proportion as may be agreed on by the meetings of the creditors and contributories and in case of difference of opinion, as may be determined by the Court. The Committee may inspect the accounts of the liquidator at all reasonable time.

The committee will meet at such times as it may from time to time appoint and the liquidator or any member of the committee may also

call a meeting of the committee as and when he thinks necessary. The quorum for a meeting of the committee will be one-third of the total number of the members or two, whichever is higher. The committee may act by a majority of its members present at a meeting but shall not act unless a quorum is present. A member may resign by notice in writing signed by him and deliver to the liquidator. If a member of the committee is adjudged as insolvent or compounds or arranges with his creditor or is absent from five consecutive meetings of the committee without leave of those members, who together with himself, represent the creditors or contributories, his office shall become vacant. A member of the committee may be removed at a meeting of the creditors, if he represents creditors, or at a meeting of contributories if he, represents contributories, by an ordinary resolution of which seven days' notice has been given stating the objects of the meeting. When any vacancy has occurred in the committee, the liquidator will call a meeting of the creditors or contributories, as the case may be, and the meeting may reappoint the same person or appoint some other person in the vacancy. However, the liquidator may apply to the Court that the vacancy need not be filled in and if the Court is satisfied that in the circumstances of the case the vacancy need not be filled, it may make an order accordingly.

Dissolution of Company in Winding up by the Court

The Court may make an order for the dissolution of a company in the following conditions : (a) When the affairs of the company have been completely wound up ; or (b) when the Court is of opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason and it is just and equitable in the circumstances of the case that an order of dissolution of the company should be made. Where such an order is made by the Court, the company will be dissolved from the date of the order of the Court. Within 30 days from the

date of the order, the liquidator must send a copy of the order to the Registrar. On the dissolution, the corporate existence of the company comes to an end.

Company in liquidation exists as juristic personality until order of dissolution is based by the Court. After the order of dissolution, the legal personality of the company come to an end. The Court may declare the dissolution void within 2 years from the date of the dissolution.

7.7 VOLUNTARY WINDING UP

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'. In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the Court, although they may apply to the Court for directions or orders if and when necessary.

A company may be wound up voluntarily under the circumstances given hereunder :

1. when the period fixed for the duration of the company by the articles has expired or the event has occurred on the occurrence of which the articles provide that the company is to be dissolved and the company in a general meeting has passed a special resolution to wind up voluntarily; or
2. the company has passed a special resolution to wind up voluntarily. Thus a company may be wound up voluntarily at any time and for any reason if a special resolution to this effect is passed in its general meeting.

When a company has passed a resolution for voluntary winding up, it must within 14 days of the passing of the resolution gives notice of

the resolution by advertisement in the official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated.

Commencement of Voluntary Winding up

A voluntary winding up is deemed to commence at the time when the resolution for winding up is passed [Sec. 486]. The date of the commencement of the winding up is important for several matters such as liability of past members and fraudulent preferences, etc..

Consequences of Voluntary Winding up

The consequences of voluntary winding up are :

1. From the commencement of voluntary winding up, the company ceases to carry on its business, except so far as may be required for the beneficial winding up thereof [Sec. 487].

2. The possession of the assets of the company vests in the liquidator for realisation and distribution among the creditors. The corporate state and powers of the company shall, however, continue until it is dissolved (Sec 456 and 487).

3. On the appointment of a liquidator, all the powers of the board of directors cease and the liquidator may exercise the powers mentioned in Sec. 512 including the power to do such things as may be necessary for winding up the affairs of the company and distributing its assets. The liquidator appointed in a members' voluntary winding up is merely an agent of the company to administer the property of the company for purposes prescribed by the statue.

Kinds of Voluntary Winding up

Voluntary winding up may be :

(a) A members' voluntary winding up; or

(b) A creditors' voluntary winding -up.

7.7.1 Members' voluntary winding up

A members' voluntary winding up takes place only when the company is solvent. It is initiated by the members and is entirely managed by them. The liquidator is appointed by the members. No meeting of creditors is held and no committee of inspection is appointed. To obtain the benefit of this form of winding up, a declaration of solvency must be filed.

