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**STUDY MATERIAL**

**EXECUTIVE PROGRAMME**

**COMPANY LAW**

**PAPER 1**



**THE INSTITUTE OF  
Company Secretaries of India**

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

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Laser Typesetting by Delhi Computer Services, Dwarka, New Delhi  
Printed at IPP/JULY 2017

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## EXECUTIVE PROGRAMME

### COMPANY LAW

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

The study material is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (including Amendments/clarifications/circulars issued there under upto June, 2017).

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

The amendments made upto June, 2017 have been incorporated in this study material. However, it may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the bulletin 'Student Company Secretary' and ICSI Journal Chartered Secretary and other publications for updation of study material. In the event of any doubt, students may contact the Directorate of Academics at [academics@icsi.edu](mailto:academics@icsi.edu).

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

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

## EXECUTIVE PROGRAMME

### SYLLABUS FOR

#### MODULE 1 - PAPER 1: COMPANY LAW (100 MARKS)

**Level of Knowledge:** Expert Knowledge

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

**Detailed Contents:**

#### 1. Introduction

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

#### 2. Incorporation and its Consequences

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

#### 3. Financial Structure

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

Minimum Subscription; Irregular Allotment; Procedure of Issue of Share Certificates and Warrants

#### **4. Membership in a Company**

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

#### **5. Management and Control of Companies**

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

#### **6. Investments, Loans and Deposits**

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

#### **7. Accounts and Audit**

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

(vi)

- Cost Audit and Special Audit

## **8. Dividends**

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

## **9. Registers, Forms and Returns**

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

## **10. Inspection and Investigation**

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

## **11. Majority Rule and Minority Rights**

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

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

## **13. Producer Companies**

- Concept, Formation, Functioning and Dissolution

## **14. Limited Liability Partnerships**

- Concept, Formation, Membership, Functioning and Dissolution

## **15. Application of Company Law to Different Sectors**

- Banking
- Insurance

(vii)

- Others

## **16. Offences and Penalties**

- Introduction
- Officer in Default
- Penalties

## **17. Compounding of Offences**

## **18. Winding up of Companies –An Overview**

- Concept and Modes

## **19. Striking Off Name of Companies**

## **20. An Introduction to E-Governance and XBRL**

## LIST OF RECOMMENDED BOOKS

### MODULE I

### PAPER 1 : COMPANY LAW

#### Readings:

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

#### References:

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



**Journals:**

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

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

## ARRANGEMENT OF STUDY LESSONS

### PAPER 1: COMPANY LAW (100 Marks)

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

TEST PAPER

## CONTENTS

## LESSON 1

## INTRODUCTION

	<i>Page</i>
Learning Objectives/Lesson Outline	... 1
Meaning and Definition of a Company	... 2
Nature and Characteristics of a Company	... 2
Company vis-a vis other Forms of Business	... 10
Development of Company Law in India	... 12
Concept Paper on Company Law, 2004 and Dr. J J Irani Committee Report	... 15
Companies Bill 2012	... 16
Companies Act 2013	... 16
Doctrine of Lifting of or Piercing the Corporate Veil	... 17
Illegal Association	... 20
Lesson Round-Up	... 21
SELF-TEST QUESTIONS	... 22

## LESSON 2

## TYPES OF COMPANIES

Learning Objectives/Lesson Outline	... 25
Introduction	... 26
Classification of Companies	... 27
Private Company	... 27
Small Company	... 38
Public Company	... 40
Limited Company	... 41
Unlimited Company	... 42
Association Not For Profit	... 42
Government Companies	... 47
Foreign Companies	... 55
Holding, Subsidiary Companies and Associate Companies	... 57
Associate Company	... 58
Investment Companies	... 59
Producer Companies	... 59
Nidhi Companies	... 60
Dormant Companies	... 71

	<i>Page</i>
Public Financial Institutions	... 71
Statutory Corporations	... 72
Lesson Round-Up	... 74
Glossary	... 75
SELF-TEST QUESTIONS	... 76

### **LESSON 3**

#### **PROMOTION AND INCORPORATION OF COMPANIES**

Learning Objectives/Lesson Outline	... 77
Definition of the word Promoter	... 78
Promoter's Contract - Ratification thereof	... 79
Legal Position of a Promoter	... 80
Duties of a Promoter	... 80
Promoters Duties under the Indian Contract Act	... 82
Termination of Promoters' Duties	... 82
Remedies available to the Company against the Promoter	... 82
Liabilities of Promoters	... 83
Rights of Promoters	... 85
Formation of Companies	... 86
Incorporation of Companies – Procedural Aspects	... 86
Filing of Documents with Registrar of Companies	... 88
Issue of Certificate of Incorporation by Registrar	... 92
Conclusive Evidence	... 93
Allotment of Corporate Identity Number	... 93
Documents of incorporation to be preserved	... 93
How to Incorporate Company under the Companies Act, 2013	... 94
Punishment for furnishing False or Incorrect Information at the time of Incorporation	... 95
Powers of Tribunal	... 95
Provision Specifically Relating to Incorporation of an OPC	... 95
Incorporation of Companies with Charitable Objects under Section 8	... 97
Rule 8 (Companies Incorporation) Rules, 2014	... 98
Lesson Round-Up	... 102
Glossary	... 102
SELF-TEST QUESTIONS	... 103

### **LESSON 4**

#### **MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION**

Learning Objectives/Lesson Outline	... 105
Memorandum of Association	... 106

	<i>Page</i>
Form of Memorandum of Association	... 107
Contents of Memorandum	... 107
Doctrine of <i>Ultra Vires</i>	... 113
Loans, borrowings, guarantees and <i>Ultra Vires</i> Rule	... 115
Implied Powers	... 115
Powers which are not Implied	... 115
Shareholder's right in respect of <i>ultra vires</i> acts	... 116
Effects of <i>ultra vires</i> Transactions	... 116
Declaration for Subscription	... 118
Signing of Memorandum	... 118
Alteration of Memorandum of Association	... 119
Alteration of Name Clause	... 120
Alteration of Registered Office Clause	... 122
Rule 30-31 of Companies (Incorporation) Rules, 2014	... 123
Alteration of Objects Clause of the Company	... 126
Registration of Alteration	... 127
Alteration of Liability Clause	... 128
Alteration of Capital Clause	... 128
Alteration of Memorandum of Association	... 129
Articles of Association	... 129
Registration of Articles	... 131
Entrenchment Provisions	... 132
Statutory Requirements	... 132
Contents of Articles	... 132
Consistency of Articles of Association with Companies Act, 2013	... 133
Alteration of Articles of Association	... 134
Effect of altered Articles	... 136
Alterations of Memorandum or Articles to be noted in every Copy	... 136
Distinction between Memorandum and Articles	... 137
Legal Effect of Memorandum and Articles	... 137
Constructive Notice of Memorandum and Articles	... 139
Monies Payable by Members is a Debt	... 140
Interpretation of Memorandum and Articles	... 140
Doctrine of Indoor Management	... 140
Exceptions to the Doctrine of Indoor Management	... 142
Doctrine of Alter Ego	... 143
Lesson Round-Up	... 144
Glossary	... 144
SELF-TEST QUESTIONS	... 145

## LESSON 5

### CONTRACTS AND CONVERSIONS

Learning Objectives/Lesson Outline	... 147
Contracts	... 148

	<i>Page</i>
Pre-incorporation contracts	... 148
Contract made after incorporation of business	... 149
Commencement of New Business by an Existing Company	... 150
Common Seal	... 150
Conversion of Companies already registered	... 150
Conversion of a Private Company into a Public Company and Vice Versa	... 150
Rule 33 of Companies (Incorporation) Rules, 2014	... 152
Private Company (which is a subsidiary of public company) Deemed to be a Public Company	... 152
Conversion of Section 8 Company into a Company of other kind	... 152
Conversion of One Person Company into a Public Company or Private Company	... 155
Rule 7- Conversion of Private Company into an OPC	... 156
Conversion of Companies	... 158
Lesson Round-Up	... 159
Glossary	... 159
SELF-TEST QUESTIONS	... 159

## **LESSON 6**

### **CONCEPT OF CAPITAL AND FINANCING OF COMPANIES**

Learning Objectives/Lesson Outline	... 161
Meaning of the term "Capital"	... 162
Publication of Authorised, Subscribed and Paid-Up Capital	... 163
Meaning and Nature of a Share	... 163
Kinds of Shares	... 164
Capital shall be Deemed to be Preference Capital	... 164
Preference Shares Compared with Equity Shares	... 165
Issue of Securities at a Premium	... 166
Issue of Sweat Equity Shares	... 167
Companies (Share Capital and Debentures) Rules, 2014	... 168
Shares with Differential Voting Rights	... 171
Issue and Redemption of Preferential Shares	... 174
Further Issue of Shares	... 177
Bonus Shares	... 179
Prescriptions under Companies (Share Capital and Debentures) Rules, 2014	... 180
Employee Stock Option Scheme	... 180
Issue of Shares on Preferential Basis	... 185
Rule 13 of Companies (Share Capital and Debentures) Rules, 2014	... 185
Lesson Round-Up	... 189
Glossary	... 189
SELF-TEST QUESTIONS	... 190

**LESSON 7****ALTERATION OF SHARE CAPITAL**

Learning Objectives/Lesson Outline	...	191
Alteration of Share Capital	...	192
Difference between Share and Stock	...	195
Reduction of Share Capital under Companies Act, 2013	...	195
Confirmation of reduction of capital [Section 66(3)]	...	196
Publication of the order of the Tribunal	...	196
Deliver a copy of order of Tribunal to Registrar	...	197
Diminution of Share Capital	...	197
Reduction of Share Capital without sanction of the Court	...	200
Buy Back of Securities	...	201
Lesson Round-Up	...	206
Glossary	...	206
SELF-TEST QUESTIONS	...	207

**LESSON 8****PRIVATE PLACEMENT AND PROSPECTUS**

Learning Objectives/Lesson Outline	...	209
Meaning and Definition of Prospectus	...	210
Invitation to Public	...	210
Provisions of Companies Act, 2013 with respect to prospectus	...	211
Private Placement	...	211
Public Offer	...	216
Deemed Prospectus	...	216
Matters to be stated in Prospectus	...	217
Reports to be set out in the Prospectus	...	221
Other matters and Reports to be stated in the Prospectus	...	223
Filing a copy of Prospectus with Registrar	...	225
Penalty for Contravention of Section 26	...	226
Rule 7 of Companies (Prospectus and Allotment of Securities) Rules, 2014	...	227
Offer of Sale by Members	...	229
Shelf Prospectus	...	230
Red-Herring Prospectus	...	231
Abridged Prospectus	...	231
The Golden Rule or Golden Legacy	...	232

	<i>Page</i>
Liability for Untrue Statement	... 232
Remedies for Misrepresentation in Prospectus	... 233
Remedies against Directors or Promoters	... 233
Criminal Liability for Mis-statements in Prospectus	... 235
Who is entitled to Remedies	... 235
Penalty for Fraudulently Inducing to Invest Money	... 236
Prohibition of Personation for Acquisition	... 236
Lesson Round-Up	... 237
Glossary	... 238
SELF-TEST QUESTIONS	... 238

## LESSON 9

### DEBT CAPITAL

Learning Objectives/Lesson Outline	... 241
Borrowing	... 242
Power of Company to Borrow	... 242
Unauthorised or <i>Ultra Vires</i> Borrowing	... 242
<i>Intra vires</i> Borrowing but Outside the Scope of Agents' Authority	... 243
Judicial pronouncement relating to borrowing powers of company	... 244
Types of Borrowing	... 245
Borrowing on Security of Property	... 246
Charge on Uncalled Capital	... 247
Debentures	... 247
Kinds of Debentures	... 247
<i>Pari passu</i> clause in case of debentures	... 248
Debenture Stock	... 249
Distinction between Debentures and Shares	... 249
Regulatory framework for Debt Securities	... 250
Provisions for Issue of Debentures under Companies Act, 2013	... 251
No Debenture shall carry Voting Right	... 251
Creation of Debenture Redemption Reserve Account	... 252
Appointment of Debenture Trustees	... 253
Duties of Debenture Trustees	... 254
Judicial Pronouncements about Debentures	... 255
Register of Debentureholders	... 256
Remedies Open to Debentureholders	... 256
Foreign Bonds	... 257



	<i>Page</i>
Recent Trends in Corporate Debt Financing	... 257
Instruments in Money Market	... 259
Lesson Round-Up	... 259
Glossary	... 260
SELF-TEST QUESTIONS	... 260

## **LESSON 10**

### **CREATION AND REGISTRATION OF CHARGES**

Learning Objectives/Lesson Outline	... 261
Definition of a Charge	... 262
Kinds of Charges	... 262
Judicial pronouncements	... 263
Crystallisation of Floating Charge	... 264
Postponement of a Floating Charge	... 265
Difference between Mortgage and Charge	... 266
Registration of Charges- Provisions of Companies Act, 2013	... 267
Condonation of Delay in filing of Charge	... 268
Rule 12 of Companies (Registration of Charges) Rules, 2014	... 269
Certificate of Registration of Charge	... 270
Acquiring Property under Charge and Modification of Charge	... 270
Satisfaction of Charges	... 270
Notice of Charge	... 271
Register of Charges	... 271
Intimation of Appointment of Receiver or Manager	... 271
Lesson Round-Up	... 272
Glossary	... 273
SELF-TEST QUESTIONS	... 273

## **LESSON 11**

### **ALLOTMENT OF SECURITIES AND ISSUE OF CERTIFICATES**

Learning Objectives/Lesson Outline	... 275
Securities	... 276
General Principles Regarding Allotment	... 276
Provisions relating to Allotment-Companies Act 2013	... 278
Judicial Pronouncements about return of Allotment	... 279
Issue of Certificates	... 279

	<i>Page</i>
Significance of Share Certificate	... 285
Split Certificate	... 286
Legal Effect of share Certificate	... 287
Personation of Shareholders	... 287
Calls and Forfeiture	... 287
Calls	... 287
Requisites of a Valid Call	... 288
Acceptance of Uncalled Capital	... 289
Quantum and Interval between two Calls	... 289
Forfeiture of shares	... 290
Legal Pronouncements about Forfeiture of Shares	... 291
Re-issue of Forfeited Shares	... 292
Surrender of Shares	... 292
Lesson Round-Up	... 292
Glossary	... 293
SELF-TEST QUESTIONS	... 293

## LESSON 12

### MEMBERSHIP IN A COMPANY

Learning Objectives/Lesson Outline	... 295
Who are Members	... 296
Modes of Acquiring Membership	... 297
Who may become a Member	... 298
Minimum Number of Members	... 301
Cessation of Membership	... 302
Expulsion of a Member	... 302
Personation and Penalty	... 303
Register of Members	... 303
Rule 3 of Companies (Management and Administration) Rules, 2014	... 304
Rule 5 of Companies (Management and Administration) Rules, 2014	... 304
Rule 8 of Companies (Management and Administration) Rules, 2014	... 305
Judicial pronouncement	... 305
Index of Members	... 305
Rule 6 of Companies (Management and Administration) Rules, 2014	... 306
Inspection of Registers	... 306
Rule 14 of Companies (Management and Administration) Rules, 2014	... 307
Register <i>prima facie</i> evidence	... 307
Rectification of a register of Members	... 308
Foreign Register	... 309
Rule 7 of Companies (Management and Administration) Rules, 2014	... 309
Closing of Register of Members	... 310

	<i>Page</i>
Rule 10 of Companies (Management and Administration) Rules, 2014	... 311
Rule 15 of Companies (Management and Administration) Rules, 2014	... 311
Power of the Central Government to Investigate into the Ownership of Shares	... 312
Rule 9 of Companies (Management and Administration) Rules, 2014	... 313
Rights of Members	... 313
Individual Rights	... 314
Collective Membership Rights	... 314
Voting Rights of Members	... 315
Shareholders' Pre-emptive Rights	... 316
Variation of Member's Rights	... 316
Rights of Dissenting Members	... 317
Nomination by Security holders	... 317
Liability of Members	... 318
Lesson Round-Up	... 319
Glossary	... 319
SELF-TEST QUESTIONS	... 320

### **LESSON 13**

#### **TRANSFER AND TRANSMISSION OF SECURITIES**

Learning Objectives/Lesson Outline	... 321
Transferability – Provisions of Companies Act, 2013	... 322
Transfer or Transmission of Securities	... 322
Power to Refuse Registration and Appeal against Refusal (Section 58)	... 324
Rectification of Register of Members under Section 59	... 326
Stamp Duty Payable and Affixation/Cancellation of Stamps	... 327
Lost Transfer Deeds	... 329
Delegation of Powers for Transfer	... 329
Transfer of Debentures	... 329
Transfer of Shares to a minor	... 329
Transmission of Securities	... 331
Distinction between Transfer and Transmission	... 333
Judicial Pronouncements about Transfer of Shares	... 334
Transfer of Securities Registered with a Depository	... 337
Compliance with Section 56 – A Mandatory provision	... 337
Blank Transfer	... 339
Forged transfer	... 340
Transposition of Name	... 342
Death of transferor or transferee before registration of transfer	... 342
Rights of Transferor	... 343
Effects of Transfer	... 345

Company's <i>lien</i> on shares	...	346
Transfer of Shares in Depository Mode	...	347
Legal Framework for Depository Systems	...	347
Free Transferability of securities	...	349
Safeguards on Transfer of Securities in Dematerialized Mode	...	349
Lesson Round-Up	...	350
Glossary	...	351
SELF-TEST QUESTIONS	...	351

## LESSON 14

### INSTITUTION OF DIRECTORS

Learning Objectives/Lesson Outline	...	353
Introduction	...	354
Minimum/Maximum Number of Directors	...	354
Number of Directorships	...	355
Indian Resident Director	...	355
Woman Director	...	355
Independent Directors	...	356
Director elected by Small Shareholders- Section 151	...	356
Appointment of Directors	...	357
Director Identification Number	...	363
Disqualification for Appointment of Directors – Section 164	...	368
Duties of Directors - Section 166	...	369
Vacation of Office of Director - Section 167	...	370
Resignation of Directors	...	371
Removal of Directors – Section 169	...	372
Lesson Round-Up	...	374
SELF-TEST QUESTIONS	...	374

## LESSON 15

### INDEPENDENT DIRECTORS

Learning Objectives/Lesson Outline	...	375
Introduction	...	376
Number of Independent Directors	...	377
Manner of selection of an Independent Director	...	379
Code for Independent Directors	...	380
Tenure of Independent Directors	...	383
Liability of Independent Director	...	384
Retirement by Rotation not applicable to Independent Directors	...	384
Remuneration of Independent Director	...	385
Lesson Round-Up	...	385
SELF-TEST QUESTIONS	...	385

**LESSON 16****BOARD AND ITS POWERS**

Learning Objectives/Lesson Outline	...	387
Distribution of Powers	...	388
Meetings of the Board	...	390
Compliance with Secretarial Standards related to Board Meetings	...	394
Quorum for Board Meetings	...	394
Passing of Resolution by Circulation	...	395
Board Committees	...	395
Audit Committee under Section 177	...	396
Nomination and Remuneration Committee under Section 178	...	401
Stakeholders Relationship Committee	...	402
Penalty for Contravention	...	402
Corporate Social Responsibility Committee	...	404
Other Board Committees	...	405
Powers of Board under Section 179	...	405
Restriction on Powers of Board	...	406
Disclosure of Interest by Directors	...	407
Related Party Transactions under Section 188	...	408
Rule 15 of the Companies (Meeting of Board and its Powers) Rules, 2014	...	410
Penalties for non-compliance	...	413
Register of Contracts or Arrangements in which Directors are interested	...	418
Contract of Employment with Managing Director or Whole-Time Directors	...	419
Payment to Directors under Section 191	...	419
Restriction on Non-Cash Transactions involving Directors	...	420
Contract by OPC	...	420
Prohibitions on Dealings in Securities under Section 194	...	421
Prohibition on Insider Trading under section 195	...	421
Lesson Round-Up	...	422
SELF-TEST QUESTIONS	...	422

**LESSON 17****APPOINTMENT AND REMUNERATION OF KEY MANAGERIAL PERSONNEL**

Learning Objectives/Lesson Outline	...	423
Introduction	...	424
Appointment of Managing Director, Whole-Time Director or Manager	...	425
Appointment with Approval of Central Government	...	426
Disqualifications	...	427
Reappointment of Managing Director	...	428

	<i>Page</i>
Appointment of Key Managerial Personnel	... 429
Functions of Company Secretary	... 431
Managerial Remuneration	... 431
Remuneration by a Company having Inadequate Profits	... 433
Remuneration to directors in other Capacity	... 436
Sitting Fees to Directors for attending the Meetings	... 436
Monthly Remuneration to Director or Manager	.. 437
Remuneration Drawn in Excess of Prescribed Limit	... 437
Insurance Premium not part of Remuneration	... 437
Disclosure of Remuneration in Board Report	... 437
Calculation of Net Profit for the purpose of Managerial Remuneration	... 438
Recovery of Managerial Remuneration under Section 199	... 438
Compensation for Loss of Office of MD, WTD or Manager	... 438
Secretarial Audit	... 439
Lesson Round-Up	... 439
SELF-TEST QUESTIONS	... 440

## **LESSON 18**

### **GENERAL MEETINGS**

Learning Objectives/Lesson Outline	... 441
Introduction	... 442
Members' Meetings	... 442
Annual General Meeting	... 443
Extra Ordinary General Meeting	... 445
Class Meetings	... 447
Procedure for convening of a valid general meeting	... 447
Notice of Meeting	... 448
Contents of Notice	... 449
Notice through Electronic Mode	... 450
Persons entitled to Receive Notice	... 451
Statement to be annexed to Notice	... 452
Quorum for Meetings	... 453
Chairman of Meeting	... 456
Presence of Statutory Auditor and Secretarial Auditor	... 457
Proxies	... 458
Voting	... 461
Demand for Poll	... 466
Manner to get the poll process scrutinized	... 467
Postal Ballot	... 467

	<i>Page</i>
Circulation of Members' Resolution	... 472
Representation of Presidents and Governors in Meetings (Section 112)	... 472
Representation of Corporations at Meeting of Companies and of Creditors (Section 113)	... 472
Ordinary and Special Resolutions	... 473
Resolutions requiring Special Notice	... 473
Resolutions passed at Adjourned Meetings	... 475
Resolutions and Agreements to be filed with the Registrar	... 475
Maintenance of minutes of meeting	... 475
Secretarial Standard on Minutes	... 476
Penalty	... 482
Report on Annual General Meeting	... 483
Applicability to One Person Company	... 483
Lesson Round-Up	... 484
SELF-TEST QUESTIONS	... 485

## **LESSON 19**

### **LOANS AND INVESTMENTS BY COMPANIES**

Learning Objectives/Lesson Outline	... 487
Introduction	... 488
Terminologies under Section 186 of Companies Act, 2013	... 488
Loans and Investments by Companies under Section 186	... 491
Register of Loans made, Guarantees given, Securities provided and Investment made	... 494
Sections 185 – Loan to Directors	... 495
Section 186 compared with Section 185	... 497
Investments to be held in Company's own name	... 498
Register of Investments not Held in Company's own name	... 499
Punishment	... 499
Lesson Round-Up	... 500
Glossary	... 500
SELF-TEST QUESTIONS	... 500

## **LESSON 20**

### **DEPOSITS**

Learning Objectives/Lesson Outline	... 503
Introduction	... 504
What is Deposit?	... 504
Who is depositor?	... 507
Acceptance of deposit	... 508
Acceptance of deposit from members	... 508
Exemption for Private Companies	... 509

	<i>Page</i>
Acceptance of Deposit from Public	... 509
Who is an Eligible Company?	... 509
Terms and conditions for acceptance of deposits	... 509
Issue of Advertisements or Circulars	... 511
Deposit Insurance	... 512
Creation of Security	... 513
Trustee for Depositors	... 513
Application for Deposits by Depositors	... 514
Nomination by depositors	... 515
Deposit Receipts	... 515
Repayment of Deposit	... 515
Deposit Repayment Reserve Account	... 515
Repayment of Deposits accepted before the commencement of the Act	... 515
General provisions regarding premature repayment of deposits	... 516
Registers of Deposits	... 517
Return of deposits to be filed with the Registrar	... 517
Disclosures in the financial statement [Rule 16A]	... 517
Penal rate of interest	... 517
Punishment for Contravention	... 518
Other remedies provided under Companies Act 2013	... 518
Lesson Round-Up	... 519
Glossary	... 519
SELF-TEST QUESTIONS	... 519

## LESSON 21

### ACCOUNTS AND AUDIT

Learning Objectives/Lesson Outline	... 521
Accounts of Companies	... 522
Requirement of Keeping Books of Account	... 522
Place of Keeping Books of Account	... 522
Maintenance of books in electronic form	... 522
Financial statement	... 524
Persons Responsible for Compliance	... 526
Penalty	... 526
Form of Financial Statement	... 526
Consolidated financial statements	... 526
Manner of Consolidation of Accounts	... 527
Re-opening of accounts on court or tribunal's order	... 527
Voluntary revision of Financial Statements or Board's Report	... 528
National Financial Reporting Authority	... 528
Central Government to prescribe accounting standard	... 530
Financial Statement, Board's report etc.	... 532



	<i>Page</i>
Corporate Social Responsibility	533
Right of Members to Copies of Audited Financial Statements	543
Copy of Financial Statement to be filed with Registrar	545
Internal Audit	546
Maintenance of Costing and Stock Records	547
Audit and auditors	548
Appointment of Auditor in Government Companies	549
Eligibility and qualification of auditors	550
Disqualification of Auditor	550
Mandatory Rotation of Auditors	551
Rotation of Auditors	552
Rotation of Auditors on expiry of their term	552
Reappointment of Retiring Auditors	553
Casual Vacancy in the Office of Auditor	553
Removal of Auditor	553
Resignation of Auditor	554
Remuneration of Auditor	554
Auditor's right to attend General Meeting	554
Powers and duties of Auditor	554
Audit Report	555
Powers of CAG of India in case of Government Company	556
Branch audit	557
Auditing standard	557
Reporting of Frauds by Auditor	559
Auditor not to render certain services	560
Appointment of auditor other than retiring auditor by special notice	561
Powers of tribunal	561
Signing of audit reports	562
Punishment for contravention	562
Cost records and audit	563
Lesson Round-Up	569
SELF-TEST QUESTIONS	570

## LESSON 22

### DIVISIBLE PROFITS AND DIVIDENDS

Learning Objectives/Lesson Outline	571
Meaning and Definition of Dividend	572
Declaration of Dividend (Section 123)	572
Unpaid Dividend Account (Section 124)	574
Investor Education and Protection Fund (Section 125)	575
Utilisation of Investor Education and Protection Fund	576

Rights Pending Registration of Transfer of Shares	...	577
Punishment for failure to distribute dividend	...	577
Lesson Round-Up	...	578
SELF-TEST QUESTIONS	...	578

## LESSON 23

### BOARD'S REPORT AND DISCLOSURES

Learning Objectives/Lesson Outline	...	579
Introduction	...	580
Disclosures pursuant to the Companies Act, 2013	...	580
Disclosures under section 134(3)	...	581
Disclosures pertaining to issue of equity shares with differential rights	...	585
Disclosures pertaining to issue of sweat equity shares	...	586
Disclosures of details of employees stock option scheme - section 62(1)(b)	...	586
Disclosures pertaining to restrictions on purchase by company or giving of loans by it for purchase of its shares – section 67	...	587
Disclosures pertaining to consolidated financial statements	...	587
Voluntary revision of financial statements or board's report - section 131(1)	...	588
Disclosures pertaining to CSR	...	588
Re-appointment of an independent director - section 149(10)	...	588
Resignation of director - section 168(1)	...	588
Composition of audit committee - section 177(8)	...	588
Details of vigil mechanism - section 177(10)	...	589
Policy relating to the remuneration for the directors, key managerial personnel and other employees – Section 178(4)	...	589
Related party transactions – Section 188(2)	...	589
Disclosures pertaining to remuneration of directors and employees –section 197(12)	...	589
Remuneration received by MD and WTD from holding or subsidiary companies – Section 197(14)...		591
Secretarial Audit Report – Section 204 (1)	...	591
Additional disclosures by Producer Company	...	591
Disclosures under SEBI (listing obligations and disclosure requirements) regulations, 2015	...	591
Disclosures under SEBI (share based employee benefits) regulations, 2014	...	592
Disclosure requirements under the sexual harassment of women at workplace (prevention, prohibition & redressal) act, 2013	...	593
Approval of the Board's Report	...	593
Signing of Board's Report [Section 134(6)]	...	593
Circulation of the Board's Report	...	593
Right of members to receive copies of financial statements, Board's Report, etc.	...	593
Filing of the Board's Report	...	594

	<i>Page</i>
Penalty for non-compliance of Section 134	... 594
Liability for mis-statement	... 595
Lesson Round-Up	... 595
Glossary	... 595
SELF-TEST QUESTIONS	... 596

## **LESSON 24**

### **REGISTERS, FORMS AND RETURNS**

Learning Objectives/Lesson Outline	... 597
Statutory Books/Registers	... 598
Register of Securities bought back	... 599
Register of Deposits	... 599
Register of Charges	... 600
Register of Members	... 600
Register of debenture holder	... 601
Foreign register of members and debenture holders	... 602
Register of Renewed and Duplicate Share Certificates	... 603
Register of sweat equity shares	... 603
Register of Postal Ballot	... 603
Books containing Minutes of proceedings of meetings	... 604
Books of account	... 605
Register of Directors and key managerial personnel	... 606
Register of Investments in Securities not held in Company's Name	... 608
Register of loans, guarantees given and security provided	... 608
Forms and Return under Companies Act, 2013	... 610
Annual Returns	... 621
Lesson Round-Up	... 622
SELF-TEST QUESTIONS	... 623

## **LESSON 25**

### **INSPECTION AND INVESTIGATION**

Learning Objectives/Lesson Outline	... 625
Introduction	... 626
Inspection	... 626
Purpose of conducting inspection	... 626
Power of registrar to call for information	... 627
Meaning of fraud	... 628

	<i>Page</i>
Conduct of inspection and inquiry	629
Punishment for disobedience	629
Submission of report of inspection to Central Government	630
Search/seizure by Registrar	630
Investigations	630
Kinds of investigation	631
Investigation by SFIO	632
Tribunal's order for investigation	635
Time limit for keeping of books and papers by inspectors	638
Failure to comply with section 217	639
Preparation by a company secretary to face investigation	641
Inspector's power to investigate the affairs of company	642
Seizure of documents [section 220(1)]	642
Inspector to return books and papers seized	642
Freezing of assets of a company (Section 221)	643
Restriction on securities [section 222(1)]	643
Interim and final reports by inspector [section 223(1)]	644
Voluntary winding-up of company not to stop investigation [Section 226]	645
Penalty for furnishing false statements [Section 229]	646
Lesson Round-Up	647
SELF-TEST QUESTIONS	648

## LESSON 26

### MAJORITY RULE AND MINORITY RIGHTS

Learning Objectives/Lesson Outline	649
Introduction	650
The Principle of Non-interference (Rule in <i>Foss v. Harbottle</i> )	650
Justification and Advantages of the Rule in <i>Foss v. Harbottle</i>	651
Exceptions to the rule in <i>Foss v. Harbottle</i>	652
"Majority Rule and Minority Rights" under Companies Act	655
Meaning of Oppression	656
Application to tribunal for relief in cases of oppression, etc.	658
Right to Members to Apply	659
Powers of Tribunal	659
Filing of Copy of Order of Tribunal	660
Interim Order	660
Alteration through Order of the Tribunal	660
Punishment in case of Contravention	661
Consequence of termination or modification of certain agreements	661
Class Action Suits	661
What is a Class Action Suit?	661

	<i>Page</i>
Filing of Application before the Tribunal on behalf of the Members or Depositors	... 661
Required Number of Members to apply	... 662
Requirement for Consideration of Application	... 663
Application of certain Provisions to Proceedings under Section 241 or Section 245	... 664
Lesson Round-Up	... 664
SELF-TEST QUESTIONS	... 665

## **LESSON 27**

### **MERGER, DE-MERGER, AMALGAMATION, COMPROMISE AND ARRANGEMENTS – AN OVERVIEW**

Learning Objectives/Lesson Outline	... 667
Regulatory framework for Merger/Amalgamation	... 668
Provisions of the Companies Act, 2013	... 669
Power of the Tribunal to Enforce Compromise or Arrangement	... 672
Merger and Amalgamation of Companies	... 673
Merger and Amalgamation of Certain Companies	... 675
Merger or Amalgamation of a Company with a Foreign Company	... 678
Power to acquire Shares of Shareholders Dissenting from Scheme or Contract Approved by Majority	... 678
Purchase of Minority Shareholding	... 679
Power of the Central Government to provide for Amalgamation of Companies in Public Interest	... 680
Lesson Round-Up	... 682
SELF-TEST QUESTIONS	... 683

## **LESSON 28**

### **PRODUCER COMPANIES**

Learning Objectives/Lesson Outline	... 685
Genesis	... 686
Objects of Producer Company	... 686
Formation of Producer Company and its Registration	... 687
Membership and voting rights of members of Producer Company	... 688
Benefits to Members	... 688
Memorandum of Association, Articles of Association	... 688
Contents of Memorandum of Producer Company	... 689
Contents of Articles of Association of Producer Company	... 689
Amendment to Memorandum and Articles	... 691
Option to Inter-State Co-operative Societies to become Producer Companies	... 691
Vesting of undertaking in Producer Company	... 692
Concession, etc. to be deemed to have been granted to Producer Company	... 692
Provisions in respect of Officers and other employees of Inter-State Co-operative Society	... 692

	<i>Page</i>
Number of Directors	... 692
Appointment of Director	... 693
Vacation of Officer by Directors	... 693
Powers and functions of Board	... 693
Matters to be transacted at the General Meeting	... 694
Liability of Directors	... 694
Committee of Directors	... 695
Meetings of the Board and Quorum	... 695
Chief Executive and his functions	... 695
Secretary of Producer Company	... 695
Quorum of the General Meeting	... 696
Voting Rights	... 696
Annual General Meetings [Section 581ZA]	... 696
Share Capital	... 697
Transferability of shares and attendant rights	... 697
Surrender of shares	... 697
Books of account	... 697
Internal Audit	... 698
Donation or Subscription by Producer Company	... 698
General and other reserves	... 698
Issue of Bonus Shares	... 698
Loan, etc., to Members [Section 581ZK]	... 699
Investment in other companies, formation of subsidiaries etc. [Section 581ZL]	... 699
Amalgamation, merger or division, etc., to form new Producer Companies	... 699
Disputes	... 699
Striking off name of Producer Company	... 700
Re-conversion of producer company to Inter-State Co-operative Society	... 700
Lesson Round-Up	... 700
Glossary	... 702
SELF-TEST QUESTIONS	... 702

## **LESSON 29**

### **LIMITED LIABILITY PARTNERSHIPS**

Learning Objectives/Lesson Outline	... 703
Introduction	... 704
Salient Features	... 704
Distinction between LLP and Partnership	... 705
Distinction between LLP and Company	... 706
Comparison of LLP with Private Limited Company	... 706
Incorporation of Limited Liability Partnership	... 707
LLP agreement	... 708
Partners and Designated Partners	... 709

	<i>Page</i>
Responsibilities of Designated Partners	... 710
Partners' obligation	... 711
Advantage and Disadvantages of LLP	... 711
LLP for the Professionals	... 711
Valuation of Capital Contribution	... 711
Maintenance of Books of Account	... 712
Audit of Limited Liability Partnership Accounts	... 712
Filing of Annual Returns	... 712
Electronic Filing of Documents	... 713
Investigation of the Affairs of LLP	... 713
Foreign LLP	... 714
Winding up of LLP	... 714
Foreign Direct Investment in LLP	... 715
Lesson Round-Up	... 715
Glossary	... 716
SELF-TEST QUESTIONS	... 716

### **LESSON 30**

#### **APPLICATION OF COMPANY LAW TO DIFFERENT SECTORS**

Learning Objectives/Lesson Outline	... 717
Introduction	... 718
Application of companies act to insurance, banking, electricity supply and other companies governed by special acts	... 718
Exceptions provided under Companies Act 2013 to specific sectors	... 718
Section 67(3)- financial assistance for purchase of shares	... 718
Proviso to section 73(1)- Prohibition on Acceptance of Deposits From Public	... 718
Proviso to section 129(1)- Financial Statements	... 719
Proviso to section 179(3) & Proviso to section 180(1)(c) - Powers of the Board to Borrow	... 719
Proviso to Section 180 – Special Resolution for Borrowing	... 719
Section 186- Loan and Investment by Company	... 720
Section 189 – Register of Contracts	... 720
IFSC Companies and Exemptions provided to them	... 720
Exemptions to IFSC Companies under Companies Act, 2013	... 720
Lesson Round-Up	... 732
SELF-TEST QUESTIONS	... 732

### **LESSON 31**

#### **OFFENCES, PENALTIES AND THEIR COMPOUNDING**

Learning Objectives/Lesson Outline	... 733
Regulatory Framework	... 734
Offences under Companies Act, 2013	... 734
Establishment of special court	... 735

	<i>Page</i>
Offences to be non-cognizable	... 735
Compounding of Offences	... 736
Appointment of company prosecutors	... 736
Punishment for fraud	... 737
Punishment for false statement	... 737
Punishment for false evidence	... 737
Punishment where no specific penalty or punishment is provided	... 737
Punishment in case of repeated default	... 737
Punishment for wrongfully withholding of property	... 738
Punishment for improper use of the word “limited” or “private limited”	... 738
Adjudication of penalties	... 738
List of offences compoundable in nature (powers vested with Regional Director)	... 739
List of offences compoundable in nature (powers vested with Tribunal)	... 746
List of offences compoundable in nature (powers vested with Special Court)	... 748
List of offences non-compoundable in nature	... 753
Lesson Round-Up	... 755
SELF-TEST QUESTIONS	... 756

## **LESSON 32**

### **WINDING UP OF COMPANIES**

Learning Objectives/Lesson Outline	... 757
Introduction	... 758
Legal provisions for Winding Up of Companies	... 758
Winding Up by the Tribunal	... 758
Circumstances in Which Company May be Wound Up by Tribunal	... 759
Petition for Winding Up	... 759
Powers of Tribunal	... 760
Company Liquidators	... 760
Voluntary Winding up	... 760
Provisions applicable to every mode of winding up	... 762
Lesson Round-Up	... 763
SELF-TEST QUESTIONS	... 763

## **LESSON 33**

### **STRIKING OFF NAME OF COMPANIES**

Learning Objectives/Lesson Outline	... 765
Power of Registrar to Remove Name of Company from Register of Companies	... 766
Restrictions on Making Application under Section 248 in Certain Situations	... 767



Fraudulent Application for Removal of Names	...	767
Appeal to tribunal for Restoration of the name of Company	...	768
Provisions of Companies Act 2013 Relating to Dormant Companies	...	768
Rule 3 of Companies (Miscellaneous) Rules 2014	...	769
Power and Role of the Registrar in case of Dormant Company	..	769
Rule 4 of Companies (Miscellaneous) Rules 2014	...	769
Minimum No. of directors in Dormant Company	...	769
Rule 5 of Companies (Miscellaneous) Rules 2014	...	770
Rule 7 of Companies (Miscellaneous) Rules 2014	...	770
Rule 8 of Companies (Miscellaneous) Rules 2014	...	770
Lesson Round-Up	...	771
SELF-TEST QUESTIONS	...	771

### **LESSON 34**

#### **AN INTRODUCTION TO E-GOVERNANCE AND XBRL**

Learning Objectives/Lesson Outline	...	773
Introduction	...	774
Important features of the e-Governance project of MCA	...	774
Some terms used while e-filing the forms	...	775
Features of e-form and e-filing process	...	776
XBRL	...	777
Benefits of XBRL	...	778
Lesson Round-Up	...	779
SELF-TEST QUESTIONS	...	780
<b>TEST PAPER</b>		
Test Paper	...	782



# Lesson 1

## Introduction

### LESSON OUTLINE

- Meaning and definition of Company
- Nature and characteristics of a company
- Company vis-à-vis other forms of business
- Development of Corporate Law in India
- Doctrine of Lifting of Corporate Veil
- Illegal association
- Lesson Round –Up
- Self Test Questions

### LEARNING OBJECTIVES

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

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

After reading this lesson, you would be able to understand the meaning and basic characteristics of company and how it differs from other forms of businesses, historical development of corporate law in India, evolution of Companies Act, 2013 etc.

*Corporations are fictional entities that are designed to make money, and they are neither people nor patriots*

**Scott Peters**

## MEANING AND DEFINITION OF A COMPANY

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

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

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

In the legal sense, a company is an association of both natural and artificial persons and is incorporated under the existing law of a country.

In terms of the Companies Act, 2013 (Act No. 18 of 2013) a **"company"** means a company incorporated under this Act or under any previous company law [Section 2(20)].

In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. A company is rather a legal device for the attainment of social and economic end. It is, therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organisation in the conduct of an enterprise". It is "an intricate, centralised, economic and administrative structure run by professional managers who hire capital from the investor(s)".

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

## NATURE AND CHARACTERISTICS OF A COMPANY

Since a corporate body (i.e. a company) is the creation of law, it is not a human being, it is an artificial juridical person (i.e. created by law) and it is clothed with many rights, obligations, powers and duties prescribed by law.

The most striking characteristics of a company are discussed below:

**(i) Corporate personality**

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

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

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

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

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

The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company's assets, viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as a principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf.

Their Lordships of the House of Lords observed:

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

should take a substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of company.”

#### CASE EXAMPLE

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

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

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

#### CASE EXAMPLE

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

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

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

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

“Seeing through the veil covering the face of NHL, it will be found that as a result of re-organisation in 1992 the company is functioning as a joint venture wherein the Indian group (TPI, LMI and WML) and Mr. Aroon Purie hold 60% shares and the Singapore based company (IIPL) holds 40% shares. Both the groups have contributed towards the resources of the joint venture in the form of machines, equipment and expertise in

the field. The company is in the nature of partnership between the Indian group of companies and Singapore based company who have jointly undertaken this commercial enterprise wherein they will contribute to the assets and share the risk. In respect of such a joint venture company, the experience of the company can only mean the experience of the constituents of the joint venture i.e. the Indian group of companies (TPI, LMI and WML) and the Singapore based company (IIPL) (*New Horizons Ltd. and another v. Union of India* (1995) 1 Comp. LJ 100 SC).

### **(ii) Company as an artificial person**

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

#### **CASE EXAMPLE**

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

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

### **(iii) Company is not a citizen**

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

#### **CASE EXAMPLE**

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

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

## CASE EXAMPLE

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

In this case, the Supreme Court stated that:

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

### **(iv) Company has Nationality and Residence**

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

“It was suggested that a body corporate has no domicile. It is quite true that a body corporate cannot have a domicile in the same sense as an individual. But by analogy with a natural person the attributes of residence, domicile and nationality can be given to a body corporate.”

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

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

### **(v) Limited Liability**

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

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

### ***Exceptions to the principle of limited liability***

- Where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration



filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members of such company shall be unlimited.

- Further under section 339(1), where in the course of winding up it appears that any business of the company has been carried on with an intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the Tribunal may declare the persons who were knowingly parties to the carrying on of the business in the manner aforesaid as personally liable, without limitation of liability, for all or any of the debts/liabilities of the company.
- When the company is incorporated as an Unlimited Company under Section 3(2)(c) of the Act
- Under Section 35(3), where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person who was a director at the time of issue of the prospectus or has been named as a director in the prospectus or every person who has authorised the issue of prospectus or every promoter or a person referred to as an expert in the prospectus shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.
- As per section 75(1), where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified or such further time as may be allowed by the Tribunal and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to other liabilities, also be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.
- Section 224(5) states that where the report made by an inspector states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

#### **(vi) Perpetual Succession**

An incorporated company never dies, except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and it remains the same entity, despite total change in the membership. Perpetual succession, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

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

**(vii) Separate Property**

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

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

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

**(viii) Transferability of Shares**

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. When the joint stock companies were established, the object was that their shares should be capable of being easily transferred, [In *Re. Balia and San Francisco Rly.*, (1968) L.R. 3 Q.B. 588]. Section 44 of the Companies Act, 2013 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles. If the articles do not provide anything for the transfer of shares and the Regulations contained in Table “F” in Schedule I to the Companies Act, 2013, are also expressly excluded, the transfer of shares will be governed by the general law relating to transfer of movable property.

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

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

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

**(ix) Capacity to Sue and Be Sued**

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

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

#### **(x) Contractual Rights**

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

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

#### **(xi) Limitation of Action**

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

#### **(xii) Separate Management**

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

#### **(xiii) Voluntary Association for Profit**

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

#### **(xiv) Termination of Existence**

A company, being an artificial juridical person, does not die a natural death. It is created by law, carries on its affairs according to law throughout its life and ultimately is effaced by law. Generally, the existence of a

company is terminated by means of winding up. However, to avoid winding up, sometimes companies adopt strategies like reorganisation, reconstruction and amalgamation.

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

### COMPANY VIS-A-VIS OTHER FORMS OF BUSINESS

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In the following paragraphs, a limited company is distinguished from a partnership firm, a Hindu Undivided Family (HUF) business and a LLP.

### Distinction between Partnership Firm and Company

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

Partnership Firm	Company
A partnership firm is not distinct from the several persons who form the partnership.	A company is a distinct legal person.
In a partnership, the property of the firm is the property of the individuals comprising it.	In a company, it belongs to the company and not to the individuals who are its members.
Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally.	The creditors of a company can proceed only against the company and not against its members.
Partners are the agents of the firm. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business.	Members of a company are not its agents. A member of a company cannot dispose of the property and incur liabilities in the course of the company's business.
A partner cannot contract with his firm.	A member can contract with his company.
A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners.	A company's share can ordinarily be transferred
A partner's liability is always unlimited.	The liability of shareholder may be limited either by shares or a guarantee.
The death or insolvency of a partner dissolves the firm, unless otherwise provided.	A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company.
The accounts of a firm are audited at the discretion of the partners.	A company is required to have its accounts audited annually by a chartered accountant.
A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement among the partners.	A company, being a creation of law, can only be dissolved as laid down by law.

### Distinction between a Hindu Undivided Family Business and a Company

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

### Distinction between Limited Liability Partnership (LLP) and a Company

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

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

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

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

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

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

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

## DEVELOPMENT OF COMPANY LAW IN INDIA

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

### The Companies Act 1956 – Based on Bhabha Committee Recommendations

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

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

The Companies Act, 1956 was enacted with the object to amend and consolidate the law relating to companies. This Act provided the legal framework for corporate entities in India and was a mammoth legislation. As the corporate sector grew in numbers and size of operations, the need for streamlining this Act was felt and as many as 24 amendments had taken place since then.

The Companies Act, 1956 had undergone changes by amendments in 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1971, 1977, 1985, 1988, 1996, 1999, 2000, 2002 (Amendment), 2002 (Second Amendment), and 2006. The Companies Act, 1956 was also amended pursuant to the enactment of the Depositories Act, 1996. Unsuccessful attempts were made in 1993 and 1997 to replace the present Act with a new law. Companies (Amendment) Bill, 2003 containing important provisions relating to Corporate Governance and aimed at achieving competitive advantage was also introduced.

- Based on the recommendations of Shastri Committee, the Companies (Amendment) Act, 1960 introduced several new provisions relating to various aspects of company management which were overlooked in the 1956 Act.
- The Companies (Amendment) Act, 1963 provided for the appointment of a Companies Tribunal and constitution of the Board of Company Law Administration. It also empowered the Central Government to remove managerial personnel involved in cases of fraud, etc.

- Based on the recommendations of the Vivian Bose Commission, the Companies (Amendment) Act, 1965 introduced some major changes, such as clear definition of the main and subsidiary objects of a company in its Memorandum of Association; Strengthening the provisions relating to investigation into the affairs of the company, etc. The Companies Act was further amended twice in 1966.
- Two important changes were introduced by the Companies (Amendment) Act, 1969. The institutions of managing agents and secretaries and treasurers were abolished with effect from April 3, 1970. Secondly, contributions by companies to any political party or for any political purpose were prohibited.
- The Companies (Amendment) Act, 1974 which came into force from February 1, 1975 had introduced some important and major changes in the Companies Act, 1956. The object of the Amendment Act was to inject an element of public interest in the working of the corporate sector.
- The Companies (Amendment) Act of 1977 brought about certain changes in Sections 58A, 220, 293, 620 and 634A of 1956 Act.
- *The Companies (Amendment) Act, 1985:* The amending Act substituted Section 293A of Companies Act, 1956 with a new section permitting Non-Government companies to make political contributions, directly or indirectly.
- With a view that legitimate dues of workers rank *pari passu* with secured creditors in the event of closure of the company and rank above even the dues to Government, Sections 529 and 530 of the Companies Act, 1956, were amended and a new Section 529A was introduced.
- *The Companies (Amendment) Act, 1988:* Based on the recommendations made by the Expert Committee (Sachar Committee), the Companies (Amendment) Act, 1988 substantially amended the Companies Act, 1956 in order to streamline some of the existing provisions of the Companies Act, 1956 and to ensure better working and administration of the Act. *The important changes introduced by the Amendment Act of 1988 were:*
  - (a) Definition of Secretary brought in line with the definition of 'Company Secretary' in the Company Secretaries Act, 1980 and includes an individual possessing the prescribed qualifications.
  - (b) The concept of company secretary in practice was introduced for the first time in the Companies Act. The Amended Act, among other things, also set up an independent Company Law Board to exercise such judicial and quasi-judicial functions, earlier being exercised either by the Court or the Central Government.
- The Depositories Act, 1996 made the following major amendments to the Companies Act, 1956:-
  - (a) Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.
  - (b) Stamping of transfer instruments is not required where both the transferor and transferee are entered as beneficial owners in the records of a depository.
  - (c) The securities of a company other than a private company have been made freely transferable. The transfer has to be effected immediately by the company/depository.
  - (d) The register of members shall indicate the shares held by a member in demat mode but such shares need not be distinguished by a distinctive number.
  - (e) Company to give in the offer document option to the investor to ask for issue of securities in demat mode.

## 14 EP-CL

- The Companies (Amendment) Act, 1999 made the following major changes to the Companies Act, 1956:-
  - (a) Companies allowed to issue Sweat Equity shares and to buy-back their own securities.
  - (b) Facility for nomination provided for the benefit of share/debenture/deposit holders.
  - (c) An Investor Education and Protection Fund to be established.
  - (d) National Advisory Committee on Accounting Standards for companies to be established.
  - (e) Prior approval of Central Government not required for inter-corporate investment/lending proposals subject to certain conditions.
- Further the Companies (Amendment) Act, 2000 made the following major amendments:
  - (a) Private Companies and Public Companies to have a minimum paid-up capital of Rupees one lakh and five lakh respectively.
  - (b) Change of place of registered office from the jurisdiction of one Registrar of Companies to another Registrar of Companies within the same state requires confirmation from the Regional Director.
  - (c) Provisions relating to deemed public companies became inoperative and a new provision relating to conversion of a public company to a private company inserted in the Companies Act, 1956.
  - (d) SEBI given powers regarding issue and transfer of securities and non-payment of dividend by listed public companies.
  - (e) Certain measures included for protecting the interest of small deposit holders in a company.
  - (f) Preferential offer/Private placement of securities to 50 (fifty) persons or more treated as public issue. This shall not apply to a preferential offer made by public financial institutions and NBFCs.
  - (g) Provisions relating to shelf-prospectus and information memorandum, issue of equity share capital with differential rights as to dividend, voting or otherwise included.
  - (h) Every listed company making initial public offer of any security for a sum of Rupees ten crores or more will have to issue the same only in a dematerialised form.
- The Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002 made the following changes to the Companies Act, 1956:-
  - (a) New Part IXA consisting of Section 581A to 581ZT relating to Producer Companies inserted
  - (b) The existing Company Law Board is proposed to be dissolved and in its place a National Company Law Tribunal (Tribunal) is to be constituted.
  - (c) Appeals against the orders of the Tribunal can be filed with the Appellate Tribunal. Further appeal against the orders of the Appellate Tribunal would lie to the Supreme Court.
  - (d) The Board for Industrial and Financial Reconstruction is to be abolished and SICA will be repealed.
  - (e) Transfer of all the powers from the BIFR to the Tribunal.
  - (f) Transfer of certain powers of the High Court to the Tribunal.
  - (g) Greater role for professionals in the administration of Company Law.
  - (h) Transfer of powers relating to winding up, mergers and amalgamations from Court to the Tribunal.



- The Companies (Amendment) Act, 2006 inserted new Sections 610B, 610C, 610D and 610E and also certain sections pertaining to Director Identification Number (DIN). Salient features of the provisions of Companies (Amendment) Act, 2006 are as follows:
  - DIN to be obtained by all existing directors and every other person, intending to become a director.
  - The applications, balance sheet, prospectus, return, declaration, memorandum and articles of association, particulars of charges or any other particulars or document required to be filed or delivered, are to be filed in electronic form .
  - The document, notice, any communication or intimation, required to be served or delivered under the Act to the Registrar of Companies, should be served or delivered through electronic form .
  - Applications, balance sheet, prospectus, return, register, MOA and AOA, particulars of charges or any other document and return filed shall be maintained by Registrar in electronic form .
  - Central Government may provide such value added services through the electronic form .
  - All the provisions of Information Technology Act, 2000 relating to the electronic records, in so far as they are not inconsistent with the Companies Act, shall apply to the records in electronic form.

### **CONCEPT PAPER ON COMPANY LAW, 2004 & J.J. IRANI REPORT**

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

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

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

The Expert Committee had recommended that private and small companies need to be given flexibilities and freedom of operations and compliance at a low cost. Companies with higher public interest which access

capital from public need to be subjected to a stricter regime of Corporate Governance. Further, Government companies and public financial institutions should be subject to similar parameters with respect to disclosures and Corporate Governance as other companies are subjected to.

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

### **Companies Bill, 2012**

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

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

### **Companies Act 2013**

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

Passed in Lok sabha	December 18, 2012
Passed in Rajya Sabha	August 08, 2013
President's assent	August 29, 2013
Total number of sections	470
Total number of chapters	29
Total number of schedules	7

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

- Associate company
- One person company
- Small company
- Dormant company
- Independent director
- Women director
- Resident director
- Special court

- Secretarial standards
- Secretarial audit
- Class action
- Registered valuers
- Rotation of auditors
- Vigil mechanism
- Corporate social responsibility
- Cross border mergers
- Prohibition of insider trading

## DOCTRINE OF LIFTING OF OR PIERCING THE CORPORATE VEIL

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

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

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

### Statutory Recognition of Lifting of Corporate Veil

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

### Lifting of Corporate Veil under Judicial Interpretation

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

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

## CASE EXAMPLE

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

A agreed to sell certain land to B. Pending completion of formalities of the said deal, A sold and transferred

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

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

#### CASE EXAMPLE

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

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

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

#### CASE EXAMPLE

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

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

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

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

#### CASE EXAMPLE

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

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

But it was held "the company was formed by the assessee purely and simply as a means of avoiding super-tax and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the

assessee as pretended loans". The Court decided to disregard the corporate entity as it was being used for tax evasion.

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

#### CASE EXAMPLE

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

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

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

#### CASE EXAMPLE

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

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

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

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

#### Lifting the Corporate Veil of Small Scale Industry

Where small scale industries were given certain exemptions and the company owning an industry was controlled by some group of persons or companies, it was held that it was permissible to lift the veil of the company to see whether it was the subsidiary of another company and, therefore, not entitled to the proposed exemptions. [*Inalsa Ltd. v. Union of India, (1996) 87 Com Cases 599 (Delhi).*]

### Use of Corporate Veil for Hiding Criminal Activities

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

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

### REVIEW QUESTIONS



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

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

**Correct answer: All**

### ILLEGAL ASSOCIATION

In order to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them did not know with whom they were contracting, the law has put a ceiling on the number of persons constituting an association or partnership. An unincorporated company, association or partnership consisting of large number of persons has been declared illegal.

By virtue of section 464 of the Companies Act, 2013, no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. Section further provides that the number of persons which may be prescribed under this section shall not exceed one hundred. Accordingly, Rule 10 of Companies (Miscellaneous) Rules, 2014 prescribes 50 persons in this regard.

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

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

- (i) cannot enter into any contract;
- (ii) cannot sue any member, or outsider, not even if the company is subsequently registered;

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

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

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

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

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

## REVIEW QUESTIONS



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

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

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

## LESSON ROUND-UP

- The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together.
- In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. A company has a separate legal entity from the persons constituting it.
- The main characteristics of a company are corporate personality, limited liability, perpetual succession, separate property, transferability of shares, capacity to sue and be sued, contractual rights, limitation of action, separate management, termination of existence etc.
- The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India. Though it has established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.
- Company Law in India has been modelled on the English Company Law.
- In India after independence, the Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations.
- Companies Act, 2013 was passed by the Lok Sabha and Rajya Sabha on 18th December and 8<sup>th</sup> August, 2013 respectively. It received the assent of the Hon'ble President of India on 29<sup>th</sup> August, 2013 and was notified in the Gazette of India on 30<sup>th</sup> August, 2013. The Companies Act, 2013 has replaced the Companies Act, 1956.
- Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to

take shelter behind the corporate personality. The Court may break through the corporate shell and apply the principle of what is known as “lifting of or piercing the corporate veil”.

- In order to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them do not know with whom they were contracting, the law has put a ceiling on the number of persons constituting an association or partnership. If the ceiling exceeds 50, then such association or partnership has to register itself either under the Companies Act, 2013 or some other Indian Statute.

## SELF-TEST QUESTIONS

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

1. Answer on the following:
  - (a) Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?
  - (b) The members of a private limited company consist of ‘A’ and ‘B’ who are also its directors. On 4th August, 2015 ‘A’ left India for a foreign business tour and on 28th August, 2015 he died abroad. On 1st September, 2015 ‘B’ purchased on credit ₹ 10,000 worth of goods from ‘C’ on behalf of the company. ‘C’ now proposes to make ‘B’ personally liable for the payment of the debt. Is ‘B’ liable?
2. (a) What types of associations are prohibited by the Companies Act, and what are the disabilities of such associations?
  - (b) “Members of a Limited Company may nevertheless have unlimited liability.” Comment.
  - (c) What do you understand by corporate veil and when is it disregarded?
3. “The fundamental attribute of corporate personality is that the company is a legal entity distinct from the members.” Elucidate the above statement.
4. Discuss briefly the history of Company Law in India. Also discuss how far Company Law in India has been influenced by the English Company Law.
5. What are the advantages of an incorporated company compared to partnership firms and unincorporated companies?
6. Write short notes on:
  - (a) Perpetual succession
  - (b) Transferability of shares
  - (c) Limited liability
  - (d) Corporate personality
  - (e) One man company.
7. A company transferred all the shares of another company held by it to its newly incorporated wholly-owned public limited subsidiary investment company.