Declaration of solvency

Section 488 provides that where it is proposed to wind up the company voluntarily the directors or a majority of them, may, at a meeting of the board, make a declaration verified by an affidavit that the company has no debts or that it will be able to pay its debts in full within a period not exceeding 3 years from the commencement of winding up as may be specified in the declaration. Such declaration shall be made within five weeks immediately preceding the date of the passing of the resolution for winding up and shall be delivered to the Registrar before that date. It shall also be accompanied by a copy of the auditors on the Profit and Loss Account and the Balance Sheet of the company prepared upto the date of the declaration and must embody a statement of the company's assets and liabilities as on that date.

Where such a declaration is duly made and delivered, the winding up following shall be called members' voluntary winding up. Where

the same is not duly made, it shall be called creditors' voluntary winding up.

Sections 490-98 of the Act deal with provisions applicable to members' voluntary winding up. They are as follows :

1. Appointment and Remuneration of Liquidator

On the passing of the resolution for winding up, the company must in a general meeting appoint one or more liquidators and fix his or their remuneration. Any such remuneration cannot be increased at all, not even with the sanction of the Court and the liquidator cannot take charge of his office unless the remuneration is so fixed [Sec. 490].

2. Powers of the Board on Appointment of Liquidator

On the appointment of a liquidator, all the powers of the board and of a managing or whole-time director, and manager, if there be any of these, shall cease, except for the purpose of giving notice of such appointment to the Registrar or in so far as the company in a general meeting or the liquidator may sanction the continuance thereof [Sec. 491].

3. Office of the Liquidator Falling Vacant

If a vacancy occurs by death, resignation or otherwise in the office of any liquidator appointed by the company, the company in a general meeting may fill the vacancy [Sec. 492].

4. Notice of Appointment to Registrar

The company must, within 10 days of the appointment of the liquidator, or the filling up of the vacancy, as the case may be, give notice to the Registrar of the event. Default renders the company and every officer (or liquidator) who is in default liable to fine upto Rs. 100 for every day of default [Sec. 493].

5. Calling Meeting of Creditors

If the liquidator at any time is of opinion that the company is insolvent, he must summon a meeting of the creditors, and lay before the meeting a statement of the assets and liabilities of the company [Sec. 495]. Thereafter the winding up proceeds as if it were a creditors' voluntary winding up and not a members' voluntary winding up [Sec. 498].

6. Calling General Meeting at the End of one Year

In the event of the winding up continuing for more than one year, the liquidator must call a general meeting of the company at the end of the first year from the commencement of the winding up at the end of each succeeding year, or at the first convenient date within three months from the end of the year or such longer period as the Central Government may allow, and must lay before the meeting an account of his acts and dealings and of the conduct of the winding up during the preceding year [Sec. 496].

7. Final Meeting and Dissolution

As soon as the affairs of the company are fully wound up, the liquidator makes up an account of winding up, showing how the winding up has been conducted and how the property of the company has been disposed of. He then calls a general meeting, of the company and lays before it accounts showing how the winding up has been conducted. This is called the final meeting of the company.

The meeting must be called by advertisement :

(a) specifying the time, place and object of the meeting ; and

(b) published not less than one month before the meeting in the official Gazette, and also in some newspaper circulating in the district where the registered office of the company is situated.

Within one week after the meeting, the liquidator is required to send to the Registrar and the official liquidator a copy of the accounts. He must also make a report to each of them of the holding of the meeting and of the date thereof. If at the final meeting no quorum was present, the liquidator is required to make a report that the meeting was duly called but no quorum was present at the meeting. On receipt of the accounts and the report, the Registrar will register them. On receipt of the accounts and report, the official liquidator will make a scrutiny of the books and papers of the company and make a report to the Court stating the result of the scrutiny. If the report shows that the affairs of the company have been conducted bonafide i. e. not in a manner prejudicial to the interests of its members or to the public interest, then from the date of the submission of the report to the Court, the company shall be deemed to have been dissolved. If the official liquidator in the report has stated that the affairs of the company have been conducted in a manner prejudicial to the interest of its members or to the public interest, the Court shall direct the official liquidator to make a further investigation of the affairs of the company and on the report of the official liquidator on such further investigation, the Court may either make an order that the company shall stand dissolved with effect from the date to be specified in the order of the Court or to make such other order as the circumstances of the case brought out in the report permit [Sec. 497].