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

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







# Lesson 2

## Types of Companies

### LESSON OUTLINE

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

### LEARNING OBJECTIVES

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

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

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

**INTRODUCTION**

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

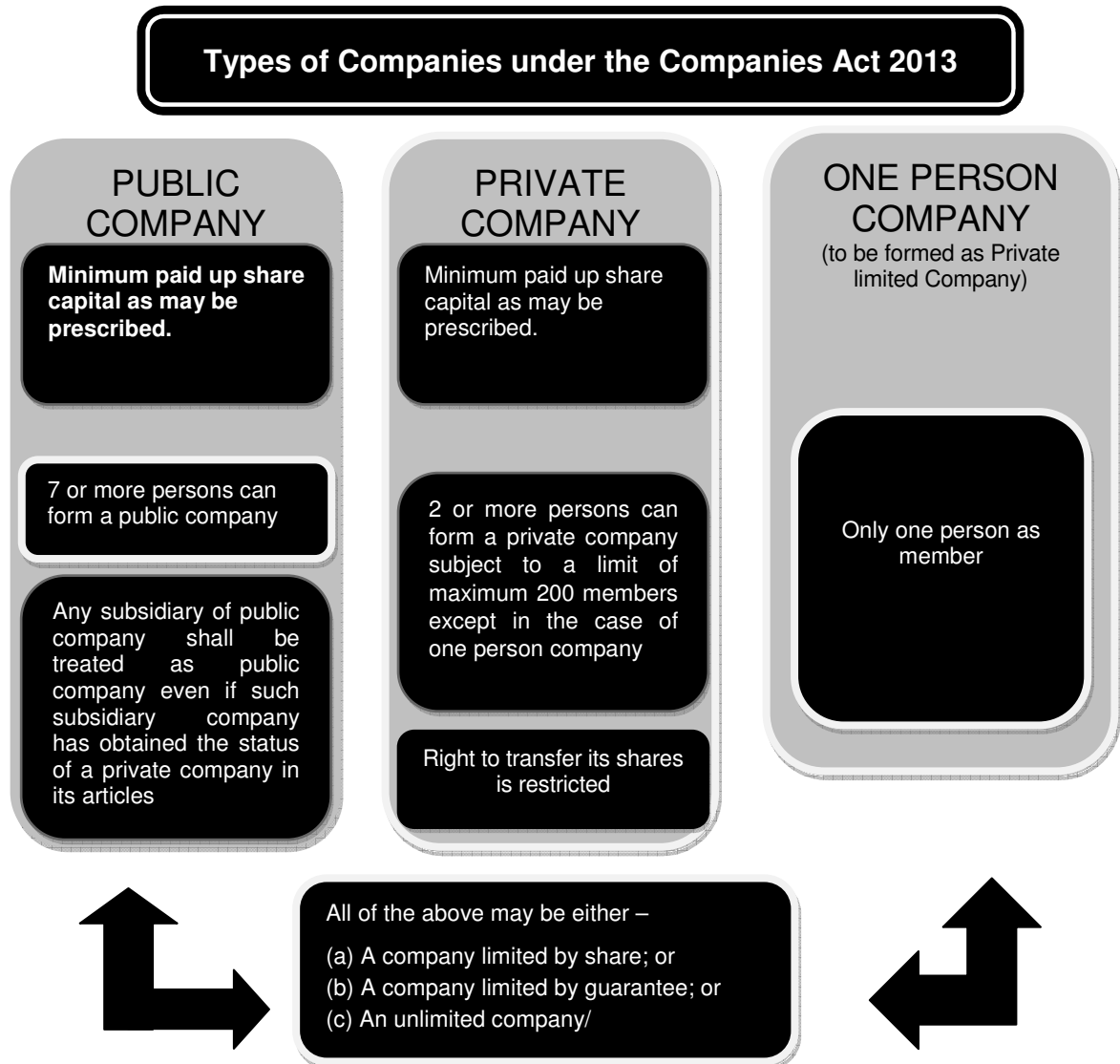
- (a) Private Companies;
- (b) Public Companies; and
- (c) One Person Company (to be formed as Private Limited)

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

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

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

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



## Classification of Companies

- (i) Classification on the basis of Incorporation: There are three ways in which companies may be incorporated.
  - (a) **Statutory Companies:** These are constituted by a special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.
  - (b) **Registered Companies:** The companies which are incorporated under the Companies Act, 2013 or under any previous company law, with ROC<sup>1</sup> fall under this category.
- (ii) Classification on the basis of Liability: Under this category there are three types of companies:
  - (a) **Unlimited Liability Companies:** In this type of company, the members are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited. Such companies may or may not have share capital. They may be either a public company or a private company.
  - (b) **Companies limited by guarantee:** A company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount.
  - (c) **Companies limited by shares:** A company that has the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. For example, a shareholder who has paid ₹75 on a share of face value ₹ 100 can be called upon to pay the balance of ₹25 only. Companies limited by shares are by far the most common and may be either public or private.
- (iii) **Other Forms of Companies**
  - (a) Associations not for profit having license under Section 8 of the Companies Act, 2013 or under any previous company law;
  - (b) Government Companies;
  - (c) Foreign Companies;
  - (d) Holding and Subsidiary Companies;
  - (e) Associate Companies/Joint Venture Companies
  - (f) Investment Companies
  - (g) Producer Companies.
  - (h) Nidhi Companies
  - (i) Dormant Companies

## PRIVATE COMPANY

As per Section 2(68) of the Companies Act, 2013, "private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

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

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<sup>1</sup> ROC. Registrar of Companies

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

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

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

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

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

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

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

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

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

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

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

## Privileges and Exemptions of Private Company

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

Private companies enjoy various privileges and exemptions. The Central Government has been empowered under section 462 (1), to issue in public interest, by notification, directing that any of the provisions of Companies Act, 2013 shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification. In this context the Central Government vide notification no. 464(E) dated 5th June, 2015 directed that respective sections of the Companies Act, 2013 shall not apply or shall apply with certain exceptions, modification and adaptations to private companies. A brief analysis of these exemptions is given hereunder.

### Exceptions, modification and adaptations for Private Companies

Sr. No.	Chapter/Section Number/ Sub-section(s) in the Companies Act, 2013	Exceptions/Modifications/Adaptations
1	Chapter 1 Section 2(76) (viii)	<p>Preliminary</p> <p>Shall not apply with respect to Section 188</p> <p>Note: Section 2(76) defines related party with reference to a company and as per Section 2(76)(viii) the following are considered to be related party.</p> <p>A holding, subsidiary or an associate company of such company or</p> <p>A subsidiary of holding company to which it is also a subsidiary.</p> <p>Effect: Section 2(76)(viii) is not applicable to a private company with respect to Section 188 (i.e related party transactions)</p> <p>Accordingly a holding/ subsidiary/ associate company of a private limited company or a subsidiary of holding company of a private limited company will not be considered as related party.</p>
2	Chapter IV Section 43 & Section 47	<p>Share Capital and Debentures</p> <p>Shall not apply where memorandum or articles of association of the private company so provides.</p> <p>Note: Section 43 deals with kinds of capital and Section 47 deals with voting rights.</p> <p>Effects: Memorandum or Articles of Association of a Private Limited Company can provide for a clause, making sections 43 and section 47 not applicable to that company.</p>
3	Chapter IV Section 62(1)(a)(i) and Section 62(2)	<p>Share capital and Debenture</p> <p>In clause (a), in sub-clause (i), the following proviso shall be inserted, namely;-</p> <p>Provided that notwithstanding anything contained in this sub-clause and sub section (2) of this section, in case ninety per cent. of the members of a private company have given their consent in writing or</p>

		<p>in electronic mode, the periods lesser than those specified in the said sub-clause or sub-section shall apply.</p> <p>Note: Section 62 deals with further issue of shares. Section 62(1)(a) deals with conditions for sending letter of offer to the existing holders. Section 62(1)(a)(i) deals with the time within which the letter of offer is to be accepted by the existing shareholders. According to Section 62(1)(a)(i) the offer shall be made by notice specifying the number of shares offered and limiting a time of not being less than fifteen days and not exceeding thirty days from the date of offer within which the offer, if not accepted, shall be deemed to have been declined.</p> <p>Effects: In case ninety per cent of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those specified in the said sub-clause or sub-section shall apply.</p> <p>Accordingly time limit for acceptance of offer by existing shareholders may be less than 15 days if 90% of the members of a private limited company have given their consent either in writing or through electronic mode.</p>
4	Section 62(1)(b)	<p>In clause (b), for the words "special resolution", the words "ordinary resolution" shall be substituted.</p> <p>Note: Section 62(1)(b) requires passing of Special Resolution for offering of further shares to employees subject to passing of special resolution and other conditions prescribed under the rules.</p> <p>Effect: For private limited companies, passing of ordinary resolution is sufficient.</p>
5	Section 67	<p>Shall not apply to private companies -</p> <p>(a) in whose share capital no other body corporate has invested any money;</p> <p>(b) if the borrowings of such a company from banks or financial institutions or any body-corporate is less than twice its paid up share capital or fifty crore rupees, whichever is lower; and</p> <p>(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.</p> <p><i>Note:</i> Section 67 deals with restrictions on purchase by a company or giving loans by it for purchase of its shares.</p> <p>Effects: Private Companies are exempted from Section 67 subject to the following three conditions.</p> <p>(a) a private limited company in whose share capital no other body corporate has invested any money;</p> <p>(b) Borrowings by such private company from banks or financial</p>



		<p>institutions or any body-corporate is less than twice its paid up share capital or fifty crore rupees, whichever is lower; and</p> <p>(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.</p>
6	<p>Chapter V</p> <p>Section 73(2)(a) to Section 73(2)(e)</p>	<p>Acceptance of Deposits by Companies</p> <p>Shall not apply to a private company which accepts from its members monies not exceeding one hundred per cent of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified.</p> <p>Note: Section 73(2) deals with conditions for acceptance of deposits from members.</p> <p>Effects: Conditions for acceptance of deposits from members is not applicable to a Private Company if the monies accepted does not exceed one hundred per cent of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified.</p>
7	<p>Chapter VII</p> <p>Section 101 to Section 107 and Section 109.</p>	<p>Management and Administration</p> <p>Shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise.</p> <p>Note: Articles of Association of a Private Company can have specific provisions with respect to - notice of the general meeting (Section 101); Statement to be annexed to notice (Section 102); Quorum for meeting (Section 103); Chairman of meetings (Section 104); proxies (Section 105); restriction on voting rights (Section 106); Voting by show of hands (Section 107); Demand for poll (Section 109).</p> <p>Effects: Articles of Association of a Private Company may have specific provisions with respect to above mentioned sections.</p>
8	<p>Section 117(3)(g)</p>	<p>Shall not apply</p> <p>Note: Section 117 deals with resolutions and agreements to be filed with registrar. Section 117(3)(g) deals with filing of resolutions passed in pursuance of sub-section (3) of section 179(i.e. resolutions to be passed only at the meeting of Board of directors).</p> <p>Effects: Private companies are not required to file with the registrar the resolutions passed under Section 179(3).</p>
9	<p>Chapter 10</p> <p>Section 141(3)(g)</p>	<p>Audit and auditors</p> <p>Shall apply with the modification that the words "other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than one</p>

		<p>hundred crore rupees" shall be inserted after the words "twenty companies".</p> <p>Note: Section 141(3) deals with conditions for eligibility for appointment as an auditor of a company. Section 143(3)(g) limits the number of audits by an auditor to twenty companies.</p> <p>Effects: One person companies, dormant companies, small companies and private companies having paid-up share capital less than one hundred crore rupees are excluded from this limit.</p>
10	Chapter XI Section 160	<p>Appointment and qualification of directors</p> <p>Shall not apply</p> <p>Note: Section 160 deal with right of persons other than retiring directors to stand for directorship.</p> <p>Effect: Now, for private companies requirement of Deposit of Rupees one lakh is not required.</p>
11	Section 162	<p>Shall not apply</p> <p>Note: Section 162 deals with appointment of directors to be voted individually.</p> <p>Effect: Now, more than one director can be appointed through a single resolution.</p>
12	Chapter XII Section 180	<p>Meetings of board and its powers</p> <p>Shall not apply</p> <p>Note: Section 180 deals with restrictions on powers of the Board.</p> <p>Effects: Special Resolution is not required to exercise such power of board as provided in Section 180.</p>
13	Section 184(2)	<p>Shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest.</p> <p>Note: Section 184 deals with disclosure of interest by director. Section 184(2) prohibits interested director from participating in meeting.</p> <p>Effects: Interested director of a private company can participate in the meeting after disclosing his interest.</p>
14	Section 185	<p>Shall not apply to a private company -</p> <p>(a) in whose share capital no other body corporate has invested any money;</p> <p>(b) if the borrowings of such a company from banks or financial institutions or anybody corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and</p>

		<p>(c) Such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this Section.</p> <p><i>Note:</i> Section 185 deals with loans to directors</p> <p>Effects: the Provisions of Section 185 shall not apply to a private company if the following conditions are fulfilled.</p> <p>(i) that no other body corporate has invested any money in share of the company ;</p> <p>(b) that the borrowings of such company from banks or financial institutions or anybody corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and</p> <p>(c) that the company has no made any default in repayment of such borrowings subsisting at the time of making transactions under this Section.</p>
15	Second proviso to Section 188(1)	<p>Shall not apply</p> <p><b>Note:</b> Second proviso to Section 188(1) states that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.</p> <p>Effects: in private company, related party to any contract or arrangement can vote on such resolution as a member of the company.</p>
16	Chapter XIII Section 196(4) and (5)	<p>Appointment and Remuneration of the Managerial Personnel</p> <p>Shall not apply</p> <p><b>Note:</b> Section 196(4) deals with appointment of managing director, whole time director or manager</p> <p>Section 196(5) deals with validating actions of managing director; whole time Director/manager, if the appointment is not approved by a company in general meeting.</p> <p><b>Effects:</b> Approval of central government on variation of terms of appointment from Schedule V is not required for private companies.</p>

### Special Obligations of a Private Company

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

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

- (i) The company has not, since the date of the closure of the last financial year with reference to which the last return was submitted or in the case of a first return since the date of the incorporation of the

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

### Consequences of Alteration of the Articles of Private Companies

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

### REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

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

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

### ONE PERSON COMPANY (OPC)

#### Background of OPC

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

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

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

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

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

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

### **Status of OPC in other countries**

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

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

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

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

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

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

### **Difference between a Sole Proprietorship and an OPC**

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

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

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

### **Position of OPC in India under the Companies Act 2013**

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

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

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

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

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

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

(1) Only a natural person who is an Indian citizen and resident in India-

- (a) shall be eligible to incorporate a One Person Company;
- (b) shall be a nominee for the sole member of a One Person Company.

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

(2) A natural person shall not be a member of more than a One Person Company at any point of time and the said person shall not be a nominee of more than a One Person Company.

(3) Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in sub rule (2) within a period of one hundred and eighty days.

(4) No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.

(5) Such Company cannot be incorporated or converted into a company under section 8 of the Act.

(6) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.

(7) No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

### **Contract by One Person Company**

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

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

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

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

### **Privileges of a One Person Company**

The privileges enjoyed by an OPC over other companies are as follows:

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

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

### Benefits of One Person Company

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

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

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

### SMALL COMPANY

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

*“The Committee sees no reason why small companies should suffer the consequences of regulation that may be designed to ensure balancing of interests of stakeholders of large, widely held corporates. Company law should enable simplified decision making procedures by relieving such companies from select statutory internal administrative procedures. Such companies should also be subjected to reduced financial reporting and audit requirements and simplified capital maintenance regimes. Essentially the regime for small companies should enable them to achieve transparency at a low cost through simplified requirements. Such a framework may be applied to small companies through exemptions, consolidated in the form of a Schedule to the Act.”*

Small company is a new form of private company under the Companies Act, 2013. A classification of a



private company into a small company is based on its size i.e. paid up capital and turnover. In other words, such companies are small sized private companies.

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

- (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and
- (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this definition shall apply to—

- (A) a holding company or a subsidiary company;
- (B) a company registered under section 8; or
- (C) a company or body corporate governed by any special Act;

### Privileges of a Small Company

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

Section	Nature of exemptions/privileges
2(40)	The financial statement, with respect to Small Company may not include the cash flow statement;
67(2)	Financial assistance can be given for purchase of or subscribing to its own shares or shares in its holding company
92(1)	The annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company. In other words it need not be signed by the company secretary in practice.
121(1)	Need not prepare a report on Annual General Meeting
134(3)(p)	Need not prepare a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
149(1)	Small company need not have more than two directors in its Board.
149(4)	Need not appoint Independent directors on its Board
152(6)	A proportion of directors need not to retire every year.
164(3)	Additional grounds for disqualification for appointment as a director may be specified in the articles.
165(1)	Restrictive provisions regarding total number of directorships which a person may hold in a public company do not include directorships held in small company which are neither holding nor subsidiary company of a public company.

Section	Nature of exemptions/privileges
167(4)	Additional grounds for vacation of office of a director may be provided in the Articles.
173 (5)	It is required to hold at least one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days.
190(4)	The provisions relating to contract of employment with managing or whole-time directors do not apply to a Small Company
197(1)	Total managerial remuneration payable by a small company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year may exceed eleven per cent. of the net profits

## PUBLIC COMPANY

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

- (a) is not a private company;
- (b) has a minimum paid-up share capital, as may be prescribed.

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

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

A public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange. The number of members is not limited to two hundred.

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

The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of *Western Maharashtra Development Corpn. Ltd. V. Bajaj Auto Ltd* [2010] 154 Com Cases 593 (Bom). It was held that the Companies Act, makes a clear distinction in regard to the transferability of shares relating to private and public companies. By definition, a "private company" is a company which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest therein, of a company, shall be freely transferable.

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

## LIMITED COMPANY

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

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

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

### Companies Limited by Shares

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

### Companies Limited by Guarantee

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

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

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

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

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

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

A guarantee company must include the word ‘limited’ or the words “private limited” as part of its name, and must register its articles, and it shall adopt the provisions of the Table ‘G’ and ‘H’ of Schedule I. It must also

state the number of members with which it proposes to be registered, although the number can be increased by means of a resolution.

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: False**

## UNLIMITED COMPANY

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

An unlimited company may or may not have share capital.

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

## ASSOCIATION NOT FOR PROFIT

As per Section 4(1), the memorandum of a company shall state the name of the company with the last word “Limited” in the case of a public limited company, or the last words “Private Limited” in the case of a private limited company. However, Section 8(1) permits the registration, under a licence granted by the Central

Government, of associations not for profit with limited liability without being required to use the word “Limited” or the words “Private Limited” after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if:

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

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

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

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

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

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

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

The Central Government may by order at any time revoke the licence whereupon the word “Limited” or “Private Limited” as the case may be, shall have to be used as part of its name and the company will lose the exemptions that might have been granted by the Central Government. However, the Central Government can do so only after providing such association an opportunity to be heard and the aggrieved association can challenge the order of the Central Government under Article 226 of the Constitution. Further a copy of every such order has to be filed with the Registrar.

The Central Government has been empowered under section 462 (1), to issue in public interest, by notification, directing that any of the provisions of Companies Act, 2013 shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications

and adaptations as may be specified in the notification. In this context the Central Government vide notification no. 466(E) dated 5th June, 2015 directed that respective sections of the Companies Act, 2013 shall not apply or shall apply with certain exceptions, modification and adaptations to Section 8 companies. A brief analysis of these exemptions is given hereunder.

#### Exceptions, modification and adaptations to Section 8 (Non -Profit) Companies

Sr. No.	Chapter/Section Number/ Sub-section(s) in the Companies Act, 2013	Exceptions/Modifications/Adaptations
1	Chapter 1 Section 2(24)	Preliminary The provisions of clause (24) of section 2 shall not apply. <i>Note:</i> The definition of the term Secretary as defined in Section 2(24) does not apply to Section 8 Companies.
2	Section 2(68)	The requirement of Minimum paid-up share capital shall not apply. <i>Note:</i> Section 2(68) defines a private company. Though the companies (amendment) Act 2015 has removed the minimum prescription of ₹1 lakh as minimum paid up capital for private limited companies, the provisions for prescribing minimum paid up capital is retained. However, the requirement of minimum-paid up capital shall not apply to section 8 companies.
3	Section 2(71)	The requirement of Minimum paid-up share capital shall not apply. <i>Note:</i> Section 2(71) defines a public company. Though the companies (amendment) Act 2015 has removed the minimum prescription of ₹5 lakh as minimum paid up capital for public limited companies, the provisions for prescribing minimum paid up capital is retained. However, the requirement of minimum-paid up capital shall not apply to section 8 companies.
4	Chapter VII Section 96(2)	Management and Administration In sub-section (2), after the proviso and before the explanation, the following proviso shall be inserted, namely:- Provided further that the time, date and place of each annual general meeting are decided upon before-hand by the board of directors having regard to the directions, if any, given in this regard by the company in its general meeting. <i>Note:</i> Section 96(2) inter-alia covers time, date venue of annual general meeting. In case of Section 8 companies, the time, date and place of each annual general meeting are decided upon before-hand by the board of directors having regard to the directions, if any, given in this regard by the company in its general meeting.
5	Section 101(1)	In sub-section (1), for the words "Twenty one days" the words "Fourteen Days" shall be substituted.

		<i>Note:</i> Section 101(1) deals with notice of the General meeting with clear twenty one days notice. In case of Section 8 Companies 14 clear days notice is sufficient for a general meeting.
6	Section 118	The section shall not apply as a whole except that minutes may be recorded within thirty days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.  <i>Note:</i> Section 118 deals with minutes of proceedings of general/board and other meetings. Provision of Section 118 does not apply to Section 8 companies except that minutes may be recorded within thirty days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.
7	Chapter IX  Section 136(1)	Accounts of Companies  In sub-section (1), for the words "twenty one days", the words "fourteen days" shall be substituted.  <i>Note:</i> Section 136(1) deals with the rights of members to copies of audited financial statement, before twenty-one days before the date of annual general meeting. Section 8 companies may send the audited financial statements 14 days before the date of annual general meeting.
8	Chapter XI  Sub-section (1) of Section 149 and the first proviso to sub-section (1)	Appointment and Qualification of Director  Shall not apply.  <i>Note:</i> Section 149(1) and first proviso to sub-section (1) relates to minimum and maximum number of directors. It is not applicable to Section 8 Companies.
9	Sub-sections (4), (5), (6), (7), (8), (9), (10), (11), clause (i) of subsection (12) and sub-section (13) of section 149.	Shall not apply.  <i>Note:</i> The cluster of sub-sections of section 149 given herein pertains to independent directors. These provisions will not apply to a Section 8 Company.
10	Section 150	Shall not apply.  <i>Note:</i> Section 150 deals with manner of selection of independent directors and maintenance of databank of independent directors, which is not applicable to Section 8 companies.
11	Proviso to sub-section (5) of section 152	Shall not apply.  <i>Note:</i> Proviso to sub-section (5) of section 152 relates to appointment of independent directors. It is not applicable to section 8 companies.
12	Section 160	Shall not apply to companies whose articles provide for election of directors by ballot.  <i>Note:</i> Section 160 deals with right of persons other than retiring

		directors to stand for directorship. Section 160 shall not apply to section 8 companies whose articles provide for election of directors by ballot.
13	Section 165(1)	Shall not apply. Note: Section 165(1) deals with restrictions on number of directorships. Directorship of Section 8 Companies are not reckoned for this purpose.
14	Chapter XII Section 173(1)	Meeting of Board and its Power Shall apply only to the extent that the Board of Directors, of such Companies shall hold at least one meeting within every six calendar months. Note: Section 173(1) mandates convening of first board meeting within 30 days of incorporation and minimum of four board meeting every year, with a gap not exceeding 120 days between two consecutive meetings. With regard to Section 8 companies this section shall apply only to the extent that the Board of Directors, of such Companies shall hold at least one meeting within every six calendar months.
15	Section 174(1)	In sub-section (1),--- (a) for the words "one-third of its total strength or two directors, whichever is higher", the words "either eight members or twenty five per cent. of its total strength whichever is less" shall be substituted; (b) the following proviso shall be inserted, namely:- "Provided that the quorum shall not be less than two members". Note: Section 174(1) states that the quorum for a meeting of the Board of Directors of a company shall be one third of its total strength or two directors, whichever is higher, and the participation of the directors by video conferencing or by other audio visual means shall also be counted for the purposes of quorum under this sub-section. In case of Section 8 companies the quorum for the board meetings shall be either eight members or twenty five per cent. of its total strength whichever is less. However, the quorum shall not be less than two members.
16	Section 177(2)	The words "with independent directors forming a majority" shall be omitted. Note: Section 177(2) requires audit committee to have majority of independent directors. It is not required for Section 8 Companies.
17	Section 178	Shall not apply Note: Section 178 pertains to nomination and remuneration committee and stakeholders' relationship committee. Section



		178 is not applicable to section 8 companies.
18	Section 179	Matters referred to in clauses (d), (e) and (f) of sub-section (3) may be decided by the Board by circulation instead of at a Meeting.  Note: Section 179(3) deals with resolutions to be passed at meetings of the Board. Section 179(3)(d), (e) and (f) pertains to resolution to borrow moneys, to invest funds of the company and to grant loans or give guarantee or provide security in respect of loans. These items may be decided by the Board by circulation in case of Section 8 companies.
19	Sub-section (2) of section 184	Shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.  Note: Section 184(2) prohibits participation of interested directors. In case of Section 8 Companies it shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.
20	Section 189	Shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.  Note: Section 189 deals with register of contracts or arrangements in which directors are interested. Section 189 is applicable to section 8 companies only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

## GOVERNMENT COMPANIES

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

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

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

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

The Central Government has been empowered under section 462 (1), to issue in public interest, by notification, directing that any of the provisions of Companies Act, 2013 shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification. In this context the Central Government vide notification no. 463(E) dated 5th June, 2015 directed that respective sections of the Companies Act, 2013 shall not apply or shall apply with certain exceptions, modification and adaptations to Government companies. A brief analysis of these exemptions is given hereunder.

### Exceptions, modification and adaptations to Government Companies

Sr. No.	Chapter/Section Number/ Sub-section(s) in the Companies Act, 2013	Exceptions/Modifications/Adaptations
(1)	(2)	(3)
1.	Chapter II Section 4	<p>Incorporation of Company and matters incidental thereto</p> <p>In section 4, in sub-section (1), in clause (a), the words in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company' shall be omitted</p>
2.	Chapter IV Section 56	<p>Share capital &amp; Debentures</p> <p>In sub-section (1), after the proviso, the following provisos shall be inserted, namely :-</p> <p>Provided further that the provisions of this sub-section, in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee , shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond:</p> <p>Provided also that the provisions of this sub-section shall not apply to a Government Company in respect of securities held by nominees of the Government.</p> <p><i>Note:</i></p> <p>Section 56(1)(prescribing instruments of transfer) shall not apply to a government company in respect of securities held by nominees of the government.</p> <p>Section 56(1), in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee , shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the</p>

		bond; and if no such certificate is in existence, along with the letter of allotment of the bond.
3.	Chapter VII Section 89	Management and Administration Shall not apply. Note: Section 89 dealing with declaration of beneficial interest does not apply to a government company.
4.	Section 90	Shall not apply. Note: Section 90 dealing with investigation of beneficial ownership of shares in certain cases shall not apply to a government company.
5.	Sub-section (2) of section 96	In sub-section (2), for the words "some other place within the city, town or village in which the registered office of the company is situate", the words "such other place as the Central Government may approve in this behalf 'shall be substituted.  Note: Section 96(2) mandates that Annual General Meeting shall be held either at the Registered Office of the Company or some other place within the city, town or village in which the registered office of the company is situate. Government company may convene its Annual General Meeting at such other place as the Central Government may approve in this behalf.
6.	Chapter VIII Second proviso to sub-section (1) of section 123	Declaration and Payment of Dividend Shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments.
7.	Subsection (4) of section 123	Shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.  Note: Section 123(4) states that the amount of dividend, including interim dividend, shall be deposited in a scheduled bank in a separate bank in a separate account within five days from the date of declaration of such dividend. It does not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.
8.	Chapter IX Section 129	Accounts of Companies Shall not apply to the extent of application of Accounting Standard 17 (Segment Reporting) to the companies engaged in defence

		<p>production.</p> <p>Note: Section 129 relates to provisions relating to financial statement. Section 129 shall not apply Shall not apply to the extent of application of Accounting Standard 17 (Segment Reporting) to the companies engaged in defence production.</p>
9.	Clause (e) of sub-section (3) of section 134	<p>Shall not apply</p> <p>Note: Section 134(3)(e) mandates Board's report to include in case of a company covered under sub-section (1) of section 178(Companies required to nomination and remuneration committee), company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178. It shall not apply to Government Companies.</p> <p>Accordingly, the Board's report does not have to disclose company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178.</p>
10.	Clause (p) of sub-section (3) of section 134	<p>Shall not apply in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology.</p> <p>Note: Section 134(3)(p) requires the Board report to include in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;</p> <p>It shall not apply in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology.</p>
11.	Chapter XI Section 149(1)(b) and first proviso to sub-section (1) of section 149	<p>Appointment and Qualification of Director</p> <p>Shall not apply.</p> <p>Note: Provisions relating to maximum number of directors as provided in Section 149 do not apply to government companies.</p>
12.	Clause (a) of sub-section (6) of section 149	<p>In section 149, in sub-section (6), in clause (a), for the word "Board", the words "Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government" shall be substituted</p> <p>Note: Section 149(6)(a) relates to one of the conditions for being</p>

		appointed as Independent director. It states that the independent director, who is in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience. In case of Government Companies, the independent director, who is in the opinion of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, is a person of integrity and possesses relevant expertise and experience, can be appointed as independent director subject to fulfilment of other conditions”
13.	Clause (c) of sub-section (6) of section 149	Shall not apply.  <i>Note:</i> Section 149(6)(c) states that independent directors not to have had pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. This provision shall not apply to a government company.
14.	Sub-section (5) of section 152	Shall not apply where appointment of such director is done by the Central Government or State Government, as the case may be.  <i>Note:</i> Section 152(5) deals with consent to act as director shall not apply to a government company.
15.	Sub-sections (6) and (7) of section 152	Shall not apply to –  (a) a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;  (b) a subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Government company.  <i>Note:</i> Section 152(7) relates to filling up of vacancy of retiring director. It shall not apply to a government company subject to above said conditions.
16.	Section 160	Shall not apply to –  (a) a Government Company in which the entire paid up share capital is held by the Central Government. or by any State Government or Governments or by the Central Government and one or more State Governments;  (b) a subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Government company.  <i>Note:</i> Section 160 relates to right of persons other than retiring directors to stand for directorship. Section 160 does not apply to a government company if the above said conditions are fulfilled.

17.	Section 162	<p>Shall not apply to –</p> <p>(a) a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;</p> <p>(b) a subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Government company.</p> <p><i>Note:</i> Section 162 relates to appointment of directors to be voted individually. Section 162 does not apply to a government company if the aforesaid conditions are fulfilled. Accordingly more than one director may be appointed through a single resolution.</p>
18.	Section 163	<p>Shall not apply to - (a) a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;</p> <p>(b) a subsidiary of a Government company referred to in (a) above, in which the entire paid up share capital is held by that Government company.</p> <p><i>Note:</i> Section 163 relates to option to adopt principle of proportional representation for appointment of directors. Section 163 does not apply to a government company if the above said conditions are fulfilled.</p>
19.	Sub-section (2) of section 164	<p>Shall not apply</p> <p>Descriptive Note:</p> <p>Section 164(2) relating to disqualification of director, for non-filing of financial statements for continuous period of three years in which he is a director or failure to repay deposits etc. Section 164(2) does not apply to a Government Company.</p>
20.	Section 170.	<p>Shall not apply to a Government Company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Governments.</p> <p><i>Note:</i> Section 170 relates to register of directors and key managerial personnel and their holdings. Section 170 does not apply to a government company if the above said conditions are fulfilled</p>
21.	Section 171.	<p>Shall not apply to a Government Company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Governments.</p>

		<i>Note:</i> Section 171 deals with member's right to inspect. Section 171 does not apply to a government company if the above said conditions are fulfilled
22.	Chapter XII Clause (i) of sub-section (4) of section 177	Meeting of Board and its Power  In clause (i) of sub-section (4) of the section 177, for the words "recommendation for appointment, remuneration and terms of appointment" the words "recommendation for remuneration" shall be substituted.  <i>Note:</i> Section 177(4) deals with terms of reference of audit committee. Audit committee of a government company can recommend only for remuneration of auditor.
23.	Subsections (2), (3) and (4) of section 178	Shall not apply to Government company except with regard to appointment of 'senior management' and other employees.  <i>Note:</i> Provision relating induction of directors, criteria/qualifications etc does not apply to a Government company and accordingly Nomination and remuneration committee of government company will lay down those criteria for senior management and other employees.
24.	Section 185	Shall not apply to Government company in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section.  <i>Note:</i> Section 185 prohibits loans to directors with few exceptions. It shall not apply to Government company in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section.
25.	Section 186	Shall not apply to –  (a) a Government company engaged in defence production;  (b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.  <i>Note:</i> Section 186 relates to loans and investment by company. It does not apply to the above said government companies.
26.	First and second proviso to sub-section (1) of	Shall not apply to –

	section 188.	<p>a Government company in respect of contacts or arrangements entered into by it with any other Government company;</p> <p>a Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, of, as the case may be, the State Government before entering into such contract or arrangement.</p> <p><i>Descriptive Note:</i></p> <p>Section 188 relates to related party transactions. Section 188 does not apply to government company if above said conditions are fulfilled.</p>
27.	Chapter XIII Sub-sections (2), (4) and (5) of section 196.	<p>Appointment and Remuneration of Managerial Person</p> <p>Shall not apply.</p> <p>Note: Section 196(2) relates to term of managing director not to exceed five years. Section 196(4) relates to approval of the members/central government as the case may be for appointment of managing director and section 196(5) relates to validity of actions of Managing Director if his appointment is not approved at the General Meeting. These provisions are not applicable to a government company.</p>
28.	Section 197	<p>Shall not apply.</p> <p><i>Note:</i> The provisions relating to overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits as given in section 197 does not apply to a government company.</p>
29.	Sub-sections (1), (2), (3) and (4) of section 203.	<p>After sub-section (4), the following sub-section shall be inserted, namely:-</p> <p>"(4A) The provisions of sub-sections (1), (2), (3) and (4) of this section shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole-time director of the Government Company."</p> <p>Note: The Provisions of section 203 relating to appointment of KMP shall not apply to MD/CEO/Manager or in their absence a whole time director of the Government Company.</p>
30.	Chapter XXIX Sub-section (2) of section 439.	<p>Miscellaneous</p> <p>In sub-section (2), the words "the Registrar, a shareholder of the company, or of" shall be omitted.</p> <p>Note: Section 439 deals with offences to be non-cognizable. As per Section 439(2) states that no court shall take cognizance of any offence under this Act which is alleged to have been committed by any</p>



		company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder of the company, or of a person authorised by the Central Government in that behalf. With the deletion of words “the Registrar, a shareholder of the company, or of” relates to a government company, no court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of a person authorised by the Central Government in that behalf.
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### CASE EXAMPLE

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

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

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

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

### FOREIGN COMPANIES

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

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

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

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

- (a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;
- (b) the full address of the registered or principal office of the company;
- (c) a list of the directors and secretary of the company containing such particulars as may be

prescribed;

- (d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;
- (e) the full address of the office of the company in India which is deemed to be its principal place of business in India;
- (f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;
- (g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
- (h) any other information as may be prescribed.