7.7.2 Creditors' Voluntary Winding up (Sections 500-509)

In creditors' voluntary winding up, it is the creditors who move the resolution for voluntary winding up of a company, and there is no solvency declaration made by the directors of the company. In other words, when a company is insolvent, that is, it is not able to pay its debts, it is the creditors' voluntary winding up.

Special provisions Relating to Creditors' Voluntary Winding up

There are certain special provisions to be completed with creditors' voluntary winding up. They are :

1. Meeting of Creditors (Sec. 500)

The company must call a meeting of the creditors of the company on the same day or on the next following day on which the general meeting of the company is held for passing a resolution for voluntary winding up. The company must send the notice of the meeting to the creditors by post simultaneously with the sending of the notices of the meeting of the company. The company must also cause the notice of the meeting of the creditors to be advertised once at least in the official Gazettee and once at least in two newspapers circulating in the district where the registered office or principal place of business of the company is situated. At the creditors' meeting, one of the directors shall preside. The board of directors is required to lay before the meeting of the creditors(a) a full statement of the position of the company's affairs and (b) a list of creditors of the company with the estimated amount of their claims.

2. Notice of Registrar [Sec. 501]

Notice of any resolution passed at a creditors' meeting shall be given by the company to the Registrar within 10 days of the passing thereof.

3. Appointment of Liquidator (Sec. 502)

The creditors and the company at their respective meetings may nominate a person to be liquidator for the purpose of winding up the affairs and distributing the assets of the company. If the creditors and the company nominate different persons, the persons nominated by the creditors

shall be the liquidator. If no person is nominated by the creditors, the person, if any, nominated by the company shall be the liquidator.

4. Committee of Inspection

The creditors at their first or any subsequent meeting may, if they think fit, appoint a committee of inspection of not more than five members. If such committee is appointed, the company may, either at the meeting at which the winding up resolution is passed or at a later meeting, appoint not more than five persons to serve on the committee. If the creditors object to persons appointed by the company, then the matter will be referred to the Court for the final decision. The powers of such committee are the same as those of a committee of inspection appointed in a compulsory winding up.

5. Remuneration [Sec. 504]

The committee of inspection or if there is no such committee, the creditors may fix the remuneration to be paid to the liquidator or liquidators. Where the remuneration is not fixed, it will be determined by the Court. Any remuneration fixed by the committee of inspection or creditors or the Court shall not be increased.

6. Board's Power to Cease (Sec. 505)

On the appointment of a liquidator, all the powers of the board of directors shall cease, except in so far as the committee of inspection, or if there is no such committee, the creditors in a general meeting, may sanction the continuance thereof.

7. Vacancy in the Office of Liquidator (Sec. 506)

If a vacancy occurs by death, resignation, or otherwise in the office of the liquidator (other than a liquidator appointed by or by the

direction of the Court), the creditors in a general meeting may fill the vacancy.

8. Final Meeting and Dissolution (Secs 508-509)

The liquidator must call a general meeting of the company and a meeting of the creditors every year within three months from the close of the liquidation year, if the winding up continues for more than one year. He must lay before the meeting an account of his acts and dealings and of the conduct of winding up during the preceding year and position of winding up. He must call, in the same manner, a final meeting when the affairs of the company are fully wound up and place the same statements before it, as he does in the case of a members' meeting in a members' voluntary winding up under Sections 496 and 497.

7.7.3 Liquidators in Voluntary Winding Up

Appointment of liquidator

In a members' voluntary winding up, the company in general meeting shall appoint one or more liquidators for the purpose of collecting the company's assets and distributing the proceeds among creditors and contributories. If a vacancy occurs by death or resignation or otherwise in the office of the liquidator the company in general meeting may fill the vacancy. [Section 490 and 492].