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

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

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

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

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

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

- (v) The provisions of Chapter XIV (Inspection, Inquiry and Investigation) shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

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

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

## **HOLDING, SUBSIDIARY COMPANIES AND ASSOCIATE COMPANIES**

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

### **Holding company**

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

### **Subsidiary company**

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

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

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

For the above purpose,—

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

The MCA has vide its General circular No. 27/2013 dated 27th December 2013 clarified that the shares held by a company or power exercisable by it in another company in a 'fiduciary capacity' shall not be counted for the purpose of determining the holding-subsidiary relationship in terms of the provision of section 2(87) of the Companies Act, 2013.

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

**The Companies (Specification of Definitions details) Rules, 2014**

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

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

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

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

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

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

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

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

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

**REVIEW QUESTIONS**

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

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

- True
- False

**Correct answer: False**

**Associate company**

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

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

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

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

The MCA vide its General circular No. 24/2013 dated 25th June, 2014, clarified that the shares held by a company in another company in a 'fiduciary capacity' shall not be counted for the purpose of determining the relationship of 'associate company' under section 2(6) of the Companies Act, 2013.

## INVESTMENT COMPANIES

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

An investment company is a company, the principal business of which consists in acquiring, holding and dealing in shares and securities. The word 'investment', no doubt, suggests only the acquisition and holding of shares and securities and thereby earning income by way of interest or dividend etc. But investment companies in actual practice earn their income not only through the acquisition and holding but also by dealing in shares and securities i.e. to buy with a view to sell later on at higher prices and to sell with a view to buy later on at lower prices.

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

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

## PRODUCER COMPANIES

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

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

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

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

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as

such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

### **Objects of Producer Companies**

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

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the members or import of goods or services for their benefit.
- (b) processing including preserving, drying, distilling, brewing, vinting, canning and packaging of the produce of its members.
- (c) manufacturing, sale or supply of machinery, equipment or consumables mainly to its members.
- (d) providing education on the mutual assistance principles to its members and others.
- (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its members.
- (f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce.
- (g) insurance of producers or their primary produce.
- (h) promoting techniques of mutuality and mutual assistance.
- (i) welfare measures or facilities for the benefit of the members as may be decided by the Board.
- (j) any other activity, ancillary or incidental to any of the activities referred to in clauses (a) to (i) above or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any other manner.
- (k) financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) above, which include extending of credit facilities or any other financial services to its members.

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

### **NIDHI COMPANIES**

The primary object of Nidhis is to carry on the business of accepting deposits and lending money to member-borrowers only against jewels, etc., and mortgage of property. For over a century Nidhis, with the objective of cultivating the habit of thrift, generally promoted by public spirited men drawn from affluent local persons, lawyers and professionals like auditors, educationists, etc., including retired persons. The area of operation was local – within municipalities and panchayats. Some Nidhis on account of their financial and administrative strength opened branches within the respective revenue district and even outside. The principle of mutual benefit has been to pool the savings from members and lend only to members and never have dealing with Non-members. Nidhis were not expected to engage themselves in the business of Chit Fund, hire purchase, insurance or in any other business including investments in shares or debentures. As stated these Nidhis do their business only with Members. Such Members are only individuals. Bodies Corporate or Trusts are never to be admitted as Members.

### Origin of the Concept in India

The history of the Nidhis, their special features, their manner of functioning, their regulations, etc., have been described by the (i) Viswanatha Shastri Committee in 1965; (ii) Banking Commission in 1972; (iii) James Raj Committee in 1975; (iv) Chakravarthy Report in 1987 ; (v) Dr.A.C.Shah Committee in 1992. Further the Central Government vide Notification No.5/7/2000-CL.V dated 23rd March 2000 constituted a Committee known as Sabanayagam Committee to examine the various aspects of the functioning of Nidhi Companies and suggested an appropriate policy framework for overall improvement of the Nidhi Companies and alternative mechanism to regulate and facilitate Nidhi Companies to play key role in mobilising and gainfully investing small savings and improving their viability resilience and performance.

In 2005, the Expert Committee on Company Law headed by Dr. Jamshed J. Irani suggested in its report on Nidhi companies as given hereunder:

### Prevailing Regulatory Aspects of Nidhi

As per section 406 of the Companies Act, 2013, “Nidhi” means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

In exercise of powers conferred under section 406 read with section 469 of the Companies Act, 2013, Central Government issued the Nidhi Rules, 2014 which came into force on the 1st day of April, 2014. Nidhi Rules, 2014 applicable to:

- every company which had been declared as a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956;
- every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under sub- Section (1) of Section 620A of the Companies Act, 1956; and
- every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act.

### Incorporation of Nidhi

- (1) A Nidhi to be incorporated under the Companies Act, 2013 shall be a public company and shall have a minimum paid up equity share capital of five lakh rupees.
- (2) Nidhi company shall not issue preference shares.
- (3) If preference shares had been issued by a Nidhi before the commencement of the Companies Act, 2013, such preference shares shall be redeemed in accordance with the terms of issue of such shares.
- (4) No Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit.
- (5) Every Company incorporated as a “Nidhi” shall have the last words ‘Nidhi Limited’ as part of its name.

### Requirements for minimum number of members and net owned funds

Sub-Rule (1) of Rule 5 of the Nidhi Rules, 2014 deals with requirements for minimum number of members,

net owned fund etc. It provides that:

- (1) Every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has—
- (a) not less than two hundred members;
  - (b) Net Owned Funds of ten lakh rupees or more;
  - (c) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in rule 14; and
  - (d) ratio of Net Owned Funds to deposits of not more than 1:20.

It may be noted that “Net Owned Funds” means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet. Further, the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds .

If a Nidhi is not complying with clauses (a) or (d) of sub-rule (1) above mentioned, it shall within thirty days from the close of the first financial year, apply to the Regional Director in Form NDH-2 along with fee specified in Companies (Registration Offices and Fees) Rules, 2014 for extension of time and the Regional Director may consider the application and pass orders within thirty days of receipt of the application. Where the failure to comply with sub-rule (1) above mentioned extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in sub-rule (1), besides being liable for penal consequences as provided in the Act.

### **Return of statutory compliances by Nidhi Companies**

Within ninety days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file a return of statutory compliances in Form NDH-1 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 with the Registrar duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

### **General restrictions or prohibitions**

In terms of Rule 6, Nidhi shall not —

- (a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;
- (b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;
- (c) open any current account with its members;
- (d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;
- (e) carry on any business other than the business of borrowing or lending in its own name. Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.



- (f) accept deposits from or lend to any person, other than its members;
- (g) pledge any of the assets lodged by its members as security;
- (h) take deposits from or lend money to any body corporate;
- (i) enter into any partnership arrangement in its borrowing or lending activities;
- (j) issue or cause to be issued any advertisement in any form for soliciting deposit. It may be noted that private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words “for private circulation to members only” shall not be considered to be an advertisement for soliciting deposits.
- (k) pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

### Share capital and allotment

- (1) Every Nidhi shall issue equity shares of the nominal value of not less than ten rupees each.
- (2) No service charge shall be levied for issue of shares.
- (3) Every Nidhi shall allot to each deposit holder at least a minimum of ten equity shares or shares equivalent to one hundred rupees:

It may be noted that a savings account holder and a recurring deposit account holder shall hold at least one equity share of rupees ten.

### Membership of Nidhi

- (1) A Nidhi shall not admit a body corporate or trust as a member.
- (2) Every Nidhi shall ensure that its membership is not reduced to less than two hundred members at any time.
- (3) A minor shall not be admitted as a member of Nidhi. It may be noted that deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.

### Branches of Nidhi

- (1) A Nidhi may open branches, only if it has earned net profits after tax continuously during the preceding three financial years. A Nidhi may open up to three branches within the district.
- (2) If a Nidhi proposes to open more than three branches within the district or any branch outside the district, it shall obtain the prior permission of the Regional Director and an intimation is to be given to the Registrar about opening of every branch within thirty days of such opening.
- (3) Nidhi shall not open branches or collection centres or offices or deposit centres, or by whatever name called outside the State where its registered office is situated.
- (4) Nidhi shall not open branches or collection centres or offices or deposit centres, or by whatever name called unless financial statement and annual return (up to date) are filed with the Registrar.
- (5) A Nidhi shall not close any branch unless it—
  - (a) publishes an advertisement in a newspaper in vernacular language in the place where it carries on business at least thirty days prior to such closure, informing the public about such closure;
  - (b) fixes a copy of such advertisement or a notice informing such closure of the branch on the notice board of Nidhi for a period of at least thirty days from the date on which advertisement

was published under clause (a) ; and

(c) gives an intimation to the Registrar within thirty days of such closure.

### Acceptance of Deposits:

Rule 13 of the Nidhi Rules, 2014 provides that any of the fixed deposits accepted by a Nidhi company shall be for a minimum period of six months and a maximum period of sixty months.

Recurring deposits shall be accepted for a minimum period of twelve months and a maximum period of sixty months. In case of recurring deposits relating to mortgage loans, the maximum period of recurring deposits shall correspond to the repayment period of such loans granted by *Nidhi*.

The maximum balance in a savings deposit account at any given time qualifying for interest shall not exceed one lakh rupees at any point of time and the rate of interest shall not exceed two per cent above the rate of interest payable on savings bank account by nationalised banks.

A *Nidhi* may offer interest on fixed and recurring deposits at a rate not exceeding the maximum rate of interest prescribed by the Reserve Bank of India which the Non-Banking Financial Companies can pay on their public deposits.

A fixed deposit account or a recurring deposit account shall be foreclosed by the depositor subject to the following conditions, namely:—

- (a) *Nidhi* shall not repay any deposit within a period of three months from the date of its acceptance;
- (b) where at the request of the depositor, a *Nidhi* repays any deposit after a period of three months, the depositor shall not be entitled to any interest up to six months from the date of deposit;
- (c) where at the request of the depositor, a *Nidhi* makes repayment of a deposit before the expiry of the period for which such deposit was accepted by *Nidhi*, the rate of interest payable by *Nidhi* on such deposit shall be reduced by two per cent from the rate which *Nidhi* would have ordinarily paid, had the deposit been accepted for the period for which such deposit had run. It may be noted that in the event of death of a depositor, the deposit may be repaid prematurely to the surviving depositor or depositors in the case of joint holding with survivor clause, or to the nominee or to legal heir with interest up to the date of repayment at the rate which the company would have ordinarily paid, had such deposit been accepted for the period for which such deposit had run.

### Un-encumbered term deposits by Nidhi

Under Rule 14 of the Nidhi Rules, 2014, every *Nidhi* shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month. In cases of unforeseen commitments, temporary withdrawal may be permitted with the prior approval of the Regional Director for the purpose of repayment to depositors, subject to such conditions and time limit which may be specified by the Regional Director to ensure restoration of the prescribed limit of ten per cent.

### Loans by Nidhi

According to Rule 15 A *Nidhi* shall provide loans only to its members. The loans given by a *Nidhi* to a member shall be subject to the following limits, namely:—

- (a) two lakh rupees, where the total amount of deposits of such *Nidhi* from its members is less than two crore rupees;
- (b) seven lakh fifty thousand rupees, where the total amount of deposits of such *Nidhi* from its members is more than two crore rupees but less than twenty crore rupees;

- (c) twelve lakh rupees, where the total amount of deposits of such *Nidhi* from its members is more than twenty crore rupees but less than fifty crore rupees; and
- (d) fifteen lakh rupees, where the total amount of deposits of such *Nidhi* from its members is more than fifty crore rupees:

Where a *Nidhi* has not made profits continuously in the three preceding financial years, it shall not make any fresh loans exceeding fifty per cent of the maximum amounts of loans specified in clauses (a), (b), (c) or (d). A member shall not be eligible for any further loan if he has borrowed any earlier loan from the *Nidhi* and has defaulted in repayment of such loan.

The amount of deposits shall be calculated on the basis of the last audited annual financial statements.

A *Nidhi* shall give loans to its members only against the following securities, namely:—

- (a) gold, silver and jewellery, and the re-payment period of such loan shall not exceed one year.
- (b) immovable property and, the total loans against immovable property [excluding mortgage loans granted on the security of property by registered mortgage, being a registered mortgage under section 69 of the Transfer of Property Act, 1882 (IV of 1882)] shall not exceed fifty per cent of the overall loan outstanding on the date of approval by the board, the individual loan shall not exceed fifty per cent of the value of property offered as security and the period of repayment of such loan shall not exceed seven years.
- (c) fixed deposit receipts, National Savings Certificates, other Government Securities and insurance policies. It may be noted that such securities duly discharged shall be pledged with *Nidhi* and the maturity date of such securities shall not fall beyond the loan period or one year whichever is earlier and in the case of loan against fixed deposits, the period of loan shall not exceed the unexpired period of the fixed deposits.

#### **Rate of interest on any loan given by a *Nidhi***

The rate of interest to be charged on any loan given by a *Nidhi* shall not exceed seven and half per cent above the highest rate of interest offered on deposits by *Nidhi* and shall be calculated on reducing balance method. *Nidhi* shall charge the same rate of interest on the borrowers in respect of the same class of loans and the rates of interest of all classes of loans shall be prominently displayed on the notice board at the registered office and each branch office of *Nidhi*.

#### **Directors in a *Nidhi* Company**

The Director shall be a member of *Nidhi*. The Director of a *Nidhi* shall hold office for a term up to ten consecutive years on the Board of *Nidhi*. The Director shall be eligible for re-appointment only after the expiration of two years of ceasing to be a Director.

Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.

The person to be appointed as a Director shall comply with the requirements Director Identification Number.

A person shall not be eligible for appointment as a director of a *Nidhi*, if —

- (a) he is of unsound mind and stands so declared by a competent court;
- (b) he is an undischarged insolvent;
- (c) he has applied to be adjudicated as an insolvent and his application is pending;
- (d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence. Provided that if a person has been

convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

- (e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;
- (f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;
- (g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

No person who is or has been a director of a Nidhi which

- (a) has not filed financial statements or annual returns for any continuous period of three financial years; or
- (b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

### **Dividend**

Under Rule 18 of Nidhi Rules, a *Nidhi* shall not declare dividend exceeding twenty five per cent or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions, namely:—

- (a) an equal amount is transferred to General Reserve;
- (b) there has been no default in repayment of matured deposits and interest; and
- (c) it has complied with all the rules as applicable to *Nidhis*.

### **Appointment of Auditor**

Nidhi shall not appoint or re-appoint an individual as auditor for more than one term of five consecutive years and Nidhi shall not appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years.

It may be noted that an auditor (whether an individual or an audit firm) shall be eligible for subsequent appointment after the expiration of two years from the completion of his or its term. Further, in case of an auditor (whether an individual or audit firm), the period for which he or it has been holding office as auditor prior to the commencement of these rules shall be taken into account in calculating the period of five consecutive years or ten consecutive years, as the case may be.

### **Auditor's certificate**

The Auditor of the company shall furnish a certificate every year to the effect that the company has complied with all the provisions contained in the rules and such certificate shall be annexed to the audit report and in case of non-compliance, he shall specifically state the rules which have not been complied with.

### **Filing of half yearly return**

As per Rule 21 of the Nidhi Rules, 2014, every Nidhi company required file half yearly return with the Registrar in Form NDH-3 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within thirty days from the conclusion of each half year duly certified by a *company secretary in practice* or chartered accountant in practice or cost accountant in practice.

### Power of Register to enforce compliance

As per Rule 23 of the Nidhi Rules, 2014, the Registrar of companies may call for such information or returns from *Nidhi* as he deems necessary and may engage the services of chartered accountants, *company secretaries in practice*, cost accountants, or any firm thereof from time to time for assisting him in the discharge of his duties.

Further, In respect of any *Nidhi* which has violated these rules or has failed to function in terms of the Memorandum and Articles of Association, the concerned Regional Director may appoint a Special Officer to take over the management of *Nidhi* and such Special Officer shall function as per the guidelines given by such Regional Director:

### Certain provisions of RBI Act not applied to Notified NBFCs. -

Reserve Bank of India issued Master Circular dated 1<sup>st</sup> July, 2014, pertaining to exemptions from the provisions of RBI Act, 1934 provides that the provisions of Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 shall not apply to any non-banking financial company Notified under Section 620A of the Companies Act, 1956, known as Nidhi Companies; and the provisions contained in Non-Banking Financial Companies Acceptance of Company; Public Deposits (Reserve Bank) Directions, 1998 shall not apply to a Mutual Benefit Financial Company or a Mutual Benefit company provided that the application of Mutual Benefit Company is not rejected by Government of India under the provisions of the Companies Act, 1956.

The Central Government has been empowered under section 462 (1), to issue in public interest, by notification, directing that any of the provisions of Companies Act, 2013 shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification. In this context the Central Government vide notification no. 463(E) dated 5th June, 2015 directed that respective sections of the Companies Act, 2013 shall not apply or shall apply with certain exceptions, modification and adaptations to Government companies. A brief analysis of these exemptions is given hereunder.

### Exceptions, modification and adaptations to Nidhi Companies

Sr. No.	Chapter/Section Number/ Sub-section(s) in the Companies Act, 2013	Exceptions/Modifications/Adaptations
1	Chapter II Section 20(2)	Incorporation of Company Shall apply subject to the modification that in the case of a Nidhi, the document may be served only on members who hold shares of more than one thousand rupees in face value or more than one per cent of the total paid-up share capital of the Nidhi's whichever is less. For other shareholders, document may be served by a public notice in newspaper circulated in the district where the Registered Office of the Nidhi is situated; and publication of the same on the notice board of the Nidhi. Note: Section 20 deals with service of documents.
2	Chapter III Section 42 except sub-section(1), explanation (II) to sub-section (2), sub-sections(4), (6), (8) (9)and (10)	Prospectus and Allotment of Securities Shall not apply. Note: Provisions of Section 42(2) except for explanation II, Section 42(3), Section 42(5), Section 42(7) shall not apply to Nidhi companies. Accordingly provision such as recording of

		names of proposed allottees prior to invitation to subscribe, restrictions on fresh offer, restrictions on payment of subscription money through cash etc. shall not apply to Nidhi companies.
3	Chapter IV Section 47(1)(b)	Share Capital & Debenture Shall apply, subject to the modification that no member shall exercise voting rights on poll in excess of five per cent of total voting rights of equity shareholders. <i>Note:</i> Section 47(1)(b) deals with voting right on a poll to be in proportion with the paid-up share capital held. In Nidhi companies it shall apply, subject to the modification that no member shall exercise voting rights on poll in excess of five per cent of total voting rights of equity shareholders.
4	Section 62	Shall not apply. <i>Note:</i> Section 62 relates to further issue of share capital. Section 62 is not applicable to Nidhi companies.
5	Section 67(1)	Shall not apply, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under section 66 of the Companies Act, 2013. <i>Note:</i> Section 67(1) states that no company limited by shares or by guarantee and having a share capital shall have power to buy its own shares unless the consequent reduction of share capital is effected under the provisions of the Act. It shall not apply to Nidhi companies when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under section 66 of the Companies Act, 2013.
6	Chapter VIII Section 123(5)	Declaration and payment of dividend Shall apply, subject to the modification that any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend. <i>Note:</i> Section 123(5) states that no dividend shall be paid by a company in respect of any shares therein except to the registered shareholder of such share or his order or to his banker and shall not be payable except in cash. These provisions shall apply subject to the modification that any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.
7	Section 127	Shall apply, subject to the modification that where the dividend payable to a member is one hundred rupees or less, it shall be sufficient compliance of the provisions of the section, if the declaration of dividend is announced in the local language in one local news paper of wide circulation and announcement of the said declaration is also displayed on the notice board of the

		<p>Nidhis for at least three months.</p> <p>Descriptive note:</p> <p>Section 127 deals with punishment for failure to distribute dividend. However for Nidhi companies, where the dividend payable to a member is one hundred rupees or less, it shall be sufficient compliance of the provisions of the section, if the declaration of dividend is announced in the local language in one local news paper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhis for at least three months.</p>
8	Chapter IX Section 136(1)	<p>Accounts of Companies</p> <p>Shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by Public notice in newspaper circulated in the district in which the Registered Office of the Nidhi is situated stating the date, time and venue of Annual General Meeting and the financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy.</p> <p>Note: Section 136(1) deals with the right of the members to copies of audited financial statement. In case of Nidhi companies, for members not holding individually or jointly shares of more than one thousand rupees in face value or more than one per cent of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by Public notice as prescribed above.</p>
9	Chapter XI Section 160	<p>Appointment and Qualification of Director</p> <p>In sub-section (1), for the words "one lakh rupees", the words "ten thousand rupees" shall be substituted.</p> <p>Note: Section 160(1) requires a deposit of ₹ 1 lakh for nomination of a director. For Nidhi companies such deposit is Rs 10,000/-</p>
10	Chapter XII Section 185	<p>Meeting of Board and Its Power</p> <p>Shall not apply, provided the loan is given to a director or his relative in their capacity as members and such transaction is disclosed in the annual accounts by a note.</p> <p>Note: Section 185 prohibits loans to directors with some exceptions. However, it shall not apply to Nidhi companies, provided the loan is given to a director or his relative in their</p>

		capacity as members and such transaction is disclosed in the annual accounts by a note.
11	Chapter XIII Second proviso to sub-section (1) of section 197	<p>Appointment and remuneration of Managerial Person</p> <p>Shall apply with the modification that the remuneration of a director who is neither managing director nor whole time director or manager for performing special services to the Nidhis specified in the articles of association may be paid by way of monthly payment subject to the approval of the company in general meeting and also to the provisions of section 197 :</p> <p>Provided that no approval of the company in general meeting shall be required where,-</p> <p>(a) a Nidhi does not have a managing director or a whole-time director or a manager;</p> <p>(b) the remuneration payable during a financial year to all the directors of the Nidhi does not exceed ten per cent of the net profits of such Nidhi or fifteen lakh rupees, whichever is less; and</p> <p>(c) a remuneration payable under clause (b) is approved by a special resolution passed in this behalf by the Nidhi.</p> <p><i>Note:</i> Section 197 deals with overall maximum managerial remuneration and managerial remuneration in case absence or inadequacy of profits. Second proviso to Section 197(1) limits the remuneration payable to directors who are neither managing directors nor whole-time directors to one percent of the net profits of the company, if there is a managing or whole-time director or manager; three percent of the net profits in any other case. However, Nidhi companies are allowed to pay remuneration to directors who are neither managing directors nor whole-time directors, for performing special services subject to conditions as laid down.</p>
12	Chapter XXIV Section 403	<p>Registration offices and Fees</p> <p>Shall apply, with the modification that the filing fees in respect of every return of allotment under sub-section (9) of section 42 shall be calculated at the rate of one rupee for every one hundred rupees or parts thereof on the face value of the shares included in the return but shall not exceed the amount of normal filing fee payable.</p> <p><i>Note:</i> Section 403 deals with filing fee. For Nidhi companies it shall apply with the modification that the filing fees in respect of every return of allotment under sub-section (9) of section 42 shall be calculated at the rate of one rupee for every one hundred rupees or parts thereof on the face value of the shares included in the return but shall not exceed the amount of normal filing fee payable.</p>



## DORMANT COMPANIES

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

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

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

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

As per section 455(2), the Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate in form MSC-1.

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

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

A dormant company shall have a minimum of three directors in case of public company and two in case of private company and one in case of One Person Company. The dormant company shall have to file a Return of Dormant company annually, *inter alia*, indicating financial portions duly by chartered accountant in practice alongwith prescribed annual fee within thirty days from the end of each financial year. The provisions relating to rotation of auditor do not apply to a dormant company.

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

### Privileges of a Dormant Company

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

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

## PUBLIC FINANCIAL INSTITUTIONS

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

- (i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance

Corporation Act, 1956;

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

However, no institution shall be so notified unless—

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

## STATUTORY CORPORATIONS

A Company formed under an Act of Parliament or State Legislature is called a Statutory Company/ Corporation. The special enactment contains its constitution, powers and scope of its activities. Change in its structure is possible only by a legislative amendment. Such companies are usually formed to carry on the work of some special public importance and for which the undertaking requires extraordinary powers, sanctions and privileges. A major objective for incorporating statutory corporations is to serve public interest. The need for establishing a statutory corporation is that the State wishes to enter a field of human activity which has traditionally been, or will in normal course be, undertaken by non-official persons and groups. Such companies do not use the word "limited" as part of their names, e.g., Reserve Bank of India, LIC, etc. However, in respect of Insurance, Banking, Electricity Supply or Electricity Generation companies and other companies governed by any special Act which are incorporated and registered under the Companies Act, the provisions of Insurance Act, Banking Regulation Act, Electricity Act and such special Act will prevail, respectively, when they are inconsistent with the provisions of the Companies Act, 2013, applicable generally.

### Principal Characteristics of Statutory Corporations

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

- (i) It is owned by the State.
- (ii) It is created by a special law of Parliament or State Legislature defining its objects, powers and privileges and prescribing the form of management and its relationship with Government departments.
- (iii) Immunity from Parliamentary Scrutiny: A basic and fundamental characteristic of a statutory corporation is its immunity from Parliamentary enquiry into its day-to-day working, as distinct from matters of policy. As stated by Professor Robson, "It has long been recognised that while Parliament has a right to discuss and determine matters of major policy concerning the nationalised industries, the day-to-day conduct of their business by the public corporations should be immune from Parliamentary inquisition".\*
- (iv) Freedom in regard to personnel: Another distinguishing characteristic of a public corporation is that excluding the officers taken from the Government department on deputation, its employees are not

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

civil servants and are not governed by Government regulations in respect of conditions of service. They are also not entitled to the protection of Article 311 of the Constitution of India. This applies to the members of the Board of directors and to other employees. Though the statutory corporations are empowered to regulate their personnel policies, many of them have borrowed wholly or partly civil service rules of promotion, seniority, dismissal etc. The corporations are also required to obtain prior approval of the Government for regulations regarding terms and conditions of service of their employees, and also publish these terms and conditions in the Gazette of India. For example, see Section 49(b) of the LIC Act, Section 45(2)(b) of the Air Corporation Act and Section 37(2) of the International Airports Authority Act. In the case of the ONGC, the Act empowers the Government to make rules even for travelling and daily allowances payable to employees [Section 31(2)(a)].

- (v) A body corporate: Each statutory corporation is a body corporate and can sue and be sued, enter into contracts and acquire property in its own name. For example, the ONGC Act states: "The commission shall be a body corporate, having perpetual succession and a common seal with power to acquire, hold and dispose of property and to contract and shall by the said name sue and be sued" [Section 3(2)]. After laying down the composition of the Commission, the Act states the various functions of the Commission. This is the standard formula for all the statutory corporations. The corporations are given full powers necessary for carrying out their functions, with some exceptions like approval for capital expenditure beyond prescribed limits, and employment of categories of persons.
- (vi) Distinct relation with the Government: The most important provision which regulate the relationship of public corporation and Government is the latter's power to issue directions. The ONGC Act, for e.g. provides, "In the discharge of its functions under this Act, the Commission shall be bound by such directions as the Central Government may, for reasons to be stated in writing give it from time to time" [Section 14(3)]. For the LIC the scope of Government directions is restricted because these should relate to "matter of policy involving public interest" [Section 21 of the LIC Act]. More or less the same approach has been adopted by the Acts of other corporations.
- (vii) Independent Finances: A major plank of autonomy of a statutory corporation is its independence in respect of its finances. Except for appropriations to provide capital or to cover losses, it is usually independent in its finances. It obtains funds by borrowing either from the Government or, in some cases, from the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenue.
- (viii) Commercial Audit: Except in the case of the banks, the financial institutions and the LIC, where chartered accountants are auditors, in all the other corporations, the audit has been entrusted to the Comptroller and Auditor General of India (CAG). In brief, a statutory corporation is ordinarily not subject to the budget, accounting and audit laws and procedure applicable to Government departments.
- (ix) Operation on business principles: In case of some corporations, the Acts lay down that "In the discharge of its functions the corporations shall act as far as may be on business principles" [Section 6(3) of the LIC Act]. Similar provisions exist in the International Airports Authority Act (Section 11), and the Air Corporations Act (Section 9). However, the practical implications of these clauses are not clear.

The Courts in India until *Raman Dayaram Shetty v. International Airport Authority*, A.I.R. 1979 S.C. 1628 considered the statutory character of the corporation as a definitive criterion to identify it with "STATE" within the meaning of Article 12 of the Constitution of India. In the case of *Rajasthan State Electricity Board v. Mohan Lal*, A.I.R. 1967 S.C. 1857, the Electricity Board of Rajasthan constituted under the Electricity Supply Act, 1948 was held to be 'other authority' to which the provisions of Part III (Fundamental Rights) of the

Constitution were applicable. The Supreme Court in this case held that the expression “Other authorities” will include Constitutional or statutory authorities on whom powers are conferred by law.

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

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

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

In *International Airport Authority* case (ibid), the International Airport Authority was held to be “other authority” for the purpose of Article 12 and therefore “State and for that reason was required to observe the principle of equality in its contractual dealings. In *Som Prakash v. Union of India* A.I.R. 1981 S.C. 212, the Bharat Petroleum Corporation was held to be a “State” and therefore amendable to the writ jurisdiction of the Supreme Court for a breach of a fundamental right. In *Ajay Hasia v. Khalid Mujib*, A.I.R. 1981 S.C. 487, the Regional Engineering College, Srinagar, was considered to be “State” and bound by the principles of equality in the matter of selection of students for admission.