In the case of a creditors' voluntary winding up, the creditors and the members at their respective meetings, may nominate a person to be the liquidator of the company. However, the creditors are given a preferential right in the matter of the appointment of the liquidator with a power to the Court to vary the appointment on application made within seven days by a director, member or creditor. (Section 502).

Power of the Court to appoint liquidator

In a members' or creditors' voluntary winding up, if for any cause whatever there is no liquidator acting, the Court may appoint the official liquidator or any other person as a liquidator of the company. The Court may also appoint a liquidator on the application of the Registrar. (Section 515).

Body corporate not to be appointed as liquidator

A body corporate shall not be qualified for appointment as a liquidator of a company in a voluntary winding up. Any appointment of a body corporate as liquidator shall be void. (Section 513).

Corrupt inducement affecting appointment as liquidator

Any person who gives or agrees or offers to give, any member or creditor of the company any gratification with a view to securing his own appointment or nomination or to securing or preventing the appointment of someone else, as the liquidator is liable to a fine which may extend upto Rs. 1,000. (Section 514).

Notice by liquidator of his appointment

When a person is appointed as the liquidator and accepts the appointment, he shall publish in the official gazette a notice of his appointment, in the prescribed form. He shall also deliver a copy of such notice to the Registrar. The liquidator shall do this within 30 days of his appointment. When the liquidator fails to comply with the above provision, he is liable to a fine which may extend to Rs. 50 for each day of default. (Section 516).

Effect of the appointment of liquidator

On the appointment of a liquidator, in a members' voluntary winding up, all the powers of the directors, including managing director, whole time directors as also the manager shall cease except so far as the company in general meeting or the liquidator may sanction their continuance. (Section 491).

On the appointment of a liquidator in creditors' voluntary winding up, all the powers of the board of directors shall cease. The committee of inspection or if there is no such committee, the creditors' meeting by resolution may sanction continuance of the powers of the board. (Section 505).

Remuneration of liquidator

In a members' voluntary winding up, the general meeting shall fix the remuneration to be paid to the liquidators. Unless the question of remuneration is resolved the liquidators shall not take charge of the company. Once remuneration is fixed it cannot be increased. (Section 490).

In a creditors' voluntary winding up, the remuneration of the liquidator is fixed by the committee of inspection and if there is no committee of inspection then by the creditors. In the absence of any such fixation, the Court shall determine his remuneration. Any remuneration so fixed shall not be increased (Section 504).

All costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, shall subject to the rights of secured creditors, be payable out of the assets of the company in priority to all other claims (Section 520).

Removal of Liquidator

In either kind of voluntary winding up, the Court may, on cause shown, remove a liquidator and appoint the official liquidator or any other person as a liquidator in place of removed liquidator. The Court may also remove a liquidator on the application of the Registrar.

7.7.4 Powers and Duties of Liquidator in Voluntary Winding Up

Powers

The powers of the liquidator in voluntary winding up are just the same as those of the official liquidator in case of winding up by the Court. In the case of members' voluntary winding up with the sanction of a special resolution of the company and in the case of creditors' voluntary winding up with the sanction of the Court or committee of inspection or the meeting of the creditors if there is no committee of inspection, the liquidator may (a) institute or defend any suit, prosecution or other legal proceedings in the name and on behalf of the company ; (b) carry on the business of the company so far as may be necessary for the beneficial winding up of the company ; (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract; and (d) raise any money required on the security of the assets of the company (Section 512). Besides, a liquidator in voluntary winding up may, without any sanction whatever, exercise any of the other powers given by this Act to the liquidator in a winding up by the Court. In addition to these powers, a liquidator in voluntary winding up exercise (i) the power of the Court of settling a list of contributories ; (ii) the power of the Court of making calls;

(iii) the power of calling general meetings of the company.

Duties

As Section 512 provides a liquidator in voluntary winding up is required to pay the debts of the company and to adjust the rights of the contributories among themselves.