### LESSON ROUND-UP

- From the point of view of incorporation, companies can be classified as chartered companies, statutory companies and registered companies. Companies can be categorized as unlimited companies, companies limited by guarantee and companies limited by shares. Companies can also be classified as public companies, private companies, one person companies, small companies, associations not for profit having licence under Section 8 of the Act, Government companies, foreign companies, holding companies, subsidiary companies, associate companies, investment companies and Producer Companies.
- A private company has been defined under Section 2(68) of the Companies Act, 2013 as a company which has a minimum paid-up capital as prescribed, and by its articles restricts the right to transfer its shares, limits the number of its members to two hundred, and prohibits any invitation to the public to subscribe for any securities of the company..
- Where a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included therein under section 2(68), the company shall, as from the date of such alteration, cease to be a private company.
- A private company can be further classified into a One Person Company and Small Company.
- One Person Company” means a company which has only one person as a member.
- ‘Small company” means a company, other than a public company, (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such

higher amount as may be prescribed which shall not be more than twenty crore rupees.

- Above definition of small company is not applicable to a holding company or a subsidiary company; or a company registered under section 8; or a company or body corporate governed by any special Act.
- A public company is a company which (a) is not a private company (b) has a minimum paid-up share capital as may be prescribed.
- A limited company is a company limited by shares or by guarantee. An unlimited company is a company not having any limit on the liability of its members.
- Associations not for profit with limited liability are permitted to be registered under a licence granted by the Central Government without using the word(s) 'Limited' or 'Private Limited'.
- Section 2(45) defines a Government company as a company in which not less than fifty one per cent of the paid-up share capital is held by Central or State Government or governments or partly by one and partly by others.
- Auditor of a government company shall be appointed or reappointed by the Comptroller and Auditor General of India (C.&A.G.).
- Foreign Company means any company or body corporate incorporated outside India which (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner
- Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.
- A Producer Company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. Section 581B(1) of the Companies Act, 1956 provides the objects for which a producer company may be registered under the Act.
- The primary object of Nidhis is to carry on the business of accepting deposits and lending money to member-borrowers only against jewels, etc., and mortgage of property. According to section 406 of Companies Act, 2013 "Nidhi" means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.
- A company formed under an Act of Parliament or State Legislature is called a Statutory Company/ Corporation.
- Principal characteristics of Statutory Corporation are State ownership, creation by special law, immunity from Parliamentary scrutiny, freedom in regard to personnel, body corporate features, distinct relation with the Government, independent finances, commercial audit and operation on business principles.
- Central Government has exempted applicability of various provisions of the Act, to Private Company, Nidhi Company, Section 8 Company and Government Company.

## GLOSSARY

### Chartered Companies

A company created by the grant of a charter by the Crown is called a Chartered Company and is regulated by that Charter.

### Statutory Companies

These are constituted by special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.

### Registered Companies

The companies which are incorporated under the Companies Act, 2013 by getting themselves registered with ROC fall under this category.

<b>Public Company</b>	The company which is not the private company.
<b>Government Company</b>	A Government company as any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments
<b>Investment Company</b>	Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.
<b>Producer Company</b>	A producer company is a body corporate having objects or activities specified in Section 581B of Companies Act, 1956 and which is registered as such under the provisions of the Act.

### SELF-TEST QUESTIONS

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

1. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
2. Define a private company and state the exemptions which it enjoys under the Companies Act, 2013.
3. Discuss in brief disadvantages and obligations of a private company.
4. Define a public company and distinguish it from a private company.
5. State the consequences in each of the following cases giving reasons for your answers:
  - (a) A Private Company has 210 members in total of which 10 are the employees of the company. 5 of these employees leave the employment of the company.
  - (b) A private firm has 20 partners, including a private company which is having 30 shareholders.
6. What is a Government Company? Summarise the special provisions of the Companies Act relating to Government Companies.
7. Write short notes on:
  - (a) Holding and Subsidiary companies.
  - (b) Associate Companies
  - (c) Investment Companies
  - (d) Finance Companies.
  - (e) Unlimited Companies.
  - (f) Small Companies
  - (g) One Person Companies
  - (h) Nidhi Companies
8. Discuss in brief the law relating to statutory corporations.
9. What is a foreign company? Summarise the provisions of the Companies Act relating to foreign companies.

# Lesson 3

## Promotion and Incorporation of Companies

### **LESSON OUTLINE**

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

### **LEARNING OBJECTIVES**

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

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

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

## A. PROMOTERS

### DEFINITION OF THE WORD PROMOTER

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

"Promoter" means a person—

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

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

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

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

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

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

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

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

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

#### CASE LAW

It was held in *Twycross v. Grant*, (1877) 2. C.P.D. 469 that promoter is "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose".

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



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

In *Phosphate Sewage Co. v. Hartmount* (1876) 5 Ch.D 394/ *Official Receiver and Liquidator of Jubilee Cotton Mills Ltd. v. Lewis*(1924) AC 958 (HL), Promoter is a person who as principle procures or aids in procuring the incorporation of a company.

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

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: False**

## PROMOTERS' CONTRACT — RATIFICATION THEREOF

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

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

## CASE LAW

In *D.R. Patil v. A.S. Dimilov* AIR 1961 MP 4 AT 5, it was held that a promoter is personally liable to third

parties upon all contracts made on behalf of the intended company, until with their consent, the company takes over this liability.

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

## LEGAL POSITION OF A PROMOTER

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

## CASE LAW

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

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

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

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

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

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

## DUTIES OF A PROMOTER

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

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

In the case of default in complying with above provisions, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to 50,000 rupees or

five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more. [Sub-section (5) of Section 102]

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

### CASE LAW

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

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

### CASE LAW

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

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

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

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

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

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

(e) As per section 167(3), where all the directors of a company vacate their offices under any of the

disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

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

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

### **Promoter's duties under the Indian Contract Act**

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

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

### **Termination of Promoters' Duties**

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

## **REMEDIES AVAILABLE TO THE COMPANY AGAINST THE PROMOTER**

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

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

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

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

This may happen in any of the following circumstances:

- (a) Where the promoter bought property with a view to sell it to the company which he intends to promote, he occupies fiduciary position *vis-a-vis* the company. He must disclose all the facts to

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\* Provision yet to be notified.

the company.

- (b) Where the promoter resells property to the company at an increased price, the property which he purchased after he has commenced to act in the capacity of a promoter, he cannot retain the profit which he has not disclosed to the company.
  - (c) Where a person is a promoter for acquiring the property for the company, the rules of agency will apply, so that any profit he makes will belong to the company.
3. Where, the promoter bought the property with a view to sell it to the company he promotes, the company may either—
- (a) rescind the contract and if he has made a profit on some ancillary transaction that may also be recovered; or
  - (b) retain the property, paying no more for it than what the promoter has paid, depriving him of his profit; or
  - (c) where the above remedies would be inappropriate, such as when the property has been altered so as to render rescission impossible and the promoter has already received his inflated price, the company may sue him for misfeasance (breach of duty to disclose). The measure of damages will be the difference between the market value of the property and the contract price.

## LIABILITIES OF PROMOTERS

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

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

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

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

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

*4. Punishment for fraudulently inducing persons to invest money:-* As per section 36, any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into, (a)

any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or (b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or (c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution, shall be liable for punishment for fraud under section 447.

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

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

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

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

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

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

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

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

- (4) He may, bring an action for damages against the directors and other persons responsible for failure to disclose matters in a prospectus.
- (5) He may, in respect of any misleading statement or the inclusion or omission of any matter in the prospectus, bring an action against directors or those who are responsible for the prospectus.

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

10. *Liability during Revival and Rehabilitation*: The liability of promoters is now dealt under Insolvency and Bankruptcy Code, 2016.

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

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

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

**Liability U/s 447 of the Companies Act, 2013**: Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud :

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. Explanation.—For the purposes of this section— (i) “fraud” in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss; (ii) “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled; (iii) “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

## RIGHTS OF PROMOTERS

### Right to receive Preliminary Expenses

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

The promoters are entitled to receive all the expenses incurred for in setting up and registering the company,

from Board of Directors. The articles will have provision for payment of preliminary expenses to the promoters. The company may pay the expenses to the promoters even after its formation, but such payments should not be *Ultra Vires* the articles of the company. The Articles may have provision regarding payment of fixed sum to the promoters.

### Right to recover proportionate amount from the Co-promoters

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

## B. FORMATION OF COMPANIES

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

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

## INCORPORATION OF COMPANIES - PROCEDURAL ASPECTS

### (a) Application for Availability of Name of company

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

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

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

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

- (a) be identical with or resemble too nearly to the name of an existing company registered under this



- Act or any previous company law; or
- (b) be such that its use by the company—
- (i) will constitute an offence under any law for the time being in force; or
  - (ii) is undesirable in the opinion of the Central Government.

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

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

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

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

Section 4(5)(ii) lays down that where after reservation of name under clause (i), it is found that name was applied by furnishing wrong or incorrect information, then,— (a) if the company has not been incorporated, the reserved name shall be cancelled and the person making application under sub-section (4) shall be liable to a penalty which may extend to one lakh rupees; (b) if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard— (i) either direct the company to change its name within a period of three months, after passing an ordinary resolution; (ii) take action for striking off the name of the company from the register of companies; or (iii) make a petition for winding up of the company

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

## REVIEW QUESTIONS



### Choose the correct answer

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

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

**Correct answer: (b)**

## **(b) Preparation of Memorandum and Articles of Association**

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

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

- (a) the name of the company with the last word “Limited” in the case of a public limited company, or the last words “Private Limited” in the case of a private limited company. (This clause does not apply to a Section 8 Company);
- (b) the State in which the registered office of the company is to be situated;
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;
- (d) the liability of members of the company, whether limited or unlimited, and also state,— (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute— (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
- (e) in the case of a company having a share capital,— (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;
- (f) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

As per Section 4(6), the memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

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

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

## **FILING OF DOCUMENTS WITH REGISTRAR OF COMPANIES**

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

- (a) Application for Incorporation of Companies: Rule 12 of Companies (Incorporation) Rules, 2014 states that an application for incorporation shall be filed with ROC within whose jurisdiction the registered office of the company is proposed to be situated, in Form No. INC-7 (Part-I company and company with more than seven subsidiaries) and Form No. INC-32 (SPICe) in case of other companies.)

An appreciable step is taken by Ministry of Corporate Affairs by introducing E-Form INC-32 under SPICe scheme vide MCA's notification dated 01/10/2016 notified Companies (Incorporation) Fourth Amendment

Rules, 2016. SPICE means Simplified Proforma for Incorporating Company Electronically. Through this notification, MCA has notified simplified integrated process for incorporating a company in E-form INC-32 alongwith Memorandum of Association in E-form INC-33 and Articles of Association in E-form INC-34. Hence, through this initiative, MCA has simplified the procedure for incorporation by introducing filing of pre-drafted Memorandum and Article of Association electronically, which will make lot of work easier for the professionals.

Earlier with effect from 01/05/2015, MCA came with the integrated process of incorporation by filing E-form INC-29. This was a major reform brought by MCA for incorporation of company which require filing of only one E-form i.e. INC-29 as against five forms filed earlier (i.e. DIR-3 for application for obtaining DIN, INC-1 for approving the name of company, INC-7 for registration of company with MOA and AOA, INC-22 for registered office and Form DIR-12 for first directors of company). As the entire process is in single form, correct filing would mean approval in 48 hours.

In continuation of its initiative of providing ease of doing business, MCA has furthermore facilitated the process of incorporation by introducing SPICe E-form INC-32 which provides the same facilities as were provided in Form INC-29 while more facilitating the process by introducing filing of Memorandum and Article of Association electronically. Relative to the old process, it has the potential to save lot of time, if properly implemented.

*SPICe (INC-32)* deals with the single application for reservation of name, incorporation of a new company and/or application for allotment of DIN. This eForm is accompanied by supporting documents including details of Directors & subscribers, MoA and AoA etc. Once the eForm is processed and found complete, company would be registered and CIN would be allocated. Also DIN gets issued to the proposed Directors who do not have a valid DIN. Maximum three Directors are allowed for using this integrated form for filing application of allotment of DIN while incorporating a company.

*Highlights of SPICe E-form INC-32:*

- This form can be filed even after INC-1 for proposal of more than one name.
- MOA and AOA have been provided electronically in E-Form INC-33 and E-Form INC-34.
- Digital Signatures of subscribers and witnesses of MOA and AOA will be affixed.
- Information in Form INC-32 has been increased in comparison to Form INC-29.

### ***Memorandum and Articles of Association of the company duly signed***

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

*Rule 13 of Companies (Incorporation) Rules 2014 states the manner of signing the documents. The same is detailed in chapter 4.*

### **(c) Declaration from professional**

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

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

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

#### **(d) Affidavit from the Subscribers to the Memorandum**

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

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

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

#### **(e) Furnishing verification of Registered Office**

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

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

#### **(f) Particulars of Subscribers**

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

*Rule 16 of Companies (Incorporation) Rules states that*

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

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

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

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

- (m) Proof of Identity:

For Indian Nationals:

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

For Foreign nationals and Non Resident Indians

- Passport

In case the subscriber is already holding DIN and the particulars are up to date and declaration to this effect is given, then proof of residence and identity is not required. Further, it was clarified by MCA vide Circular No. 16/2014 that, a declaration from foreign national in the prescribed format shall be furnished as an attachment of INC-7 (Application for Incorporation), in case if he does not have a PAN.

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

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

- (o) Proof of nationality in case the subscriber is a foreign national.
- (p) If the subscriber is already a director or promoter of a company(s), the particulars relating to
  - (i) Name of the company;
  - (ii) Corporate Identity Number;
  - (iii) Whether interested as a director or promoter;

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

- (a) Corporate Identity Number of the Company or Registration number of the body corporate, if any
- (b) GLN, if any;
- (c) the name of the body corporate
- (d) the registered office address or principal place of business;
- (e) E-mail Id;
- (f) if the body corporate is a company, certified true copy of the board resolution specifying *inter alia* the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed by the

body corporate, and the name, address and designation of the person authorized to subscribe to the Memorandum;

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

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

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

Section 7(1)(g) states that the particulars of the interests of the persons in form MGT 14, mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors in form DIR 2 of the company in such form and manner as may be prescribed.

*Rule 17 of Companies (Incorporation) Rules 2014* states that

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

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

### **(h) Power of Attorney**

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

### **Issue of Certificate of Incorporation by Registrar**

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

From the date of incorporation mentioned in the certificate of incorporation, the entity is formed as a body corporate by the name provided in the MoA, subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, it is capable of exercising all the functions of an incorporated company under Companies Act, 2013 and having perpetual succession and a common seal (if the company has adopted or adopts the same), it has the power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name. (Section 9). The subscribers would become the members of the company.

*(As per the Companies (Amendment) Act, 2015 the mandatory requirement of Common seal has been omitted. The Company may or may not adopt a common seal.)*

### Conclusive Evidence

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

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

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

### Allotment of Corporate identity number

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

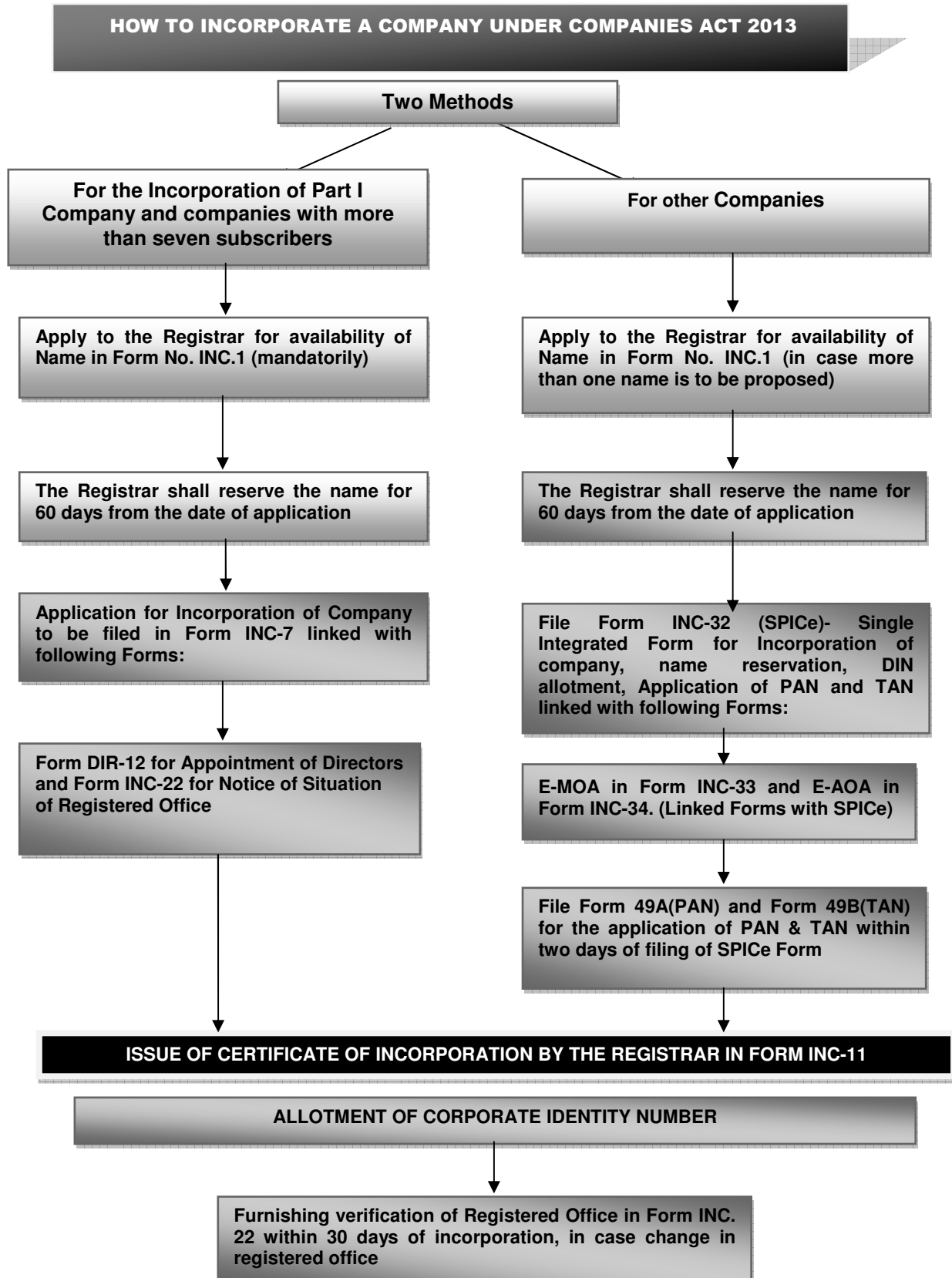
The Certificate of Incorporation issued in **Form INC-11** as per Companies (Incorporation) Rules, 2014 shall also mention permanent account number of the company which is issued by the Income Tax Department.

### Documents of incorporation to be preserved

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

As per Section 12(c) every company shall get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications.

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





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

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

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

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

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

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

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

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

### **PROVISIONS SPECIFICALLY RELATING TO INCORPORATION OF ONE PERSON COMPANY**

#### **Nomination by the subscriber or member of One Person Company**

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

*Rule 4(2) of Companies (Incorporation) Rules, 2014 states that subscriber of memorandum of one person company shall nominate such person in form INC-32 alongwith the nominee's consent obtained in INC-3.*

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

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

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

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

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

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

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

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

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

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

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

**INCORPORATION OF COMPANIES WITH CHARITABLE OBJECTS UNDER SECTION 8**

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

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

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

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

**Rule 20 -License for existing companies.-**

- (1) A limited company registered under this Act or under any previous company law, with any of the objects specified in clause (a) of sub-section (1) of section 8 and the restrictions and prohibitions as mentioned respectively in clause (b) and (c) of that sub-section, and which is desirous of being registered under section 8, without the addition to its name of the word “Limited” or as the case may be, the words “Private Limited”, shall make an application in Form No.INC-12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 to the Registrar for a licence under sub-section (5) of section 8.
- (2) The application under sub-rule (1), shall be accompanied by the following documents, namely:-
  - (a) the memorandum and articles of association of the company;
  - (b) the declaration as given in Form No.INC-14 by an Advocate, a Chartered accountant, Cost Accountant or Company Secretary in Practice, that the memorandum and articles of association have been drawn up in conformity with the provisions of section 8 and rules made there under and that all the requirements of the Act and the rules made there under relating to registration of the company under section 8 and matters incidental or supplemental thereto have been complied with;
  - (c) For each of the two financial years immediately preceding the date of the application, or when the company has functioned only for one financial year, for such year (i) the financial statements, (ii) the Board's reports, and (iii) the audit reports, relating to existing companies;
  - (d) a statement showing in detail the assets (with the values thereof), and the liabilities of the company, as on the date of the application or within thirty days preceding that date;

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

**Rule 8 of Companies (Incorporation) Rules, 2014 (As updated on 26<sup>th</sup> January, 2016)**

- (1) In determining whether a proposed name is identical with another, the differences on account of the following shall be disregarded-
- (a) the words like Private, Pvt, Pvt., (P), Limited, Ltd, Ltd., LLP, Limited Liability Partnership;
  - (b) words appearing at the end of the names – company, and company, co., co, corporation, corp, corpn, corp.;
  - (c) plural version of any of the words appearing in the name;
  - (d) type and case of letters, spacing between letters and punctuation marks;
  - (e) joining words together or separating the words does not make a name distinguishable from a name that uses the similar, separated or joined words;
  - (f) use of a different tense or number of the same word does not distinguish one name from another;
  - (g) using different phonetic spellings or spelling variations shall not be considered as distinguishing one name from another. Illustration (For example, P.Q. Industries limited is existing then P and Q Industries or Pee Que Industries or P n Q Industries or P & Q Industries shall not be allowed and similarly if a name contains numeric character like 3, resemblance shall be checked with 'Three' also;)
  - (h) misspelled words, whether intentionally misspelled or not, do not conflict with the similar, properly spelled words;

- (i) the addition of an internet related designation, such as .com, .net, .edu, .gov, .org, .in does not make a name distinguishable from another, even where (.) is written as 'dot';
  - (j) the addition of words like New, Modern, Nav, Shri, Sri, Shree, Sree, Om, Jai, Sai, The, etc. does not make a name distinguishable from an existing name and similarly, if it is different from the name of the existing company only to the extent of adding the name of the place, the same shall not be allowed; such names may be allowed only if no objection from the existing company by way of Board resolution is submitted;
  - (k) different combination of the same words does not make a name distinguishable from an existing name, e.g., if there is a company in existence by the name of "Builders and Contractors Limited", the name "Contractors and Builders Limited" shall not be allowed unless it is change of name of existing company;
  - (l) if the proposed name is the Hindi or English translation or transliteration of the name of an existing company or limited liability partnership in English or Hindi, as the case may be.
- (2) (a) The name shall be considered undesirable, if-
- (i) it attracts the provisions of section 3 of the Emblems and Names (Prevention and Improper Use) Act, 1950 (12 of 1950);
  - (ii) it includes the name of a registered trade mark or a trade mark which is subject of an application for registration under the Trade Marks Act, 1999 and the rules framed thereunder, unless the consent of the owner or applicant for registration, of the trade mark, as the case may be, has been obtained and produced by the promoters;
  - (iii) it includes any word or words which are offensive to any section of the people;
- (b) The name shall also be considered undesirable, if-
- (i) the proposed name is identical with or too nearly resembles the name of a limited liability partnership;
  - (ii) the company's main business is financing, leasing, chit fund, investments, securities or combination thereof, such name shall not be allowed unless the name is indicative of such related financial activities, viz., Chit Fund or Investment or Loan, etc.;
  - (iii) it resembles closely the popular or abbreviated description of an existing company or limited liability partnership;
  - (iv) the proposed name is identical with or too nearly resembles the name of a company or limited liability partnership incorporated outside India and reserved by such company or limited liability partnership with the Registrar:  
  
Provided that if a foreign company is incorporating its subsidiary company in India, then the original name of the holding company as it is may be allowed with the addition of word India or name of any Indian state or city, if otherwise available;
  - (v) any part of the proposed name includes the words indicative of a separate type of business constitution or legal person or any connotation thereof e.g. co-operative, sehkari, trust, LLP, partnership, society, proprietor, HUF, firm, INC., PLC, GMBH, SA, PTE, SDN, AG etc.;

*Explanation.-* For the purposes of this sub-clause, it is hereby clarified that the name including

phrase 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT):

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

- (vi) the proposed name contains the words 'British India';
- (vii) the proposed name implies association or connection with embassy or consulate or a foreign government;
- (viii) the proposed name includes or implies association or connection with or patronage of a national hero or any person held in high esteem or important personages who occupied or are occupying important positions in Government;
- (ix) the proposed name is identical to the name of a company dissolved as a result of liquidation proceeding and a period of two years have not elapsed from the date of such dissolution:

Provided that if the proposed name is identical with the name of a company which is struck off in pursuance of action under Section 248 of Companies Act, 2013, then the same shall not be allowed before the expiry of twenty years from the publication in the Official Gazette being so struck off;

- (x) it is identical with or too nearly resembles the name of a limited liability partnership in liquidation or the name of a limited liability partnership which is struck off up to a period of five years;
- (xi) the proposed name include words such as 'Insurance', 'Bank', 'Stock Exchange', 'Venture Capital', 'Asset Management', 'Nidhi', 'Mutual fund' etc., unless a declaration is submitted by the applicant that the requirements mandated by the respective regulator, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;
- (xii) the proposed name includes the word "State", the same shall be allowed only in case the company is a government company;
- (xiii) the proposed name is containing only the name of a continent, country, state, city such as Asia limited, Germany Limited, Haryana Limited, Mysore Limited;
- (xiv) the name is only a general one, like Cotton Textile Mills Ltd. or Silk Manufacturing Ltd., and not Lakshmi Silk Manufacturing Co. Ltd;
- (xv) the proposed name includes name of any foreign country or any city in a foreign country, the same shall be allowed if the applicant produces any proof of significance of business relations with such foreign country like Memorandum of Understanding with a company of such country.

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

(4) The following words and combinations thereof shall not be used in the name of a company in English or any of the languages depicting the same meaning unless the previous approval of the Central Government

has been obtained for the use of any such word or expression-

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

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

(8) The names released on change of name by any company shall remain in data base and shall not be

allowed to be taken by any other company including the group company of the company who has changed the name for a period of three years from the date of change subject to specific direction from the competent authority in the course of compromise, arrangement and amalgamation.

### LESSON ROUND-UP

- Promoters are the persons who conceive the idea of forming a company, and take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire the business or property which it is to manage.
- A promoter is neither an agent of, nor a trustee for the company. But he occupies a fiduciary position in relation to the company.
- A promoter is not forbidden to make profit but he should not make any secret profit.
- Disclosure by promoters to the company should be through the medium of the Board of Directors.
- Disclosures of sources of promoter's contribution have to be made in the prospectus.
- Civil as well as criminal liability may be imposed on a promoter for any misleading statement in the prospectus if loss or damage has been sustained by a person who has subscribed for any securities of the company on the faith of the prospectus.
- A promoter has no legal right to claim promotional expenses for his services unless there is a valid contract.
- The first few steps to be taken by a promoter in incorporating a company are to apply for availability of name of company, prepare the memorandum and articles of association and get them vetted, printed, stamped and signed. The promoter should then execute power of attorney and file additional documents as required under section 7. He should then file statutory declaration and pay the registration fees.
- The Registrar on the basis of documents and information filed above shall register all those documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.
- The certificate of incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein.
- Any person who furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, shall be punishable for fraud under section 447. In such a case, the Tribunal may also on an application made to it pass suitable orders.

### GLOSSARY

<b>Prospectus</b>	Any document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any securities of a body corporate.
<b>Preliminary Expenses</b>	The expenses incurred at the time of incorporation of a company.
<b>Certificate of Incorporation</b>	A certificate issued by the Registrar of Companies of a State indicating that a company's memorandum of association and articles of association have been accepted for filing and that the company is incorporated.
<b>Remuneration</b>	It is a reward for the efforts in employment.







# Lesson 4

## Memorandum of Association and Articles of Association

### LESSON OUTLINE

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

### LEARNING OBJECTIVES

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

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

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

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

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

**– Lord Macmillan**

## MEMORANDUM OF ASSOCIATION

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

The first step in the formation of a company is to prepare a document called the memorandum of association. In fact memorandum is one of the most essential pre-requisites for incorporating any form of company under the Companies Act, 2013 (hereinafter referred to as 'Act'). This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

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

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

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

## CASE LAW

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

## FORM OF MEMORANDUM OF ASSOCIATION

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

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

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

## CONTENTS OF MEMORANDUM

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

- (a) the name of the company with “Limited” as its last word in the case of a public company; and “Private Limited” as its last words in the case of a private company; (*Name Clause*)

*This shall not apply in case of companies registered under section 8.*

*Similarly, in case of government companies the name of the company shall end with the words “Limited”. This is as per the exemptions to Government Companies under Section 462 of Companies Act, 2013 vide notification dated June 5, 2013.*

- (b) the State in which the registered office of the company is to be situated; (*Situation Clause*)
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof; (*objects clause*)

Provided that nothing in this clause shall apply to a company registered under section 8;

- (d) the liability of members of the company, whether limited or unlimited, and also state,—(*Liability Clause*)
  - (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
  - (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute—
    - (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
    - (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
- (e) in the case of a company having a share capital,—(*Capital Clause*)
  - (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the

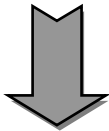
- memorandum agree to subscribe which shall not be less than one share per subscriber; and
- (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;
  - (f) in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

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

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

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

**MEMORANDUM OF ASSOCIATION [SECTION 4 READ WITH SCHEDULE 1]**



<b>NAME CLAUSE</b>	<b>SITUATION CLAUSE</b>	<b>OBJECT CLAUSE</b>	<b>LIABILITY CLAUSE</b>	<b>CAPITAL CLAUSE</b>	<b>SUBSCRIPTION CLAUSE (STATED IN SCHEDULE 1)</b>
Name of the company should indicate whether the company is private or public. No undesirable name as specified in Rule 8 of Companies (Incorporation) Rules, 2014. No identical name that resembles the name of an existing company.	This specifies the state in which the registered office is situated. Companies are required to have registered office within 15 days of its incorporation. Registrar to be intimated about the details of registered office within 30 days of incorporation or 15 days of change if any as the case may be in Form INC-22.	Memorandum to state the object of the company. The bifurcation of main, ancillary and other objects as required under Companies Act 1956 has been dispensed with in Companies Act, 2013.	This states that liability of the members is limited or unlimited. In case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them (including premium if any) as against Companies Act 1956 where in it was limited to the amount unpaid on the face value of the share.	This states the amount of the capital with which the company is registered. The shares into which the capital is divided must be of fixed amount and the no. of shares which the subscribers to the memorandum agree to subscribe to shall not be less than one share. The capital is variously described as “Nominal”, “Authorised”	Subscribers agree to subscribe the prescribed no. of shares stated against their name in the memorandum. The statutory requirements regarding subscription of memorandum are that: ~Each subscriber must take at least 1 share ~Each subscriber must write opposite his name the no. of shares which he agrees to take

**NAME CLAUSE**

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

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

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

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

- (a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or
- (b) such word or expression, as may be prescribed, (See annexure 3.1 of Chapter 3)

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

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

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

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

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

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

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

### CASE LAW

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

The rule will apply also to foreign companies or traders, whose goods are imported into the country, as it was applied in the case of *La Societe Anonyme Panchard at Levevor v. Panchard Levevor Motor Co. Ltd.*, (1901) 2 Ch. 513. The plaintiffs were a French company carrying on business in Paris as motor car manufacturers and were using the name “Panchard” in connection with motors of their manufacture. They objected to the use of the word “Panchard” in the name of the defendant company on the ground that the principal object of the defendants was to injure wrongfully and fraudulently the plaintiffs’ business by passing off their goods as those of the plaintiffs’ manufacture and succeed even though they had no agencies in England but had a market for their goods there.

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

However, any application rejected by Regional Director under Section 22(1) (ii)(b) of the Companies Act, 1956 on the ground that such applications were made after the requisite period of twelve months specified therein, cannot apply afresh under Section 16(1) (a) Companies Act, 2013 as the extinguished limitation cannot be considered to be revived even if no limitation period has been prescribed/ laid down in the said section.

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

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

### CASE LAW

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



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

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

A person cannot be permitted to name a company even after his personal name if that name resembles the name of an existing company. [*K.G. Khosla Compressors Ltd. v. Khosla Extractions Ltd.*, (1986) 1 Comp LJ 211: AIR 1986 Del 181]

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

### **SITUATION CLAUSE**

The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein. According to section 12 of the Act within 15 days of company's incorporation, and at all times thereafter, the company must have a registered office to which all communications and notices may be sent. The company must also furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation in such manner as may be prescribed. (e-form INC-22)

### **Publication of Name and Address of the Company**

According to Section 12(3) every company is required to display its name and address in legible letters in conspicuous position and in all its business letters, bill heads, letter papers. Accordingly, the company shall—

- (a) paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed therefor are not those of the language or of one of the languages in general use in that locality, also in the characters of that language or of one of those languages;
- (b) have its name engraved in legible characters on its seal, if any;
- (c) get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and
- (d) have its name printed on negotiable instruments such as hundies, promissory notes, bills of exchange.

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

Further in case of One Person Company, the words "One Person Company" shall be mentioned in brackets

## 112 EP-CL

below the name of such company, wherever its name is printed, affixed or engraved.

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

The MCA has also clarified that a share certificate is not an official publication of a company within the meaning of Section 147 of the Companies Act, 1956 [This corresponds to Section 12 of the Companies Act, 2013] [Circular No. 3/73/8/10(147)/ 72-CC-V dated 3.2.1973].

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

### OBJECTS CLAUSE

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

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

#### Do you know?

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

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

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

The memorandum of association of a company is its charter defining the objects of its existence and operations. As pointed out in *Cotman v. Brougham* 1918 AC 514, its purpose is 'to enable the shareholders, creditors and those dealing with the company to know what is the permitted range of the enterprise. The objects clause or clauses in the memorandum are to be so construed as to confer on the company all powers reasonably required to the attainment of the objects.' "A memorandum of association like any other document must be read fairly and its importance derived from a reasonable interpretation of the language which it employs" [*Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd.* AC 677: (1931) 1 Com Cases 285: AIR 1931 PC 182; 62 MLJ 163; *Deuchar v. Gas, Light and Coke Co.*, (1925) AC 691]. The natural and

ordinary meaning of the language used in several clauses should be taken into consideration for determining whether a particular transaction does or does not fall within the objects stated in the memorandum [*Bell Houses Ltd. v. City Wall Properties Ltd.* (1966) 36 Com Cases 779: (1966) 2 All ER 674 (CA)].

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

### DOCTRINE OF ULTRA VIRES

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

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

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

### REVIEW QUESTIONS



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

**Answer: No**

### CASE LAW

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

The memorandum of the company in the said case defined its objects thus: "The objects for which the company is established are to make and sell, or lend or hire, railway plants..... to carry on the business of mechanical engineers and general contractors.....".

The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. On subsequent repudiation of this contract by the company on the ground of

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

its being *ultra vires*, Riche brought a case for damages on the ground of breach of contract, as according to him the words “general contractors” in the objects clause gave power to the company to enter into such a contract and, therefore, it was within the powers of the company. More so because the contract was ratified by a majority of shareholders.

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

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

#### CASE LAW

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

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

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

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

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

Further, in the case of *Bell Houses Ltd. v. City Wall Properties Limited* (1966) 36 Com Cases 779, the objects clause included a power to “carry on any other trade or business whatsoever which can, in the opinion of the Board of directors, be advantageously carried on by the company.” The Court has held the same to be in order.

### **Loans, Borrowings, Guarantees and *Ultra Vires* Rule**

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

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

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

### **Implied Powers**

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

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

### **Powers which are not implied**

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

- (1) acquiring any business similar to the company’s own business. [*Ernest v. Nicholls*, (1857) 6 HLC 40];
- (2) entering into an agreement with other persons or companies for carrying on business in partnership or for sharing profit, joint venture or other arrangements. Very clear powers are necessary to justify such transactions [*Re European Society Arbitration Act* (1878) 8 Ch 679];
- (3) taking shares in other companies having similar objects. [*Re Banned’s Banking Co., ex parte and The Contract Corporation* (1867) 3 Ch. App. 105. *Re William Thomas & Co. Ltd.* (1915) 1 Ch 325];

- (4) taking shares of other companies where such investment authorises the doing indirectly that which will not be *intra vires* if done directly;
- (5) promoting other companies or helping them financially [*Joint Stock Discount Co. v. Brown*, (1869) LR 8 EQ 381];
- (6) a power to sell and dispose of the whole of a company's undertaking;
- (7) a power to use funds for political purposes;
- (8) a power to give gifts and make donations or contribution for charities not relating to the objects stated in the memorandum;
- (9) acting as a surety or as a guarantor.

### Shareholder's right in respect of ultra vires acts

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

### Effects of *ultra vires* Transactions

- (i) *Void ab initio* – The *ultra vires* acts are null and void *ab initio*. The company is not bound by these acts. Even the company cannot sue or be sued upon [*Ashbury Railway Carriage and Iron Company v. Riche*].

*Ultra vires* contracts are *void ab initio* and hence cannot become *intra vires* by reason of estoppel or ratification.

- (ii) *Injunction*: The members can get an injunction to restrain a company wherein *ultra vires* act has been or is about to be undertaken [*Attorney General v. Gr. Eastern Rly. Co.*, (1880) 5 A.C. 473].
- (iii) *Personal liability of Directors*: It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted to purposes alien to the company's memorandum, the directors will be personally liable to replace it. In *Jehangir R. Modi v. Shamji Ladha*, [(1866-67) 4 Bom. HCR (1855)], the Bombay High Court held, "A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit".

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

However, a distinction must be drawn between transactions which are *ultra vires* the company and the transactions which are *ultra vires* the directors. Where the directors exceed their authority the same may be ratified by the general body of the shareholders. Provided the company has the capacity to do that transaction as per its memorandum of association.

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

**REVIEW QUESTIONS**

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

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

- True
- False

**Correct answer: True**

**LIABILITY CLAUSE**

Section 4 sub-section 1(d) of the Act, states that the liability of members of the company is to be specifically mentioned in the MoA. It is provided that the liability of member may either be limited or unlimited, further it shall also state that,—

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

**CAPITAL CLAUSE**

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

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

If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorised to issue capital beyond its authorised/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorised capital, the amount received on excess number of shares should be returned.

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

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

## REVIEW QUESTIONS



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

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

- True
- False

**Correct answer: True**

## DECLARATION FOR SUBSCRIPTION

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

The statutory requirements regarding subscription of memorandum are that:

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

## SIGNING OF MEMORANDUM

### Rule 13 Companies (Incorporation) Rules 2014

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

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

(2) Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.



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

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

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

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

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

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

### Subscription induced by Misrepresentation

A subscriber to the memorandum cannot, after the issue of the certificate of incorporation, repudiate his subscription on the ground that he was induced to sign by misrepresentation [*Re Metal Constituents Ltd., Lord Lurgan's case - Re*, (1902) 1 Ch 707].

### ALTERATION OF MEMORANDUM OF ASSOCIATION

Section 13(1) of the Act provides that save as provided in section 61 (Dealing with power of limited company to alter its share capital), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. The memorandum of association of a company may be altered in the following respects:

- (1) By changing its name [Sections 13(2)].
- (2) By altering it in regard to the State in which the registered office is to be situated [Section 13(4) & (7)].
- (3) By altering its objects [Section 13 (1) & (9)].

- (4) By altering its share capital (Section 61).
- (5) By reorganising its share capital (Sections 230 to 237).
- (6) By reducing its capital (Section 66).

The provisions or conditions of the memorandum of association relating to the name clause, registered office clause, the objects clause, limited liability clause, subscriber's share clause as provided in Section 4 of the Companies Act, 2013 or any other specific provisions contained therein, can be altered by following the prescribed procedure laid down in the Act. Strict compliance of the prescribed procedure is demanded by law. Failure to comply with the express provisions made under the Act for the purpose of alteration of the provisions or conditions contained in the memorandum will be deemed as a nullity.

Further section 13(6) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).

Section 13(10) provides that no alteration made under this section shall have any effect until it has been registered in accordance with the provisions of the said section.

Further, any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void. [Section 13 (11)]

The procedure for the alteration of the compulsory clauses or conditions of the memorandum is discussed in detail in the following paragraphs.

## **ALTERATION OF NAME CLAUSE**

The name of the company can be altered by a special resolution and with the approval of the Central Government in writing. Approval of the Central Government is not required, in case where the change in the name of the company relates to the addition/deletion of the word 'Private' to the name of the company consequent to the conversion of a company into a public company and *vice versa*. [Section 13 (2)]

When any change in the name of a company is made under section 13(2), the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and such change in the name shall be complete and effective only on the issue of such a certificate [Section 13(3)].

According to Rule 29 of Companies (Incorporation) Rules, 2014, the change of name shall not be allowed to a company which has not filed annual returns or financial statements due for filing with the Registrar or which has failed to pay or repay matured deposits or debentures or interest thereon. Provided that the change of name shall be allowed upon filing necessary documents or payment or repayment of matured deposits or debentures or interest thereon as the case may be.

An application shall be filed in Form No. INC-24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No. INC-25 shall be issued to the company consequent upon change of name.

Under Section 16 of the Act, rectification of the name of the company is required to be carried out if, through inadvertence or otherwise, a company (whether on its first registration or on its registration by a new name) is registered by a name which is identical to or too nearly resembles the name of a company already in existence. The rectification of the name must also be carried out if the Central Government so directs at any point of time after the registration of the company. The direction of the Central Government is required to be complied with by the company within a period of 3 months from the date of issue thereof. Further where a

company changes its name or obtains a new name under section 16 (1), it shall within a period of fifteen days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum. Any default in complying with the direction issued by the Central Government would render the company liable for punishment with fine which may extend to one thousand rupees for every day during which default continues and its officers in default shall be liable for fine which shall not be less than five thousand rupees but which may extend to one lakh rupees.

### **Name change requirement under Regulation 45 of SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015**

If the company has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name.

Further, all listed companies which decide to change their names shall be required to comply with the following conditions:

1. A time period of atleast 1 year should have elapsed from the last name change.
2. At least 50% of its total revenue in the preceding 1 year period should have been accounted for by the new activity suggested by the new name, or, the amount invested in the new activity/project (Fixed Assets + Advances + Work in Progress + Inventories + Investments+ Trade Receivables + Cash & Cash equivalents) is at least 50% of the assets of the company. The 'advances' shall include only those extended to contractors and suppliers towards execution of project, specific to new activity as reflected in the new name. To confirm the compliance, the company would have to submit auditor's certificate to the stock exchange.
3. The new name along with the old name shall be disclosed through the web sites of the respective stock exchange/s where the company is listed for a continuous period of one year, from the date of the last name change.

If any listed entity has changed its activities which are not reflected in its name, it shall change its name in line with the activities within a period of six months from the change of activities in compliance of provisions as prescribed in the Companies Act, 2013.

### **EFFECT OF CHANGE**

The change of name shall not affect any rights or obligations of the company, or render defective any legal proceedings by or against it, and any legal proceedings which might have been continued or commenced by or against the company in its former name may be continued by or against the company in its new name.

However, where a company changes its name and the new name has been registered by the Registrar, the commencing of legal proceedings in the former name is not valid [*Malhati Tea Syndicate Ltd. v. Revenue Officer*, (1973) 43 Com Cases 337]. In spite of a change in name the entity of the company continues. The company is not dissolved nor does any new company come into existence. If any legal proceeding is commenced, after change in the name, against the company in its old name, the company should be treated as if it is not in existence. It is not an incurable defect and the plaint can be amended to substitute the new name [*Pioneer Protective Glass Fibre (P) Ltd. v. Fibre Glass Pilkington Ltd.*, (1986) 60 Com Cases 707 (Cal.)].

The courts have held that proceedings commenced by the company in its former name can be continued under its new name [*Solvex Oils and Fertilizers v. Bhandari Cross-Fields (P) Ltd.*, (1978) 48 Com Cases 260 (P & H)].

In *Economic Investment Corporation Ltd. v. CIT (WB)* AIR (1970) 40 Com Cases 1 (Cal.), it was held that by change of name, the constitution of the company is not changed, only the name changes. It is not similar to the reconstitution of a partnership which means creation of a new legal entity altogether.

### **ALTERATION OF REGISTERED OFFICE CLAUSE**

#### ***(a) Change within the local limits of same town***

The change of registered office of the company within the local limits can be implemented by the Board of Directors.

A company by passing Board Resolution can change the situation of its registered office within the limits of same city, town or village. An intimation of the change of registered office and verification of registered address shall be given to the registrar in e-form INC-22, within 15 days of such change.

This does not involve alteration of memorandum.

#### ***(b) Change outside the local limits of any city, town or village***

According to Section 12(5) of the Act except on the authority of a special resolution passed by a company, the registered office of the company shall not be changed,—

- (a) in the case of an existing company, outside the local limits of any city, town or village where such office is situated at the commencement of this Act or where it may be situated later by virtue of a special resolution passed by the company; and
- (b) in the case of any other company, outside the local limits of any city, town or village where such office is first situated or where it may be situated later by virtue of a special resolution passed by the company.

In case the company is eligible for conducting business through postal ballot any change in place of registered office outside the local limits of any city, town or village the same shall be transacted only by means of voting through a Postal Ballot [Rule 22 of Companies (Management and Administration) Rules, 2014.

#### ***(c) Change within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies***

No company shall change the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State unless such change is confirmed by the Regional Director. Proviso to Section 12(5) provides that confirmation by the Regional Director will be necessary for changing registered office of a company from one place to another if the change of registered office is from the jurisdiction of one Registrar to the jurisdiction of another within the same State.

Section 12(6) states that the Regional Director, after hearing the parties shall pass necessary orders within a period of thirty days from the date of the receipt of the application. Thereafter, the company concerned shall file a copy of the said order with the Registrar of Companies (ROC) within a period of sixty days from the date of the confirmation order by Regional Director. The said ROC shall record the ordered changes in its records. The ROC of the state where the registered office of the company was previously situated, shall transfer all the documents and papers to the new ROC.

Rule 28 of Companies (Incorporation) Rules 2014 states that an application seeking confirmation from the Regional Director for shifting the registered office within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies, shall be filed by the company with the Regional Director in **Form No. INC- 23** along with the fee.

The company shall, not less than one month before filing any application with the Regional Director for the change of registered office.-

- (a) publish a notice, at least once in a daily newspaper published in English and in the principal language of that district in which the registered office of the company is situated and circulating in that district; and
- (b) serve individual notice on each debenture holder, depositor and creditor of the company, clearly indicating the matter of application and stating that any person whose interest is likely to be affected by the proposed alteration of the memorandum may intimate his nature of interest and grounds of opposition to the Regional Director with a copy to the company within twenty one days of the date of publication of that notice:
- (c) Additionally, Form no MGT.14 is to be filed with the Registrar towards special resolution.

### **Change of Registered office from one State to another**

The change of registered office from one State to another State involves alteration of memorandum, and the change can be effected by a special resolution of the company which must be confirmed by the Central Government on an application made to it [Section 13(4)].

According to Section 13(1), a company may, by special resolution and after complying with the procedure specified alter the provisions of its memorandum

Further, the alteration of the provisions of the memorandum relating to the change of the place of its registered office from one State to another shall not take effect unless it is confirmed by the Central Government on an application made to it in the prescribed form and manner [Section 13(4)].

The Central Government shall dispose of the application under sub-section (4) within a period of sixty days and before passing its order may satisfy itself that the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company or that a sufficient provision has been made by the company either for the due discharge of all its debts and obligations or that adequate security has been provided for such discharge. [Section 13(5)].

A company shall, in relation to any alteration of its memorandum involving change of registered office from one State to another, file with the Registrar the special resolution passed by it in MGT 14 [Section 13(6)].

Where an alteration of the memorandum results in the shifting of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in INC-22, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration. [Section 13(7)].

### **Rule 30-31 of Companies (Incorporation) Rules 2014**

Rule 30 states that

(1) An application under sub-section (4) of section 13, for the purpose of seeking approval for alteration of memorandum with regard to the change of place of the registered office from one State Government or Union territory to another, shall be filed with the Central Government in **Form No. INC-23** along with the fee and shall be accompanied by the following documents, namely:-

- (a) a copy of the memorandum and articles of association;

**124 EP-CL**

- (b) a copy of the notice convening the general meeting along with relevant Statement;
- (c) a copy of the special resolution sanctioning the alteration by the members of the company;
- (d) a copy of the minutes of the general meeting at which the resolution authorizing such alteration was passed, giving details of the number of votes cast in favor or against the resolution;
- (e) an affidavit verifying the application;
- (f) the list of creditors and debenture holders entitled to object to the application;
- (g) an affidavit verifying the list of creditors;
- (h) the document relating to payment of application fee;
- (i) a copy of board resolution or Power of Attorney or the executed Vakalatnama, as the case may be.
- (j) a copy of the No Objection Certificate from the Reserve Bank of India where the applicant is a registered Non-Banking Financial Company.

(2) There shall be attached to the application, a list of creditors and debenture holders, drawn up to the latest practicable date preceding the date of filing of application by not more than one month, setting forth the following details, namely:-

- (a) the names and address of every creditor and debenture holder of the company;
- (b) the nature and respective amounts due to them in respect of debts, claims or liabilities:

Provided that the applicant company shall file an affidavit, signed by the Company Secretary of the company, if any and not less than two directors of the company, one of whom shall be a managing director, where there is one, to the effect that they have made a full enquiry into the affairs of the company and, having done so, have formed an opinion that the list of creditors is correct, and that the estimated value as given in the list of the debts or claims payable on a contingency or not ascertained are proper estimates of the values of such debts and claims and that there are no other debts of or claims against the company to their knowledge.

(3) There shall also be attached to the application an affidavit from the directors of the company that no employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory

(4) A duly authenticated copy of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of a sum not exceeding ten rupees per page to the company.

(5) There shall also be attached to the application a copy of the acknowledgment of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

(6) The company shall at least fourteen days before the date of hearing-

- (a) advertise the application in the Form No. INC-26 in a vernacular newspaper in the principal vernacular language in the district in which the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district;

- (b) serve, by registered post with acknowledgement due, individual notice(s), to the effect set out in clause (a) on each debenture-holder and creditor of the company; and
- (c) serve, by registered post with acknowledgement due, a notice together with the copy of the application to the Registrar and to the Securities and Exchange Board of India, in the case of listed companies and to the regulatory body, if the company is regulated under any special Act or law for the time being in force.

(7) Where any objection of any person whose interest is likely to be affected by the proposed application has been received by the applicant, it shall serve a copy thereof to the Central Government on or before the date of hearing.

(8) Where no objection has been received from any of the parties, who have been duly served, the application may be put up for orders without hearing.

(9) Before confirming the alteration, the Central Government shall ensure that, with respect to every creditor and debenture holder who, in the opinion of the Central government, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Central government, either his consent to the alteration has been obtained or his debt or claim has been discharged or has determined, or has been secured to the satisfaction of the Central Government.

(10) The Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper:

Provided that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

On completion of such inquiry, inspection or investigation as a consequence of which no prosecution is envisaged or no prosecution is pending, shifting of registered office shall be allowed.

Rule 31. The certified copy of the order of the Central Government, approving the alteration of the memorandum for transfer of registered office of the company from one State to another, shall be filed in Form No.INC-28 along with the fee as with the Registrar of the State within thirty days from the date of receipt of certified copy of the order. Cases under the erstwhile Companies Act 1956

No notice of the petition is required to be served on the State, but in view of the wider language of Section 17 [Corresponds to section 13 of the Companies Act, 2013] Central Government may direct notice to be served on the State if it is of the view that the interest of the State will be affected by the alteration. Where the alteration is affected by changing the registered office from one State to another State, the loss of revenue in one State would be accompanied by increase in revenue in the other and in such a case the interest of a particular State ought not to be considered but it is the interest of the country as a whole which should be considered. The decision to shift the registered office of the company to another state being a domestic matter rests with shareholders and the company is the best judge of how to run its business more economically, efficiently or conveniently, even though it would result in loss of revenue to the State. [*Satyashree Balaji Wires & Cables (P) Ltd.*, In re (2006) 71 CLA 231 (CLB)].

A company was allowed to shift its registered office from Bihar to West Bengal in spite of the fact that Bihar Government had granted lease of land for the company's factory on the condition that it would not shift its registered office. The CLB also held that interest free loans, sales tax, electricity and other subsidies would have no bearing on the shifting [*Usha Beltron Re*, (2000) 27 SCL 124].

### Employees' right to object in case of shifting of registered office from one state to another – Some legal cases

In the case of *Bharat Commerce and Industries Ltd., Re*, (1973) 43 Com Cases 162 (Cal.), it was held that employees' union, which was a registered body and which represented quite a number of the employees at the registered office of the company, would have the legal standing to appear before the court and oppose the application on the ground that their interests are likely to be prejudicially affected if the resolution for shifting the registered office of the company from one state to another is confirmed by the court. However, it was held that the employees' union cannot oppose on the ground that there would be loss of revenue or unemployment in the State or that the meeting at which the special resolution was passed was itself not valid.

Further, in the case of *Metal Box India Ltd. Re*, (2000) 37 CLA 15, it was held that where the shifting of the registered office was in accordance with a scheme approved by the BIFR, it was held that the workers had no right of objection because their continuation in the company's employment was ensured unless, of course, a worker preferred voluntary retirement.

A different dimension to the employees' right can be seen in the case of *Kwality Ice Creams (India) P Ltd., Re*, (2009) 91 SCL 231 : (2009) 148 Com Cases 631 : (2010) 98 CLA 218 (CLB). In that case, the company's petition for shifting its registered office from West Bengal to Delhi was opposed by two employees of the head office on the ground that their action against the company would be prejudiced. The CLB said that the facility for litigation is not a valid ground to stall shifting. There was no restraint order from any Court against the proposed shifting. The Company Law Board allowed shifting subject to the condition that the interest of none of the employees at the registered office would be prejudiced by retrenchment or otherwise.

### REVIEW QUESTIONS



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

Change of the registered office from one city to another within the same State involves alteration of Memorandum.

- True
- False

**Correct answer: False**

### ALTERATION OF OBJECTS CLAUSE OF THE COMPANY

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change its objects by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1). As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13(6)(a).

Consequently pursuant to Section 13(1) a company can change its objects clause by passing a special resolution. Further in case the company is eligible for conducting business through postal ballot any alteration in the objects clause of the Memorandum of Association, shall implement the same through Postal Ballot in terms of section 110.



Further, section 13(8) lays down that a company, which has raised money from public through prospectus and has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

- (i) the details, as may be prescribed, in respect of such resolution shall be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;
- (ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

Also for deleting any portion of the objects clause, the procedure laid down in this section has to be followed.

A company may wish to alter its objects stated in its memorandum due to various reasons e.g. if a company wishes to cut-back i.e. where it feels it has diversified in various directions and that management of the company has become difficult or uneconomical, it may alter its objects to sell or dispose of whole or part of its undertaking(s).

## REGISTRATION OF ALTERATION

Section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar :

- (a) the special resolution passed by the company under section 13(1); and
- (b) the approval of the Central Government under section 13(2), if the alteration involves any change in the name of the company.

The special resolution shall be filed with the Registrar within thirty days of the passing or making thereof in the prescribed manner and payment of prescribed fees within the time specified under section 403.

As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13 (6)(a).

Further section 13(7) provides that where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

The certificate of incorporation shall be conclusive evidence that all the requirements of this Act with respect to the alteration and confirmation thereof have been complied with. The Registrar of the State from which the registered office is transferred will send to the Registrar of the other State all the documents relating to the company registered in his office.

No alteration made under section 13 (i.e., alteration of memorandum) shall have any effect until it has been registered in accordance with the provisions of this section. [Section 13(10)].

The main spirit behind Section 13(7) of the Companies Act, 2013 in regard to the filing of the order

confirming the transfer of the company's registered office from one State to another State with the Registrar of Companies of each State is that the Registrar of Companies from whose State the registered office is transferred should keep the order duly registered in his office as an evidence to such shifting and should transfer all other records of the company to the Registrar of Companies to whose State the Registered Office has been so shifted. The other Registrar of Companies will register the other copy of the order and keep that order with the records transferred to him by his counterpart.

### **ALTERATION OF LIABILITY CLAUSE**

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change the liability clause of its memorandum of association by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).

### **ALTERATION OF CAPITAL CLAUSE**

A limited company having a share capital may make the following types of alterations in its memorandum by an ordinary resolution, if so authorised by its articles, at its general meeting to (Section 61)—

- (i) increase its authorised share capital by such amount as it thinks expedient;

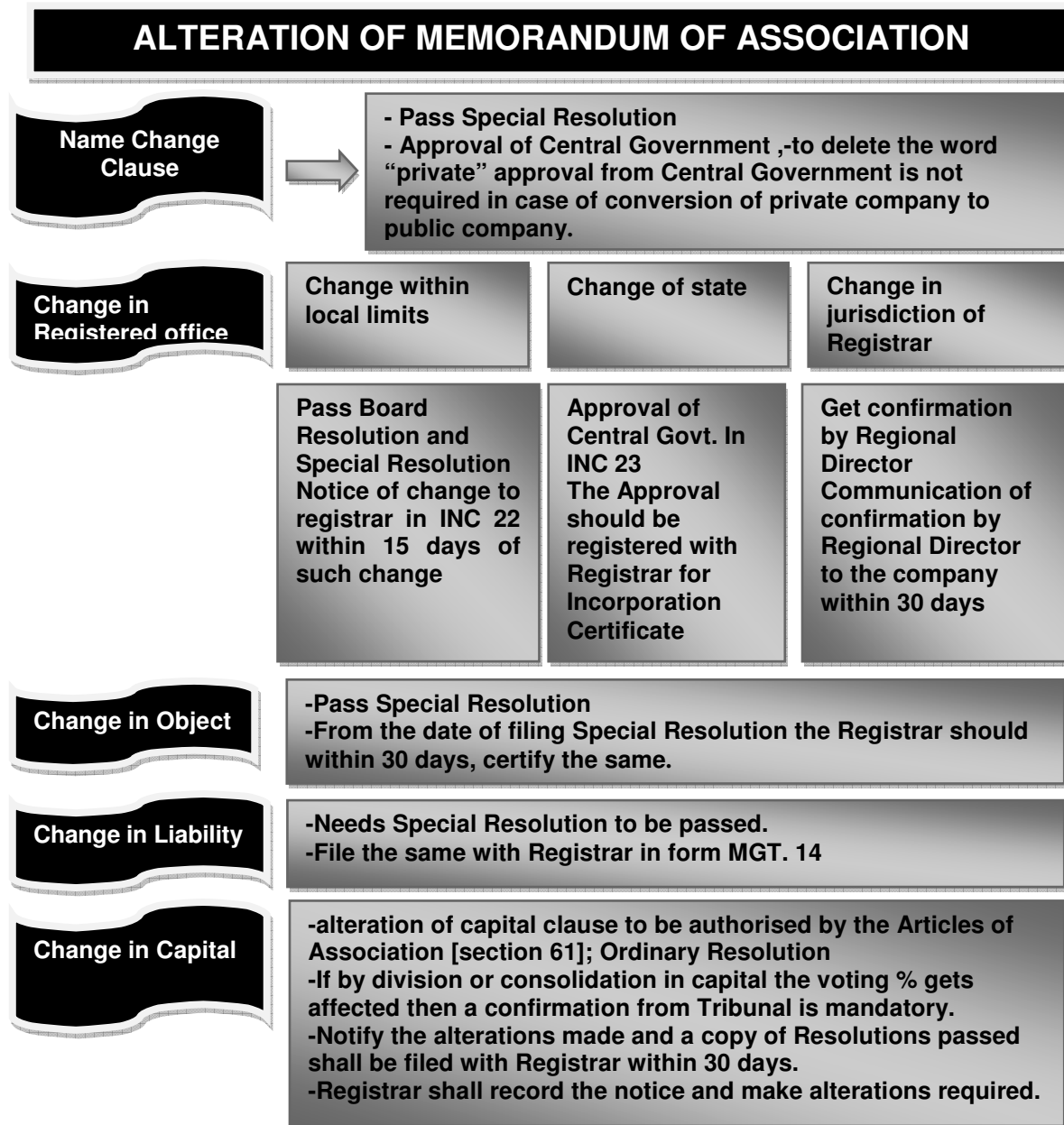
A company may at any time increase its authorised share capital by the alteration of its memorandum. Although, section 61(1) (a) of the Companies Act, 2013 refers to the issue of new shares, it really deals with a case of increase in the authorised share capital, and not increase of the issued share capital. The case of increase of the issued or subscribed capital is dealt with separately by section 62 of the Act.

- (ii) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares;
- (iii) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
- (iv) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that the proportion between the amount paid and unpaid shall remain the same.
- (v) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

All the above alterations do not require the confirmation by the Tribunal except that alteration relating to consolidation and division which results in changes in the voting percentage of shareholders shall not take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

These alterations are, however, required to be notified and a copy of the resolution should be filed with the Registrar within 30 days of the passing of the resolution along with an altered memorandum. [Section 64(1)]

The Registrar shall record the notice and make any alteration which may be necessary in the company's memorandum or articles or both. It must be noted that cancellation of shares in pursuance of section 61(1) does not amount to reduction of share capital.



## ARTICLES OF ASSOCIATION

### NATURE OF ARTICLES

According to Section 2(5) of the Companies Act, 2013, ‘articles’ means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

In terms of section 5(1), the articles of a company shall contain the regulations for management of the company. The articles of association of a company are its bye-laws or rules and regulations that govern the

management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company *inter se*. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1875) L.R. 7 H.L. 653 as follows:

“The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit”.