7.8 WINDING UP SUBJECT TO SUPERVISION OF THE COURT

Voluntary winding up may be under the supervision of the Court. At any time after a company has passed a resolution for voluntary winding up, the Court may make an order that the voluntary winding up shall continue, but subject to such supervision of the Court. The Court may give such liberty to creditors, contributories or others to apply to the Court and generally on such terms and conditions as the Court thinks just (Sec. 522).

A petition for the continuance of a voluntary winding up subject to the supervision of the Court shall be deemed to be a petition for winding up by the Court (Sec. 523).

The Court will not in general make a supervision order on the petition of a contributory, unless it is satisfied that the resolution for winding up was so obtained that the minority of members were overborne by fraud or improper or corrupt influence. Where the company is insolvent, the wishes of the creditors only are regarded or the investigation is required.

If a company is being wound up voluntarily or subject to supervision of the Court, a petition for its winding up by the Court may be presented by :

(a) any person authorised to do so under Sec. 439 (which deals with provisions as to applications for winding up), or

(b) the official liquidator [Sec. 440(1)].

Where a supervision is made, the Court may appoint an additional liquidator or liquidators, or remove any liquidator at any time and fill any vacancy. The Court may also appoint the official liquidator as an additional liquidator or to fill any vacancy. The Registrar is also given power to apply to the Court for the removal of a liquidator and the Court may do so (Sec. 524). The liquidator appointed by the Court will act as a voluntary liquidator (Sec. 525). In a voluntary liquidation brought under the Court's supervision, the liquidator's remuneration cannot be increased.

A liquidator appointed by the Court has the same powers, is subject to the same obligations, and in all respects stand in the same position, as if he had been duly appointed in accordance with the provisions of the Companies Act with respect to the appointment of liquidators in voluntary winding up (Sec. 525).

Consequences of Winding up

The consequences of winding up may be discussed under the following heads :

1. Consequences as to Shareholders

A shareholder is liable to pay the full amount upto the face value of the shares held by him. Not only the present, but also the past members are liable on the winding up of the company. The liability of a present member is the amount remaining unpaid on the shares held by him, while a past member can be called upon to pay if the present contributory is unable to pay.

2. Consequences as to Creditors

A company, whether solvent or insolvent, can be wound up under the Act. In case of a solvent company, all claims of its creditors when

proved are fully met. But in case of an insolvent company, the rules under the law of insolvency apply.

A secured creditor need not prove his claim against the company. He may realise his security and satisfy the debts. For deficiency, if any, he may put his claim before the liquidator. The secured creditor has also the option to relinquish his security and to prove the amount as if he were an unsecured creditor.

Where an insolvent company is being wound up, the insolvency rules will apply and only such claims shall be provable against the company as are provable against an insolvent person. (Section 529).

When the list of claims is settled the liquidator has to commence making payments. The assets available to the liquidator are applied in the following order :

a. Secured creditors .

b. Cost of the liquidation.

c. Preferential payments.

d. Debentureholders secured by a floating charge.

e. Unsecured creditors

f. Balance returned to the contributories.

Preferential payment

Section 530 enumerates certain debts which are to be paid in priority to all other debts. Such payments are called preferential payments. It may however by noted that such payments are made after paying the secured creditors, and costs, charges and expenses of the winding up.

These preferential payments are : (a) All revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority. The amount should have become due and payable within 12 months before the winding up. (b) All wages or salary of any employee in respect of services rendered to the company and due for a period not exceeding 4 months within 12 months, before the winding up and any compensation payable to any workman under any of the provision of Chapter V-A of the Industrial Disputes Act, 1947. The amount must not exceed Rs. 20,000 in the case of any one claimant. (c) All accrued holiday remuneration becoming payable to any employee or in the case of his death to any other person in his right, on the termination of his employment before or by the effect of the winding up. (d) All amounts due in respect of contributions payable by the company as employer but this is not payable if the company is being wound up voluntarily for the purpose of reconstruction and amalgamation (e) All amounts due in respect of any compensation or liability for compensation in respect of death or disablement of any employee under the Workmen's Compensation Act, 1923 but this is not payable if the company is being wound up voluntarily for reconstruction or amalgamation. (f) All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employee maintained by the company. (g) The expenses of any investigation held in pursuance of Sections 235 and 237, in so far as they are payable by the company.

3. Consequences as to servants and officers

A winding up order by a Court operates as a notice of discharge to the employees and officers of the company except when the business of the company is continued. The same principle will apply as regards discharge of employees in a voluntary winding up. Where there is a contract of service

for a particular period, an order for winding up will amount to wrongful discharge and damages will be allowed as for breach of contract of service.

4. Consequences of proceedings against the company

When a winding up order is made, or an official liquidator has been appointed as provisional liquidator no suit or legal proceedings can be commenced and no pending suit or legal proceeding continued against the company except with the leave of the Court and on such terms as it may impose. In the case of a voluntary winding up, the Court may restrain proceedings against the company if it thinks fit.

It may be noted that law does not prohibit proceedings being taken by the company against others including directors, or officers or other servants of the company.

5. Consequences as to costs

Where the assets of the company are insufficient to satisfy the liabilities, the Court may make an order for payment out of the assets of the costs, charges and expenses incurred in the winding up. The Court may determine the order of priority in which such payments are to be made (Section 476).

6. Consequences as to documents

When a company is being wound up whether by or under the supervision of the Court or voluntarily, the fact must be made known to all those having any dealing with the company; every document in the nature of an invoice, order for goods or business letter issued in the name of the company, after the commencement of winding up must contain a statement that the company is being wound up (Sec. 547).

Where a company is being wound up, all documents of the company and of the liquidators shall, as between the contributories of the company, be prima facie evidence of the truth of all matters recorded therein (Sec. 548).

Where an order for winding up of the company by or subject to the supervision of the Court is made, any creditor or contributory of the company may inspect the books and the papers of the company, subject to the provisions made in the rules by the Central Government in this behalf.

7.9 WINDING UP OF INSOLVENT COMPANIES

Section 529 of the Companies Act applies to winding up of the company which cannot pay all its debts i.e. to an insolvent company only in respect of the following :

(a) debts provable.

(b) the valuation of annuities and future and contingent liabilities; and

(c) the respective rights of secured and unsecured creditors.

All persons who would be entitled to prove for and receive dividends out of the assets of the company may come in under the winding up and made such claims against the company as they respectively are entitled to. But it is not necessary for a secured creditor to prove his debt in the winding up and he can stand wholly outside the winding up proceedings. However, if a secured creditor instead of giving up his security and providing for his debt proceeds to realise his security, he shall be liable to pay the expenses incurred by the liquidator for the presentation of the security before its realisation by the secured creditor.

The rules of insolvency in India are to be found in the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. Only such of the rules contained in these Acts as relate to the respective rights of the secured and unsecured creditors, and to debts provable and to the valuation of certain liabilities shall apply under Section
529. Apart from these provisions, in respect of other matters such as those relating to priority of debts, all questions have to be determined with reference to the Companies Act only.

Section 529 ceases to be applicable as soon as it is found the company in the course of winding up is not insolvent. The provisions of the laws of insolvency applicable to insolvent companies will not apply to such company and it will be treated as having been solvent throughout the winding up proceedings.

7.10 WINDING UP OF UNREGISTERED COMPANIES (SECTIONS 582-583)

The term "Unregistered Company" includes any partnership, association of company consisting of 8 or more members at the time when the petition for winding up is presented, but it does not include a railway company incorporated under any Act of Parliament or other Indian Law or any Act of Parliament of U.K., a company registered under the present Indian Companies Act or any of the previous Indian Companies Acts. An unregistered company may be wound up under the provisions of this Act and with some exception all the provisions relating to the winding up are applicable to it. However such a company can only be wound up by the Court and cannot be wound up voluntarily or subject to the supervision of the Court. Such a company may be wound up if (a) the company is dissolved or has ceased to carry on business or is carrying on business only to wind up its

affairs; (b) the company is unable to pay its debts; and (c) the Court is of opinion that it is just and equitable that the company should be wound up.