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members *inter se*. This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal v. The Calcutta Stock Exchange Association Ltd.*, AIR 1971 SC 422, (1971) 41 Com Cases 51]. But the Articles of Association of a company are not ‘law’ and do not have the force of law. In *Kinetic Engineering Ltd. v. Sadhana Gadia*, (1992) 74 Com Cases 82 : (1992) 1 Comp LJ 62 (CLB), the CLB held that if any provision of the articles or the memorandum is contrary to any provisions of any law, it will be invalid in toto.

### **Articles Subordinate to Memorandum**

The articles of a company are subordinate to and subject to the memorandum of association and any clause in the Articles going beyond the memorandum will be *ultra vires*. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit. Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum [*Ashbury v. Watson*, (1885) 30 Ch. D 376 (CA)]. Articles that go beyond the company’s sphere of action are inoperative, and anything done under the authority of such article is *void* and incapable of ratification.

But neither the articles nor the memorandum can authorise the company to do anything so as to contravene any of the provisions of the Act. [See *Re Peveril Gold Mines*, (1989) 1 Ch 122 (CA)].

### **Articles in relation to Memorandum**

The functions of the Articles in relation to the Memorandum have already been summed up in the *Ashbury Railway Carriage case* and even though the articles are subordinate to the memorandum yet if there be any ambiguity in the memorandum, the articles may be used to explain it but not so as to extend the objects. [Re. *South Durham Brewery Company* (1885) 3 Ch. D 261]. The memorandum of a company was not clear as to the classes of shares to be issued by a company but the articles made clear the doubt by giving the power to the company to issue shares of different classes.

The relationship between the two documents was further emphasised in *Guinness v. Land Corporation of*

*Ireland*, (1882) 22 Ch D 349, where it was observed: “The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors, and the outside public, as well as of the shareholders. The articles of association are the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation and the internal regulations of the company are to be construed together... In any case it is, as it seems to me, certain that for anything which the Act of Parliament says shall be in the memorandum you must look at the memorandum alone. If the legislature has said one instrument is to be dominant you cannot turn to another instrument and read it in order to modify the provisions of the dominant instrument”. Where the memorandum clearly establishes the rights of shareholders, a reference in the memorandum to the articles and an ambiguity said to arise from the construction of the articles should not be used to depart from the clear meaning of the memorandum so as to diminish those rights [*Scottish National Trust Co. Ltd.* 1928 SC 499 (Scot); *Kinetic Engineering Ltd. v. Sadhana Gadia*, (1992) 1 Comp LJ 62 (CLB)].

## REVIEW QUESTIONS



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

Regulations provided for in the Articles must not exceed the powers of the company as laid down by its Memorandum.

- True
- False

**Correct answer: True**

## REGISTRATION OF ARTICLES

Section 7(1) provides that at the time of incorporation of a company the company shall file with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

Every type of company whether public or private and whether limited by shares or limited by guarantee having a share capital or not having a share capital or an unlimited liability company must register their articles of association.

Section 5(2) provides that the articles shall also contain such matters, as prescribed in Rule 11 of Companies (Incorporation) Rules, 2014. However, nothing prescribed in this sub-section shall be deemed to prevent a company from including such additional matters in its articles as may be considered necessary for its management. The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company either in totality or otherwise. [Section 5(6)]

A company may adopt all or any of the regulations contained in the model articles applicable to such company. [Section 5(7)]

Section 5(8) provides that in case of any company, which is registered after the commencement of Companies Act 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Therefore in terms of Section 5 of the Companies Act, 2013, a public company limited by shares may at its

option register its articles of association signed by the same subscribers as to the memorandum, or alternatively it may adopt all or any of the regulations contained in Table F of First Schedule of the Act. If articles are not registered, automatically Table F in Schedule I apply, and if registered, Table F in Schedule I apply except in so far as it is excluded or modified by the articles. To avoid any confusion, normally every public company delivers its articles alongwith the memorandum for registration. Further it will be specifically stated therein that Table 'F' will not apply. The articles of a private company must contain the three restrictions as contained in Section 2(68).

A company limited by guarantee having a share capital or a company limited by guarantee not having a share capital or an unlimited company having a share capital or an unlimited company not having a share capital might adopt any of the appropriate regulations of Table G, H, I and J respectively in Schedule I [Section 5(6)].

However nothing in section 5 shall apply to the articles of a company registered under any previous company law unless amended under this Act [Section 5(9)].

## **ENTRENCHMENT PROVISIONS**

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are met or complied with. [Section 5 (3)]

The Companies Act 2013, recognizes an interesting concept of entrenchment. Essentially, the entrenchment provisions allow for certain clauses in the articles to be amended upon satisfaction of certain conditions or restrictions greater than those prescribed under the Act (such as obtaining 100% consent). This provision acts as a protection to the minority shareholders and is of specific interest to the investment community. This shall empower the enforcement of any pre-agreed rights and provide greater certainty to investors, especially in joint ventures.

The provisions for entrenchment referred to in section 5(3) shall be made either (a) on formation of a company, or (b) by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company. [Section 5 (4)]

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed. [Section 5 (5)]

## **STATUTORY REQUIREMENTS**

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act 2013.

## **CONTENTS OF ARTICLES**

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

1. Exclusion wholly or in part of Table F.
2. Adoption of preliminary contracts.

3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
9. Nomination.
10. Forfeiture of shares.
11. Alteration of capital.
12. Buy back.
13. Share certificates.
14. Dematerialisation.
15. Conversion of shares into stock.
16. Voting rights and proxies.
17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
19. Nominee directors.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
26. General meetings.
27. Directors meetings.
28. Borrowing powers.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Indemnity.
33. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

#### **CONSISTENCY OF ARTICLES OF ASSOCIATION WITH COMPANIES ACT, 2013**

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. The proviso to

Section 5(2) provides that nothing in that sub-section shall be deemed to prevent a company from including any additional matters in its Articles, as may be considered necessary for its management. Section 5(8) provides that in case of any company, which is registered after the commencement of the Companies Act 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Section 6 of the Companies Act, 2013 provides that:-

- (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and
- (b) any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be..

In the light of above provisions, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 6 of the Act. It is opposed to the fundamental principles of the company's jurisprudence and is ultra vires of the company. [(Circular No. 32 of 1975) dated 01.11.1975]

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles. The regulation of stock exchanges is mainly governed by Securities Contracts Regulation Act, 1956 (SCRA) and SEBI, Act, 1992 which are Special Acts. Hence, the Articles of Stock Exchange may provide for additional matters as per SCR Act, which may not be possible for inclusion in the Articles of a company, as per the provisions of the Companies Act. [*Madras Stock Exchange Ltd. v. S.S.R. Rajkumar* (2003) 116 Com Cases 214 (Mad.)].

## **ALTERATION OF ARTICLES OF ASSOCIATION**

A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Section 14(1) provides that subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having the effect of conversion of a private company into a public company; or a public company into a private company. First proviso to section 14(1) lays down that where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company. Second proviso to section 14(1) stipulates that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.

Every alteration of the articles under this section and a copy of the order of the Tribunal approving the alteration as per section 14(1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same. [Section 14 (2)]



Any alteration of the articles registered under section 14(2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles. [Section 14(3)]

The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles [*Walker v. London Tramway Co.* (1879) 12 Ch. D. 705].

However, in spite of the power to alter its articles, a company can exercise this power subject only to certain limitations. These are:

1. The alteration must not exceed the powers given by the memorandum. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

Similarly, where a resolution was passed expelling a member and authorising the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act [*Madhava Ramachandra Kamath v. Canara Banking Corporation* [1941] 11 Com Cases 78 (Mad)].

On the other hand, articles may impose on the company conditions stricter than those provided under the law; for example, they may provide that a matter should be passed by a special resolution when the Act requires it to be passed by an ordinary resolution.

3. The Articles must not include anything which is illegal or opposed to public policy.
4. The alteration must be *bona fide* for the benefit of the company as a whole.
5. The alteration must not constitute a fraud on the minority by a majority. If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter. [*All India Railway Mens Benefit Fund v. Jamadar Baheshwarnath Bali* (1945) 15 Com Cases 142 (Nag.)]

In *Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd.* [1992] 73 Com Cases 80 (Ker.), the Kerala High Court held that no majority of shareholders can, by altering the article retrospectively, affect, the prejudice of the consenting owners of shares, the right already existing under a contract nor take away the right accrued, e.g., after a transfer of share is lodged, the company cannot have a right of lien so as to defeat the transfer.

6. Articles cannot be altered so as to compel an existing member to take or subscribe for more shares or in any way increase his liability to contribute to the share capital, unless he gives his consent in writing (Section 38).
7. By effecting alteration in its articles, a company cannot defeat escape from its contractual obligation with any person. The company will always be liable in such a case.
8. The Articles of Association cannot be altered so as to have retrospective effects. The articles only operate from the date of the amendment [*Pyare Lal Sharma v. Managing Director, J.K. Industries Ltd.* (1989) 3 Comp LJ (SL) 70].
9. The alteration must not be inconsistent with an order of the Court under Sections 397 or 398 and 404 of the Companies Act, 1956.

Subject to the foregoing conditions, the Articles in a company can be altered and no clause can be included in the Articles that it is not alterable. Persons who become members of a company have no right to assume that the Articles will always remain in a particular form.

Of course a section or a class of shareholders cannot be unfairly or oppressively treated. Thus, though the requisite majority of members could pass a special resolution to alter the Articles and if the alteration has the effect of making a fraud on the minority, the minority shareholders not being less than the number specified in Section 397 and 398 could move the Court for redressing their grievances. The Courts have entertained such applications from shareholders even where they are smaller in number [See *Menier N. Hooper Telegraph Works* (1874) 9 Ch. App. 350].

As already mentioned, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company. [*Southern Foundries v. Shirlaw*, [1940] AC 701].

The discussion on the above matter will not be complete without referring to the rule in *Foss v. Harbottle* (1843) 2 Hare 461 where the court held that no individual shareholder nor a minority of shareholders in a company can take it upon himself or themselves to remedy an alleged wrong involved in the actions of directors if the said wrongful act is something which the majority can regularise and approve of.

## REVIEW QUESTIONS



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

The Articles of Association are subsidiary both to the Companies Act and the Memorandum of Association.

- True
- False

**Correct answer: True**

## ***Effect of Altered Articles***

Alteration binds members in the same way as original articles. The altered articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles.

## ***Section 8 Company cannot alter Articles except with the prior approval of Central Government***

Section 8(4)(i) provides that a company registered under section 8 i.e. companies with charitable objects shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

## ALTERATIONS OF MEMORANDUM OR ARTICLES TO BE NOTED IN EVERY COPY

Every alteration made in the memorandum or articles of a company shall be noted in every copy of the

memorandum or articles, as the case may be. [Section 15(1)]

If a company makes any default in complying with the provisions of section 15(1), the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the memorandum or articles issued without such alteration. [Section 15(2)]

### **DISTINCTION BETWEEN MEMORANDUM AND ARTICLES**

The main points of distinction between the memorandum and articles are given below:

1. Memorandum of association is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation. Articles of association are the rules and regulations framed to govern this internal management of the company.
2. Clauses of the memorandum cannot be easily altered. They can only be altered in accordance with the mode prescribed by the Act. In some of the cases, alteration requires the permission of the Central Government or the Court. In the case of articles of association, members have a right to alter the articles by a special resolution. Generally there is no need to obtain the permission of the Court or the Central Government for alteration of the articles.
3. Memorandum of association cannot include any clause contrary to the provisions of the Companies Act. The articles of association are subsidiary both to the Companies Act and the memorandum of association.
4. The memorandum generally defines the relation between the company and the outsiders, while the articles regulate the relationship between the company and its members and between the members *inter se*.
5. Acts done by a company beyond the scope of the memorandum are absolutely void and *ultra vires* and cannot be ratified even by unanimous vote of all the shareholders. But the acts of the directors beyond the articles can be ratified by the shareholders.

### **LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES**

The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles. Also, all monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company (Section 10).

We shall examine the extent to which the memorandum and articles bind:

- (a) the members to the company;
- (b) the company to the members;
- (c) the members *inter se*; and
- (d) the company to outsiders.

### **Members Bound to the Company**

The memorandum and articles constitute a contract binding the members of the company. The members, as members, are bound to the company. Each member must, therefore, observe the provisions of the memorandum and articles.

Each member is bound by the covenants of the Memorandum as originally made and as altered from time to time [*Malleson v. National Insurance Co.*]. In another case, the shareholders could not enter into an

agreement which was contrary to or inconsistent with the articles of association of the company [*V.B. Rangaraj v. V.B. Gopalkrishnan* (1992) 73 Com Cases 201 (SC)].

### CASE LAW

In *Boreland's Trustee v. Steel Brother and Co. Ltd.* (1901) 1 Ch. 279, the articles of a company contained a clause that on the bankruptcy of a member his shares would be sold to other persons and at a price fixed by the directors. B, a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at their true value. It was held that the trustee was bound by the articles, as the shares were purchased by B in terms of the articles.

### Company Bound to the Members

Since the articles constitute a contract binding the company to its members in their capacity as members, a member can bring an action against the company for infringement by it of the memorandum or articles. For example, an individual member can sue the company for an injunction restraining it from improper payment of dividend [*Hoole v. Great Western Railway* (1867) 3 Ch. D. 262]. Further, the company is bound to individual members in respect of their ordinary rights as members, e.g. the right to receive share certificate in respect of shares allotted to them, or to receive notice of general meeting, etc. Normally, action for breach of articles against the company can be brought only by a majority of the members. Individual or minority members cannot bring such a suit except when it is intended for enforcement of personal rights of members or to prevent the company from doing any ultra vires or illegal act, fraud, or oppression and mismanagement.

### Member Bound to Member

As between the members inter se each member is bound by the articles to the other members but that does not mean the memorandum and articles create an express contract among the members of the company. Thus, a member of a company has no right to bring a suit to enforce the articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members inter se are regulated. A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or ultra vires acts.

Articles do not affect or regulate the rights arising out of a commercial contract, with which the members have no concern, i.e., rights completely outside the company's relationship.

### Company not Bound to Outsiders

The term "outsider" signifies a person who is not a member of the company even if he is a director of or solicitor to the company. Even in regard to members, the articles bind the company to them in their capacity as members.

As between outsiders and the company, neither the memorandum nor the articles would give any contractual rights to outsiders against the company or its members even though the names of outsiders are mentioned in those documents in connection with the arrangements that the company might have contemplated for carrying on its business. The articles do not confer any contractual rights even upon a member in a capacity other than that of a member. To succeed, the party suing must prove a contract outside and independent of the articles [*Eley v. Positive Life Insurance Co.*, (1876) 1 E.X.D. 88].

In this case the articles provided that the solicitor to the company would not be removed from office except for misconduct. Eley acted as solicitor to the company and also became a member of the company. The company discontinued his services and then he sued the company for damages for breach of contract. It was held that he had no cause of action because the articles did not constitute any contract between the company and himself. His action was dismissed.

This rule, however, proved to be rather harsh and so the Courts later on modified it. The modified rule is as follows:

While the articles cannot create a contract between the company and any person other than a member in his capacity as a member, they may indicate the basis upon which contracts may be made by the company. If such a contract is entered into whether with a member of the company or any other person, the conditions stated in the articles will be tacitly adopted by that contract, unless expressly negated or varied by the contract itself.

The question sometimes arises as to whether directors are bound by whatever is contained in the articles. In case the directors contravene the provisions in the articles, the directors render themselves liable for an action by members. On the other hand, members can also ratify acts of directors. If any loss is incurred by the company, directors are liable to reimburse to the company any loss so incurred.

### CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

The memorandum and articles, when registered, become public documents and can be inspected by anyone on payment of nominal fee. Therefore, every person who contemplates entering into a contract with a company has the means of ascertaining and is consequently presumed to know, not only the exact powers of the company but also the extent to which these powers have been delegated to the directors, and of any limitations placed upon the exercise of these powers. In other words, every person dealing with the company is deemed to have a “constructive notice” of the contents of its memorandum and articles. In fact, he is regarded not only as having read those documents but also as having understood them according to their proper meaning [*Griffith v. Paget*, (1877) Ch. D. 517]. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum, or outside the limits set on the authority of the directors, he cannot, as a general rule, acquire any rights under the contract against the company [*Mohony v. East Holyfrod Mining Co.*, (1875) L.R. 7 H.L. 869]. For example, if the articles provide that a bill of exchange to be effective must be signed by two directors, a person dealing with the company must see that it is so signed; otherwise he cannot claim under it.

In another case, the articles required that all documents should be signed by the managing director, secretary and the working director on behalf of the company. A deed of mortgage was executed by the secretary and the working director only and the Court held that no claim would lie under such a deed. The Court said that the mortgagee should have consulted the articles before the deed was executed. Therefore, even though the mortgagee may have acted in good faith and the money borrowed applied for the purpose of the company, the mortgage was nevertheless invalid [*Kotla Venkataswamy v. Rammurthy*, AIR 1934 Mad 579]. The doctrine of indoor management protects third parties who are entitled to an assurance that all the procedural aspects of a transaction are carried out.

Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.

The impact of this doctrine on practical relations is thus stated in HALSBURY: “A company is subject to the rule that, where the conduct of a party charged with a notice shows that he had suspicions of a state of facts the knowledge of which would affect his legal rights, but that he deliberately refrained from making inquiries, he will be treated as having had notice, though he is not entitled to claim for his own advantage,” [*Jones v. Smith*, (1841) 1 Hare 43].

### MONIES PAYABLE BY MEMBERS IS A DEBT [SUB-SECTION (2) OF SECTION 10]

Though all monies payable under the memorandum or articles by members is a debt due, the liability on the debt is not enforceable, unless proper notice is given in accordance with the articles. [*Pabna Dhana-Bhandar Co. Ltd. v. Foyezud din Mia* (1933) 3 Com Cases 41 : AIR 1932 Cal 716].

### INTERPRETATION OF MEMORANDUM AND ARTICLES

Articles should be construed as a business document so as to give business efficacy preference to a construction which will prove unworkable [*Holmes v. Keyes (Lord)* (1958) 2 All ER 129 (CA)]. Where the conduct of the parties reveals that there has been some practice in vogue for several years which was accepted by everyone concerned without any challenge or question, then that practice in the course of long years in itself becomes an indication that the rules or articles which are framed by way of internal management were understood in that sense [*Krishnaswamy (S) v. South India film Chamber of Commerce*, AIR 1969 Mad 42 : (1968) 1 Comp LJ 75; cited in *Sunil Dev v. Delhi and District Cricket Assn.*, (1990) 2 Comp LJ 245, 255 : (1994) 80 Com Cases 174 (Del)].

The memorandum must like any other document be construed according to accepted principles applicable to the interpretation of all legal documents. No rigid canon of construction is to be applied to such a document. Like any other document, it must be read fairly and its import derived from a reasonable interpretation of the language which it employs. [*A Lakshmanaswami Mudaliar v. LIC of India* (1963) 33 Com Cases 420, 430 (SC); *Egyptian Salt & Soda Co. v. Port Said Salt Assn.*, (1931) AC 677 : AIR 1931 PC 182)].

The memorandum and articles must be read together in the event of any ambiguity. In *Angostura Bitters & Co. Ltd. v. Kerr*, (1933) AC 550 : (1934) 4 Com Cases 1; the Privy Council held, "Except in respect of such matters as must be statutorily provided for by the conjunction with the articles. The two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum or to supplement it upon any matter as to which it is silent" — quoted with approval by the Supreme Court in *A. Lakshmanaswami Mudaliar v. LIC of India Ltd.* (1963) SC 1185.

### DOCTRINE OF INDOOR MANAGEMENT

While the doctrine of 'constructive notice' seeks to protect the company against the outsiders, the principal of indoor management operates to protect the outsiders against the company.

According to this doctrine, as laid down in *Royal British Bank v. Turquand*, (1856) 119 E.R. 886, persons dealing with a company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the memorandum and articles, are not bound to inquire the regularity of any internal proceedings. In other words, while persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. It is no part of the duty of an outsider to see that the company carries out its own internal regulations.

### CASE LAW UNDER ERSTWHILE COMPANIES ACT 1956

In *Royal British Bank v. Turquand*, the directors of a banking company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by resolution of the company in general meeting, be authorised to borrow. The directors gave a bond to Turquand without the authority of any such resolution. It was held that Turquand could sue the company on the strength of the bond, as he was entitled to assume that the necessary resolution had been passed. Lord Hatherly observed : "Outsiders are bound to know the external position of the company, but are not bound to know its indoor management".

Section 176 Provides for the Validity of Acts of Directors - No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles of the company:

Provided that nothing in this section shall be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or have been terminated.

The object of the section is to protect persons dealing with the company - outsiders as well as members by providing that the acts of a person acting as director will be treated as valid although it may afterwards be discovered that his appointment was invalid or that it had terminated under any provision of this Act or the Articles of the company [*Ram Raghubir Lal v. United Refineries (Burma) Ltd.*, (1932) 2 Com Cases 359; AIR 1931 Rang 139].

### **Relation of company with members and outsiders**

The validation of the acts of unqualified directors may apply to circumstances from two different angles : (1) as between outsiders, strangers and the company as in *Royal British Bank v. Turquand*, (1956) 5 E&B 327, *British Asbestos Co. Ltd. v. Boyd*. (1903) 2 Ch 439 : (1900-3) All ER Rep 323; and *Ram Buran Singh v. Mufassil Bank Ltd.* AIR 1925 All 206; and (2) in relation to the internal affairs of the company as in *Dawson v. African Consolidated Land & Trading Co.*, (1898) 1 Ch 6 (CA), where calls made by unqualified directors were held valid. Even if the public documents of the company, and the facts which are apparent, would make it clear that a director was not duly qualified to act, this will not oust the effect of the Section 176 (British Asbestos case) (supra). Similarly in *Boschoek Proprietary Co. Ltd.*, v. *Fuke*, (1906) 1 Ch 148, a resolution of a general meeting convened by de facto directors was upheld.

### **Forgery and incompetent acts**

This section does not apply where the act itself is not in the competence of the Board of directors, e.g. compromising unpaid calls under the guise of forfeiture, the transaction being ultra vires and invalid [*Bhagirath Spinning & Wvg. Co. v. Balaji Bhavani Pawar*, AIR 1930 Bom. 267].

### **Directors not aware of their disqualification**

The allotment and forfeiture of shares made by the directors who continued to act even after they were disqualified but were not aware of it, were saved by the Section 179. [*Shiromani Sugar Mills Ltd. v. Debi Prasad*, (1950) 20 Com Cases 296: AIR 1950 All 508]. Where this section does not save the situation, the company may in general meeting ratify allotment of shares even if made by *de facto* directors with *mala fide* intentions [*Bamford v. Bamford*, (1969) 39 Com Cases 838 : (1969) 2 WLR (1107) (CA) and an appeal (1969) : 1All ER 969].

Where the directors in question were not aware of the fact that by virtue of certain provisions in the articles, they had vacated their office, their acts in passing resolutions for starting certain business transactions were held to be valid [*Seth Mohan Lal v. Grain Chambers Ltd.*, (1968) 38 Com Cases 543 : AIR 1968 SC 772; *Shiromani Sugar Mills Ltd. v. Debi Prasad*, (Supra).]

It is important to remember that the doctrine of “constructive notice”, can be invoked by the company and it does not operate against the company. It operates against the person who has failed to inquire but does not operate in his favour. But the doctrine of “indoor management” can be invoked by the person dealing with the company and cannot be invoked by the company.

An outsider is entitled to act on a certified copy of the resolution of the Board of directors delegating the

powers of borrowing money to the managing director subject to the limitation mentioned therein [*C.K. Siva Sankara Panicker v. Kerala State Financial Corporation*, (1980) 50 Com Cases 817 (Ker.)].

## EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The above noted 'doctrine of indoor management' is, however, subject to certain exceptions. In other words, relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances.

1. **Where the outsider had knowledge of irregularity** — The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company. Thus, a person knowing fully well that the directors do not have the authority to make the transaction but still enters into it, cannot seek protection under the rule of indoor management. In *Howard v. Patent Ivory Co.* (38 Ch. D 156), the articles of a company empowered the directors to borrow upto one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting. Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount. Held that, the debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity.
2. **No knowledge of memorandum and articles** — Again, the rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them. In *Rama Corporation v. Proved Tin & General Investment Co.* (1952) 1All. ER 554, T was a director in the company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. The Plaintiff relied on the rule of indoor management. Held, they could not because they even did not know that power could be delegated.
3. **Forgery** — The rule of indoor management does not extend to transactions involving forgery or to transactions which are otherwise void or illegal *ab initio*. In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction, and the question of his consent being free or otherwise does not arise. Consequently, it is not that the title of the person is defective but there is no title at all. Therefore, howsoever clever the forgery might have been, the personates acquire no rights at all. Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management [*Rouben v. Great Fingal Consolidated* (1906) AC 439].

Forgery, in the case of a company, can take different forms. It may, besides forgery of the signatures of the authorised officials, include the execution of a document towards the personal discharge of an official's liability instead of the liability of the company. Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted [*Kreditbank Cassel v. Schenkers Ltd.* (1927) 1 KB 826]. The bill in this case was held to be forged because it purported to be a different document from what it



was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

4. **Negligence** — The 'doctrine of indoor management', in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he is estopped from relying on the Rule. In the case of *Underwood v. Benkof Liverpool* (1924) 1 KB 775, a person who was a sole director and principal shareholder of a company deposited into his own account cheques drawn in favour of the company. Held, that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

Similarly, in the case of *Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd.* AIR 1942 Oudh 417, an accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

5. Again, the doctrine of indoor management does not apply where the question is in regard to the very existence of an agency. In *Varkey Souriar v. Keraleeya Banking Co. Ltd.* (1957) 27 Com Cases 591 (Ker.), the Kerala High Court held that the 'doctrine of indoor management' cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is with regard to the very existence of the agency.
6. This Doctrine is also not applicable where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely *ultra vires* the directors/officers but *ultra vires* the company itself — *Pacific Coast Coal Mines v. Arbuthnot* (1917) AC 607.

In the end, it is worthwhile to mention that section 6 of the Companies Act, 2013 gives overriding force and effect to the provisions of the Act, notwithstanding anything to the contrary contained in the memorandum or articles of a company or in any agreement executed by it or for that matter in any resolution of the company in general meeting or of its board of directors. A provision contained in the memorandum, articles, agreement or resolution to the extent to which it is repugnant to the provisions of the Act, will be regarded as void.

A corporation, organization or other entity set up to provide a legal shield for the person actually controlling the operation.

### DOCTRINE OF ALTER EGO

It is used by the courts to ignore the status of shareholders, officers, and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly.

In *Lennards Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] AC 705, Viscount Haldane propounded the "alter ego" theory and distinguished it from vicarious liability. The House of Lords stated that the default of the managing director who is the "directing mind and will" of the company, would be attributed to him and he be held for the wrong doing of the company.

## LESSON ROUND-UP

- The Memorandum of Association is a document which sets out the constitution of the company and is the foundation on which the structure of the company stands. It defines as well as confines the powers of the company. If the company enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be *ultra vires* the company and hence void. However, the Companies Act, 2013 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act.
- The memorandum of association of a company may be altered by changing its name, altering it in regard to the State in which the registered office is to be situated or its objects, altering or reorganizing its share capital, reducing its capital or making the liability of the directors unlimited.
- Articles means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. It also includes the regulations contained in Tables F to J in Schedule I of the Act, in so far as they apply to the company.
- The memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members.
- A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Any alteration so made shall be as valid as if originally contained in the articles.
- The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.
- As per doctrine of constructive notice, every person dealing with the company is deemed to have a “constructive notice” of the contents of its memorandum and articles. Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.
- While the doctrine of constructive notice seeks to protect the company against the outsiders, the doctrine of indoor management operates to protect the outsiders against the company. While persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. However, there are certain exceptions to doctrine of indoor management.

## GLOSSARY

Memorandum of Association	of	The Memorandum of Association is the constitution of a company. It is a document, which amongst other things, defines the area within which the company can act. It is, therefore, required to state the object for which the company has been formed, the business that it would undertake, the liability, the capital which it shall be allowed to raise, the nature of liability of its members, the name of the State where the registered office of the company shall be located.
Articles of Association	of	Articles of Association which contains the rules and regulations relating to the internal management of a company.
Indoor Management		It operates to protect outsiders against the company. It protects innocent parties who are doing business with the Company and are not in a position to know if some internal rule has not been complied with.

Rule of Constructive Notice	To protect the company against outsiders. The rule of constructive notice is confined to the external position of the company and, therefore, it follows that there is no notice as to how the company's internal machinery is handled by its officers.
Alteration	The state of being altered; a change made in the form or nature of a thing; changed condition. In Company Law the memorandum and articles sometime requires alterations.

**SELF-TEST QUESTIONS**

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

1. What do you understand by the memorandum of association? What is its purpose?
2. "Memorandum of association is a charter of the company". Comment upon the statement and explain the clauses which are included in a memorandum of association of a company.
3. What is "registered office" of a company? Within how much time a company must have a registered office?
4. What do you understand by the doctrine of "ultra-vires"? Discuss the decided case "Ashbury Railway & Iron Co. v. Riche".
5. What is the importance of the objects clause of the memorandum of association? If a company undertakes to do anything which is not either expressly or impliedly provided for by the objects clause, what would be the consequences?
6. "The power of altering the articles is wide, yet it is subject to a large number of limitations". Explain.
7. Discuss the extent to which articles of association binds:
  - (a) the members to the company,
  - (b) the company to the members,
  - (c) the members among themselves, and
  - (d) the company to the outsiders.
8. Distinguish Articles from Memorandum.
9. "The articles may contain provisions for entrenchment." Comment upon the statement and explain the significance of the entrenchment provisions.
10. What is the meaning and significance of the doctrine of "Indoor Management". Discuss with reference to decided case "Royal British Bank v. Turquand".

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# Lesson 5

## Contracts and Conversions

### LESSON OUTLINE

- Preliminary Contracts/Pre-incorporation contracts
- Commencement of new business
- Conversion of private company into public company and vice versa.
- Conversion of public company into private company.
- Conversion of one person company and conversion into a one person company
- Conversion of Section 8 Company to any other class of companies

### LEARNING OBJECTIVES

Contracts made before the incorporation of company is called pre-incorporation contracts. Contracts made after incorporation, but before the company becomes entitled to commence business are called provisional contracts. Provisional contracts are no more valid as provisions relating to commencement of business have been omitted by Companies (Amendment) Act, 2015. The contracts after the incorporation should be within the purview of Memorandum of Association.

Companies Act 2013 provides for conversion of public companies to private companies vice versa, conversion of one person company into public/private Company, conversion of Section 8 companies (companies for charitable purpose) into any other class of companies. Companies (Incorporation) Rules 2014 provides details of the procedural aspects.

After reading this lesson, you will be able to understand the various types of contracts entered into by a public and private company; viz. preliminary or pre-incorporation contracts, post incorporation contracts. In addition you will be able to understand the overall legal and procedural aspects relating to various conversions.