7.11 WINDING UP OF FOREIGN COMPANIES

Where a foreign company which has been carrying on business in India, cease to carry on business in India, it may be wound up as an unregistered company, not withstanding that the foreign company, has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated (Section 584).

7.12 EFFECTS OF WINDING UP ON ANTECEDENT AND OTHER TRANSACTIONS

The effects of winding up on antecedent and other transactions are as follows:

1. Fraudulent Preference (Sec. 531)

Any transfer of property, movable or immovable, delivery of goods, payment, execution or other act relating to property, within six months before the commencement of its winding up, shall be deemed a fraudulent preference of its creditors and be invalid accordingly.

Fraudulent preference here relates similarly to fraudulent preference under insolvency law, where any individual transfers any property or makes any payment within three months before the presentation of an insolvency petition, such transfers shall be deemed a fraudulent preference in his insolvency. Under the Companies Act, 1956, the period is six months instead of three months.

2. Avoidance of the Voluntary Transfer

Section 531 A introduced by the Amendment Act, 1960, lays down that any transfer of property, movable or immovable, or any delivery

of goods made by a company within a period of one year before the commencement of its winding up shall be void against the liquidator unless such transfer or delivery is made in the ordinary course of business or in favour of a purchaser or encumbrancer in good faith and for valuable consideration.

Further, any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors in void (Sec. 532).

3. Avoidance of floating charge

Section 534, prevents an insolvent company from creating a floating charge on its undertaking to secure past debts or for moneys which do not come in the hands of the company. It provide that where a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, shall unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, expect to the amount of any cash paid to the company at the time of or subsequently to the creation of, and in consideration, for the charge, together with interest on that amount at the rate of five per cent, per annum or such other rate as may for the time being be notified by the Central Government in this behalf in the official gazettee :

Section 534 makes the charge invalid but the debt is not affected. The debt secured by such charge becomes an unsecured debt.

4. Disclaimer of Onerous Property (Sec. 535)

Disclaimer means abandoning. Where any part of the property of a company which is being wound up consists of :

(a) land of any tenure, burdened with onerous covenants ;

(b) shares or stock in companies;

(c) any other property which is unsaleable by reason of its binding the possessor thereof either to the performance of any onerous act or to the payment of any sum of money ; or

(d) unprofitable contracts.

The liquidator of the company may, with the leave of the Court, by a writing signed by him, at any time within 12 months after the commencement of the winding up, disclaim the property.

The disclaimer shall release the company and the property from the rights, interests and liabilities. The disclaimer shall not affect the rights or liabilities of any other person.

The Court before or on granting leave to disclaim may require such notices to be given to persons interested.

7.13 SUMMARY

Winding up of a company may be defined in the proceeding by which a company is dissolved. These are three modes of winding up of a company namely compulsory winding up by the court, voluntary winding up and voluntary winding up with the intervention of the court section 433 of the Companies Act contains the cases in which the company may be wound up by the court. The petition for winding up of a company may be presented to the court by any of the person enumerated in Section 439. The winding up proceedings are conducted by an official to be known as the official liquidator. The voluntary winding up means the winding up by the members or creditors themselves without any intervention of the court. The members and creditor are left free to settle their affairs without going to the court. The winding up with the intervention of the court is ordered when the

voluntary winding up has already commenced. As a matter of fact, it is the voluntary winding up but under the supervision of the court.

7.14 KEYWORDS

Winding-up: Winding-up is a proceeding for the realisation of the assets, the payment of creditors, and the distribution of the surplus, if any, among the shareholders so that the company may be finally dissolved.

Contributory: A contributory means any person liable to contribute to the assets of a company in the event of its being wound up.

Liquidator: A liquidator is a person who is appointed by the court to conduct the proceedings in winding up the company and perform such duties in reference thereto as the court may impose.

Voluntary Winding-up: Winding-up the creditors or members without any intervention of the court is called voluntary winding-up.

Unregistered Company: It includes any partnership association, or company consisting of more than seven members at the time when petition for winding up is presented before the Tribunal.

Official Liquidator: An official liquidator is an officer who helps the court in conducting and completing the winding up proceedings.