## CONTRACTS

A company being an artificial person can contract only through its agents. A contract will be binding on a company only, if it is made on its behalf by any person acting under its authority, express or implied. The powers of the company are defined by its Memorandum of Association and any contract made beyond the limits laid down in the Memorandum of Association, will be *ultra vires* to the company and void even if all the shareholders assent to it.

When the company is being formed, the promoters, purporting to act on behalf of the company, enter into contracts for the purchase of property, or for securing the services of managers or other experts. Such contracts are obviously made before the incorporation of the company.

There are two situations as discussed below in the case of every company having a share capital (whether public or private) in which contracts are made:

- (a) Contracts made on behalf of the company before its incorporation—preliminary or pre-incorporation contracts.
- (b) Contracts made after the incorporation.

(Contracts made after incorporation but before commencement of business or the provisional contracts is the third category but is no more relevant as the provisions relating to commencement of business (section 11 and relevant rules), have been omitted by Companies (Amendment) Act, 2015).

Similarly, in the case of a company not having a share capital, there are only two situations in which contracts are made, i.e. contracts made on behalf of companies before incorporation and contracts made after incorporation.

### Pre-incorporation Contracts

In Pennington's Company Law, the position is stated as under:

"Although a contract made before the company's incorporation cannot bind the company, it is not wholly denied of legal effect. It takes effect as a personal contract with the persons who purport to contract on the company's behalf and they are liable to pay damages for failure to perform the promises made in the company's name, even though the contract expressly provides that only the company's paid-up capital shall be answerable for performance".

Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation. Before incorporation, a company is non-existent and has no capacity to contract. Consequently, nobody can contract as agent on its behalf because an act which cannot be done by the principal himself cannot be done by him through an agent. Hence, a contract by a promoter purporting to act on behalf of a company prior to its incorporation never binds the company because at the time the contract was concluded the company was not in existence. Therefore it has no legal existence. Even if the parties act on the contract it will not bind the company. [*Northumberland Avenue Hotel Co.*, (1886) 33 Ch.D.16 (CA)]. Further even after incorporation such a purported contract cannot be ratified by the company (*Kelner v. Baxter* (1866) L.R. 2 C.P. 174]. The persons purporting to act as agents on behalf of the company would be personally liable. In *Kelner v. Baxter* (*ibid*) three persons A B and C purported to enter into a contract as agents on behalf of a company before its incorporation for the purchase of certain goods from Kelner and signed it : "A, B and C, Directors". The company later obtained the certificate of incorporation but collapsed before the money was paid for the

goods which were supplied to it by Kelner. It was held that A, B and C were personally liable on the agreement and no subsequent ratification by the company would relieve them from that liability without the assent of Kelner.

Even if the company takes some benefit from a contract purported to have been made before its formation, the contract is not binding on the company. The promoters alone, therefore, remain personally liable for any contract they purport to make on behalf of the company, unless the company enters into the contract in terms of such agreement after incorporation. A company cannot ratify a pre-incorporation contract, but it is open to it to enter into a new contract after its incorporation to give effect to a contract made before its formation [*Howard v. Patent Ivory Co.* (1888) 38 Ch.D.] Since the pre-incorporation contract is a nullity, even the company cannot sue the vendor of property if he fails to carry out such a contract.

In India, however, Sections 15 and 19 of the Specific Relief Act, 1963, have considerably alleviated the difficulty. Section 15(h) provides that where the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of incorporation, the company may, if it has accepted the contract, and has communicated such acceptance to the other party to the contract, obtain specific performance of the contract. Under Section 19(e) under similar circumstances, specific performance may be enforced against the company by the other party to the contract.

A company cannot acquire shares prior to its incorporation. Where a company was named as the transferee in the share transfer forms prior to its incorporation, it was held that such transfers could not be registered. [*Inlec Investment (P) Ltd. v. Dynamic Hydraulics Ltd.*, (1989) 3 Comp LJ 221, 225 (CLB)].

Any pre-incorporation agreement to subscribe to shares of a company to be formed, cannot be enforced and is usually revocable unless accepted by the company after its formation.

## REVIEW QUESTIONS



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

Pre-incorporation contracts cannot be ratified.

- True
- False

**Correct answer: True**

## Contracts made after incorporation of business

A company can do all such acts, as by its Memorandum, it is expressly or impliedly authorised, to do. Any purported act, which is not so authorized, is *ultra vires* the company, and the company cannot enforce it, nor can the other party enforce it against the company. Such a contract cannot be ratified even if every member of the company assents to it, as it is *void ab initio*. This rule is commonly known as the Doctrine of *Ultra Vires*. ‘*Ultra vires*’ means “beyond the powers”. The powers of the company are derived from its Memorandum of Association and the statute constituting it. Consequently, only those contracts which are *intra vires* or within the powers of the company will be valid and binding.

Where a contract is *intra vires* the company but *ultra vires* the directors, the company may be liable and may even ratify it. According to the rule in *Royal British Bank v. Turquand* (1856) 6 E and B 327, so long as the act done by the directors is not inconsistent with the memorandum and articles, an outsider is entitled to assume that the directors have acted properly.

## COMMENCEMENT OF NEW BUSINESS BY AN EXISTING COMPANY

A company cannot commence any business other than those stated under “objects” clause of memorandum without obtaining the prior approval of the shareholders in general meeting by a special resolution.

Section 4(1)(c) requires all companies to state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change its objects by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1) in Form no. MGT 14. As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13(6)(a).

No business other than those given in the “objects clause” can be commenced without obtaining prior approval of the shareholders by way of special resolution. It means that a company can commence a new business i.e. a business not covered by its “objects” clause of the memorandum only after amending the objects clause after obtaining the approval of the shareholders by special resolution.

In this connection, the Department of Company Affairs (now Ministry of Corporate Affairs), has clarified that new business means a business which is not germane to the existing business carried on by the company. The guiding criterion, therefore, is whether the new activity is germane to the original business or not. In case the reply is ‘yes’, no special resolution is necessary and *vice versa*.

## COMMON SEAL

Companies (Amendment) Act, 2015, has diluted the mandatory adoption of common seal. Section 12(3)(b) provides that every company shall have its name engraved in legible characters on its seal, if any. A company may or may not have a common seal.

The company may contract under its common seal, if any and in case, the company does not have a common seal then according to the requirements of that particular section the contract shall be validated.

## CONVERSION OF COMPANIES ALREADY REGISTERED

Section 18(1) of the Companies Act, 2013 provides that a company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of Chapter II of the Act (Incorporation of Companies).

Where the conversion is required to be done under this section, the Registrar shall on an application made by the company, after satisfying himself that the provisions of this Chapter applicable for registration of companies have been complied with, close the former registration of the company and after registering the documents referred to in section 18(1), issue a certificate of incorporation in the same manner as its first registration. [Section 18(2)]

The registration of a company under section 18 shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before conversion and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done. [Section 18(3)].

## CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY AND VICE VERSA

Section 14 (1) states that subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having



the effect of conversion of—

- (a) a private company into a public company; or
- (b) a public company into a private company:

***Private Company ceases to be private company on alteration of articles removing the restrictions required under Section 2(68) [Proviso to Section 14(1)]***

When a company being a private company alters its articles in such a manner that they no longer include any of the three restrictions and limitations which are required to be included in the articles of a private company under section 2(68), the company shall, as from the date of such alteration, cease to be a private company. It also ceases to have the privileges and exemptions conferred on it by the Act as a private company. It becomes a public company and all the provisions of the Act applicable to such companies become applicable to it.

The company shall accordingly change its name and no approval of Central Government is required for the name change as per the proviso to section 13(2).

***Let us Remember***

As per section 2(68) Private Company means a company

- having a minimum paid-up share capital as may be prescribed, and
- which by its articles
  - (a) Restrict the right to transfer its shares
  - (b) Limits the number of members to two hundred
  - (c) Prohibits any invitation to public to subscribe for securities of the company

***Conversion of a Public company into a Private company- requires approval of National Company Law Tribunal***

The second proviso to Section 14(1) states that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.

Section 14(2) states that every alteration of the articles under this section and a copy of the order of the Tribunal approving the alteration as per sub-section (1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same. The company shall accordingly change its name and no approval of Central Government is required for the name change as per the proviso to section 13(2).

**REVIEW QUESTIONS**



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

A Private Limited Company cease to be a Private Company and becomes a Public Company when it fails to comply with any of the three restrictive provisions required by Section 2(68) to be incorporated in its articles.

- True
- False

**Correct answer: True**

**Rule 33 of Companies (Incorporation) Rules 2014**

(1) For effecting the conversion of a private company into a public company or vice versa, the application shall be filed in Form No. INC-27 with fee.

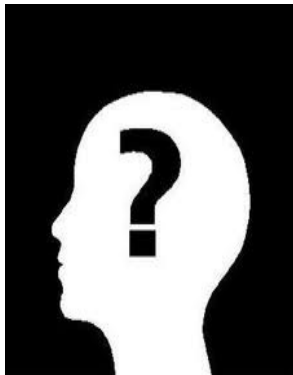
(2) For effecting the conversion of a public company into a private company a copy of order of the Tribunal approving the alteration shall be filed with the Registrar in Form No. INC-27 with fee together with the printed copy of the altered articles within fifteen days of the receipt of the order from the Tribunal.

**Let us remember**

Conversion of Private Company to public company and vice versa requires Special Resolution as it results in alteration of Articles of Association.

**PRIVATE COMPANY (WHICH IS A SUBSIDIARY OF PUBLIC COMPANY) DEEMED TO BE A PUBLIC COMPANY**

Under proviso to section 2(71) of the Companies Act, 2013, a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles. Thus, it has been clearly provided that a subsidiary of public company shall be deemed to be public company even if it continues to be private company in its Articles. It places such a 'private company' at the same level as that of a public company and thereby demarcates between a private company and a private company which is not a subsidiary of a public company.

**REVIEW QUESTIONS**

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

A Public Company can be converted into a Private Company only after the approval of the Tribunal.

- True
- False

**Correct answer: True**

**CONVERSION OF SECTION 8 COMPANY INTO A COMPANY OF ANY OTHER KIND**

Section 8(4)(ii) provides that a company registered under section 8 i.e. companies with charitable objects may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

**As prescribed under Rule 21 and 22 of Companies (Incorporation) Rules 2014, the company has to abide by the following procedure for conversion.**

**Conversion requires Special Resolution**

A company registered under section 8 which intends to convert itself into a company of any other kind shall pass a special resolution at a general meeting for approving such conversion.

***Explanatory Statement as per Section 102 of the Act to be annexed to the notice***

The statement annexed to the notice convening the general meeting shall set out in detail the reasons for opting for such conversion including the following, namely:-

- (a) the date of incorporation of the company;
- (b) the principal objects of the company as set out in the memorandum of association;
- (c) the reasons as to why the activities for achieving the objects of the company cannot be carried on in the current structure i.e. as a section 8 company;
- (d) if the principal or main objects of the company are proposed to be altered, what would be the altered objects and the reasons for the alteration;
- (e) what are the privileges or concessions currently enjoyed by the company, such as tax exemptions, approvals for receiving donations or contributions including foreign contributions, land and other immovable properties, if any, that were acquired by the company at concessional rates or prices or gratuitously and, if so, the market prices prevalent at the time of acquisition and the price that was paid by the company, details of any donations or bequests received by the company with conditions attached to their utilization etc.
- (f) details of impact of the proposed conversion on the members of the company including details of any benefits that may accrue to the members as a result of the conversion.

***Certified copy of Special Resolution to be filed in Form No MGT-14***

A certified true copy of the special resolution along with a copy of the Notice convening the meeting including the explanatory statement shall be filed with the Registrar in Form No.MGT.14 along with the fee

***Application to Regional Director***

The company shall file an application in Form No.INC-8 with the Regional Director with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for converting itself into a company of any other kind and the company shall also attach the proof of serving of the notice served to all the authorities prescribed. In this regard Rule 22(b) states that the company shall send a copy of the notice, simultaneously with its publication, together with a copy of the application and all attachments by registered post or hand delivery, to the Chief Commissioner of Income Tax having jurisdiction over the company, Income Tax Officer who has jurisdiction over the company, the Charity Commissioner, the Chief Secretary of the State in which the registered office of the company is situated, any organisation or Department of the Central Government or State Government or other authority under whose jurisdiction the company has been operating and if any of these authorities wish to make any representation to Regional Director, it shall do so within sixty days of the receipt of the notice, after giving an opportunity to the Company.

***A copy to be filed with the Registrar***

A copy of the application with annexures as filed with the Regional Director shall also be filed with the Registrar.

***Publication of notice***

The company shall, within a week from the date of submitting the application to the Regional Director, publish a notice at its own expense, and a copy of the notice, as published, shall be sent forthwith to the

Regional Director and the said notice shall be in Form No. INC-9 and shall be published-

- (a) at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district; and
- (b) on the website of the company, if any, and as may be notified or directed by the Central Government.

The copy of proof of serving such notice shall be attached to the application.

***Declaration to the effect that no dividend /bonus shares***

The Board of directors shall give a declaration to the effect that no portion of the income or property of the company has been or shall be paid or transferred directly or indirectly by way of dividend or bonus or otherwise to persons who are or have been members of the company or to any one or more of them or to any persons claiming through any one or more of them.

***No objection certificate from relevant authorities, in case of special status***

Where the company has obtained any special status, privilege, exemption, benefit or grant(s) from any authority such as Income Tax Department, Charity Commissioner or any organisation or Department of Central Government, State Government, Municipal Body or any recognized authority, a "No Objection Certificate" must be obtained, if required under the terms of the said special status, privilege, exemption, benefit or grant(s) from the concerned authority and filed with the Regional Director, along with the application.

***No failure in filing financial statements/Annual Return***

The company should have filed all its financial statements and Annual Returns upto the financial year preceding the submission of the application to the Regional Director and all other returns required to be filed under the Act up to the date of submitting the application to the Regional Director and in the event the application is made after the expiry of three months from the date of preceding financial year to which the financial statement has been filed, a statement of the financial position duly certified by chartered accountant made up to a date not preceding thirty days of filing the application shall be attached.

***Attach certificate of compliance for conversion***

The company shall attach with the application a certificate from practicing Chartered Accountant or Company Secretary in practice or Cost Accountant in practice certifying that the conditions laid down in the Act and these rules relating to conversion of a company registered under section 8 into any other kind of company, have been complied with.

***Company to give up concessions enjoyed or being enjoyed***

On receipt of the application, and on being satisfied, the Regional Director shall issue an order approving the conversion of the company into a company of any other kind subject to such terms and conditions as may be imposed in the facts and circumstances of each case including the following conditions, namely:-

- (a) the company shall give up and shall not claim, with effect from the date its conversion takes effect, any special status, exemptions or privileges that it enjoyed by virtue of having been registered under the provisions of section 8;
- (b) if the company had acquired any immovable property free of cost or at a concessional cost from any

government or authority, it may be required to pay the difference between the cost at which it acquired such property and the market price of such property at the time of conversion either to the government or to the authority that provided the immovable property;

- (c) any accumulated profit or unutilised income of the company brought forward from previous years shall be first utilized to settle all outstanding statutory dues, amounts due to lenders claims of creditors, suppliers, service providers and others including employees and lastly any loans advanced by the promoters or members or any other amounts due to them and the balance, if any, shall be transferred to the Investor Education and Protection Fund within thirty days of receiving the approval for conversion;

***On receipt of Approval of Regional Director***

- (i) the company shall convene a general meeting of its members to pass a special resolution for amending its memorandum of association and articles of association as required under the Act consequent to the conversion of the section 8 company into a company of any other kind;
- (ii) the Company shall thereafter file with the Registrar.-
- (a) a certified copy of the approval of the Regional Director within thirty days from the date of receipt of the order in Form No.INC-20 along with the fee;
- (b) amended memorandum of association and articles of association of the company.
- (c) a declaration by the directors that the conditions, if any imposed by the Regional Director have been fully complied with.

On receipt of the documents referred above, the Registrar shall register the documents and issue the fresh Certificate of Incorporation.

***Let us remember!***

The Company shall file an application in Form No.INC-18 with the Regional Director with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for converting itself into a company of any other kind and the company.

**CONVERSION OF ONE PERSON COMPANY INTO A PUBLIC COMPANY OR PRIVATE COMPANY**

**Rule 3 of Companies (Incorporation) Rules, 2014**

One Person Company may voluntarily convert itself into any kind of company, subject to the following:

1. An OPC cannot convert itself into a company under Section 8 of the Act, i.e. charitable company
2. Two years have expired from the date of incorporation of such OPC.

**Rule 6 of Companies (Incorporation) Rules, 2014**

***Paid up capital/turn over of one person company not to exceed prescribed limits***

When the paid up share capital of an One Person Company exceeds fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees, it shall cease to be entitled to continue as a One Person Company.

***One Person Company to compulsorily convert itself on exceeding the above limits***

One Person Company where the paid up capital/turnover as the case may be exceeds the prescribed limits, shall be required to convert itself, within six months of the date on which its paid up share capital is increased beyond fifty lakh rupees or the last day of the relevant period during which its average annual turnover exceeds two crore rupees as the case may be, into either a private company with minimum of two members and two directors or a public company with at least of seven members and three directors in accordance with the provisions of section 18 of the Act.

***Alteration of Memorandum and Articles***

The One Person Company shall alter its memorandum and articles by passing a resolution to give effect to the conversion and to make necessary changes incidental thereto.

***Notice to Registrar***

The One Person Company shall within period of sixty days from the date of applicability, give a notice to the Registrar in Form No.INC-5 informing that it has ceased to be a One Person Company and that it is now required to convert itself into a private company or a public company by virtue of its paid up share capital or average annual turnover, having exceeded the threshold limit.

***Penalty for default***

If One Person Company or any officer of the One Person Company contravenes the provisions of these rules, One Person Company or any officer of the One Person Company shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

***Minimum number of members/directors/ capital to be complied on conversion***

A One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to two or minimum of seven members and two or three directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion of companies already registered.

**RULE 7- CONVERSION OF PRIVATE COMPANY INTO ONE PERSON COMPANY**

(1) A private company other than a company registered under section 8 of the Act having paid up share capital of fifty lakhs rupees or less and average annual turnover during the relevant period is two crore rupees or less may convert itself into one person company by passing a special resolution in the general meeting.

(2) Before passing such resolution, the company shall obtain No objection in writing from members and creditors.

(3) The one person company shall file copy of the special resolution with the Registrar of Companies within thirty days from the date of passing such resolution in Form No. MGT.14.

(4) The company shall file an application in Form No.INC-6 for its conversion into One Person Company along with fees as provided in in the Companies (Registration offices and fees) Rules, 2014, by attaching the following documents, namely:-

- (i) The directors of the company shall give a declaration by way of affidavit duly sworn in confirming

that all members and creditors of the company have given their consent for conversion, the paid up share capital company is fifty lakhs rupees or less or average annual turnover is less than two crores rupees, as the case may be;

- (ii) the list of members and list of creditors;
- (iii) the latest Audited Balance Sheet and the Profit and Loss Account; and
- (iv) the copy of No Objection letter of secured creditors.

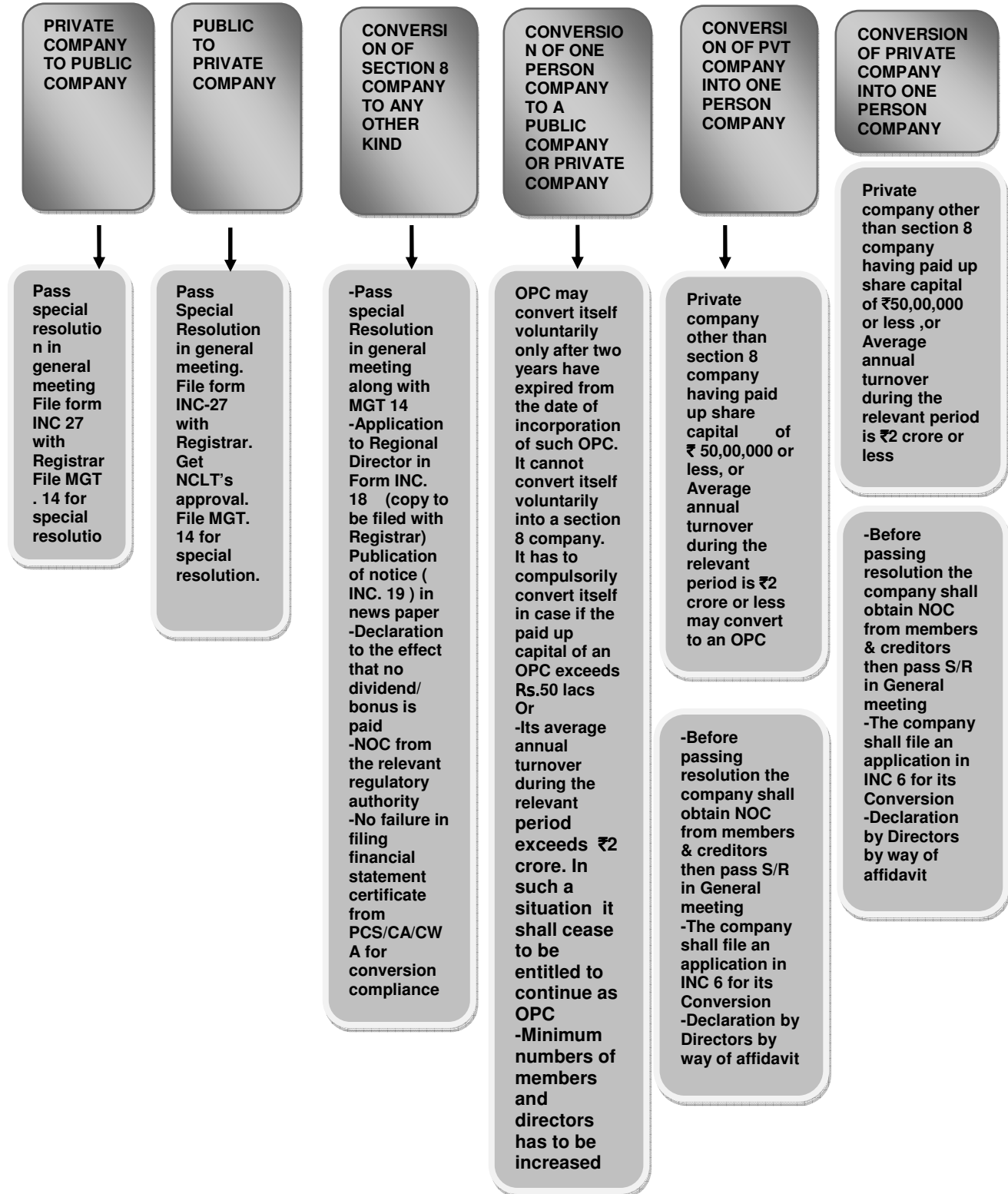
On being satisfied and complied with requirements stated herein the Registrar shall issue the Certificate.

**Penalty:** If a One Person Company (OPC) or any officer of such company contravenes any of the provisions of these Rules, the OPC or any other Officer of such company shall be punishable with fine which may extend to ₹5,000/- and with a further fine which may extend to ₹500/- per day after first offence, during which such contravention continues.

***Let us remember!***

When the paid up share capital of an One Person Company exceeds fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees, it shall cease to be entitled to continue as a One Person Company

# CONVERSION OF COMPANIES





## LESSON ROUND-UP

- Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation.
- A company cannot ratify a pre-incorporation contract, but it is open for the company to enter into a new contract after its incorporation to give effect to a contract made before its formation.
- The Companies (Amendment) Act, 2015 has omitted section 11 of the Companies Act, 2013 and hence thereby the requirement of commencement of business.
- Only those contracts which are intra vires or within the powers of the company will be valid and binding. Where a contract is intra vires the company but ultra vires the directors, the company may ratify it.
- Pursuant to Section 12(3)(b), every company shall have its name engraved in legible characters on its seal; if any.
- Under section 2(71), a subsidiary of public company shall be deemed to be public company even if it continues to be private company in its Articles.
- A public company can be converted into a private company only after the approval of the Tribunal.
- For commencement of new business by an existing company, the guiding criterion is whether the new activity is germane to the original business or not.

## GLOSSARY

<b>Preliminary Contract</b>	When the company is being formed, the promoters, purporting to act on behalf of the company, enter into contracts for the purchase of property, or for securing the services of managers or other experts. Such contracts are obviously made before the incorporation of the company.
<b>Provisional Contract</b>	In the case of a company having a share capital, contracts made after incorporation but before the company becomes entitled to commence business are provisional. Such contracts are no more relevant as the requirement of commencement have been omitted.
<b>Company Seal</b>	An embossing press used to indicate the official signature of a company. A company under the new Act, may or may not have a common seal.

## SELF-TEST QUESTIONS

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

1. (a) Discuss the legal effects of pre-incorporation contracts.  
 (b) "A company cannot ratify a pre-incorporation contract though it is open to it to enter into fresh contract" — Discuss.
2. What are the requirements for conversion of a public company into a private company?
3. Can contracts before incorporation be enforced against the company?
4. State the provisions for conversion of a private company into a public company.
5. Write short notes on:
  - (a) Pre-incorporation contracts;
  - (b) Conversion by default under proviso to Section 14(1) of the Companies Act, 2013.



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# Lesson 6

## Concept of Capital and Financing of Companies

### LESSON OUTLINE

Meaning and classification of capital

Meaning and kinds of shares

Various sources of capital

Issue of shares/securities at premium/ discount.

Issue of shares with differential voting rights

Issue and redemption of preference shares

Further issue of shares

Bonus shares

Preferential issue by existing companies

Employee stock option scheme

Issue of Sweat equity shares

### LEARNING OBJECTIVES

Sources of capital broadly include equity capital and preference capital. There are various ways to raise capital which include preferential allotment, employee stock option, issue of rights shares, issue of shares with differential voting rights. It involves various approvals, disclosures, filings, maintenance of records etc which are prescribed under Chapter IV of the Companies Act 2013. Besides this Companies (Share Capital and Debentures) Rules, 2014 also prescribes various aspects such as disclosures in the directors' report, matters to be stated in the explanatory statement to the resolution, prescribed forms as to maintenance of records, filings with registrar and so on.

After reading this lesson you will be able to understand the regulatory aspects and the broader procedural aspects involved in different types of issue of capital covered in the Companies Act 2013 and Companies (Share Capital and Debentures) Rules, 2014.

## MEANING OF THE TERM “CAPITAL”

The term “Capital” has variety of meanings. It may mean one thing to an economist, one to an accountant, while another to a businessman or a lawyer. A layman views capital as the money, which a company has raised by issue of its shares. It uses this money to meet its requirements by way of acquiring business premises and stock-in-trade, which are called the fixed capital and the circulating capital respectively.

The phrase “loan or borrowed capital” is sometimes used to mean money borrowed by the company and secured by issuing debentures. This, however, is not the proper use of the word “capital”.

In relation to a company limited by shares, the word “capital” means the share capital i.e., the capital in terms of rupees divided into specified number of shares of a fixed amount each. For e.g. share capital of a company is ₹1,00,000 which can be divided into 10,000 shares of ₹10 each or 1,000 shares of ₹100 each, whichever is feasible to the company.

## USE OF THE WORD “CAPITAL” IN (COMPANY LAW)

In Company Law, the “Capital” is the share capital of a company, which is classified as:

- (a) **Nominal, Authorised or Registered Capital:** As per section 2(8), “authorised capital” or “nominal capital” means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.
- (b) **Issued Capital:** As per section 2(50), “issued capital” means such capital as the company issues from time to time for subscription. It is that part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.
- (c) **Subscribed Capital:** According to Section 2(86), “subscribed capital” means such part of the capital which is for the time being subscribed by the members of a company. It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. It is clear that the entire issued capital may or may not be subscribed.
- (d) **Called up Capital:** As per section 2(15), “called-up capital” means such part of the capital, which has been called for payment. It is that portion of the subscribed capital which has been called up or demanded on the shares by the company
- (e) **Paid-up Share Capital:** As per section 2(64), “paid-up share capital” or “share capital paid-up” means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.
- (g) **Preference and Equity Share Capital:** As per explanation to Section 43

“equity share capital”, with reference to any company limited by shares, means all share capital which is not preference share capital;

“preference share capital”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

- (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

A preference share has a preference in regard to payment of fixed amount of dividend or fixed rate of dividend and preferential right of the repayment of capital in the event of winding up of company.

### PUBLICATION OF AUTHORISED, SUBSCRIBED AND PAID-UP CAPITAL

Section 60 (1) states that when any notice, advertisement or other official publication, or any business letter, billhead or letter paper of a company contains a statement of the amount of the authorised capital of the company, such notice, advertisement or other official publication, or such letter, billhead or letter paper shall also contain a statement, in an equally prominent position and in equally conspicuous characters, of the amount of the capital which has been subscribed and the amount paid-up. Sub-section (2) states that any default is made in complying with the requirements of sub-section (1), the company shall be liable to pay a penalty of ten thousand rupees and every officer of the company who is in default shall be liable to pay a penalty of five thousand rupees, for each default.

### REVIEW QUESTIONS



#### Choose the correct answer

1. For which type of capital a company pays the prescribed fees at the time of registration?
- (a) Subscribed capital
  - (b) Authorised capital
  - (c) Paid-up capital
  - (d) Issued capital

**Answer: (b)**

### MEANING AND NATURE OF A SHARE

Section 2(84) of the Act defines a share as “a share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied.”

#### Nature of a Share

- (a) A share is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities while the company is a going concern and in its winding up. (Halsbury's Laws of England)
- (b) A share is the interest of a shareholder in the company measured by a sum of money, for the purposes of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se. [Borland's Trustee v. Steel Bros., (1901)].
- (c) A share is a right to participate in the profits made by a company, while it is a going concern and

declares a dividend and in the assets of company when it is wound up [*Bacha Guzdar v. CIT* 57 Bom. L.R. 617 (SC)].

- (d) A share is not a sum of money but a bundle of rights and liabilities; it is an interest measured by a sum of money. These rights and liabilities are regulated by the articles of a company.
- (e) Section 44 of the Companies Act provides that a share or other interest of any member in a company is a movable property transferable in the manner provided by the articles of the company.
- (f) In India, a share is regarded as goods. According to the Sale of Goods Act, 1930, "Goods" means any kind of movable property other than actionable claim and money, and includes stock and shares.
- (g) According to Section 45 of the Companies Act, 2013 every share in a company having a share capital shall be distinguished by its distinctive number but this provision shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

## REVIEW QUESTIONS



**State whether the following statements are "True" or "False"**

1. Shares are regarded as goods.
2. A share is a right to participate in the profits made by a company.

**True**

**False**

**Correct answer: 1. True 2. True**

## KINDS OF SHARES

Section 43 of the Companies Act, 2013 permits a company limited by shares to issue two classes of shares, namely:

- (a) Equity share capital—
  - (i) with voting rights; or
  - (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Equity share capital may be with similar rights or equity shares with different voting rights as described in Rule 4 of Companies (Share Capital and Debentures) Rules, 2014.

- (b) Preference Share Capital.

Section 43 of the Act shall not apply to private companies, unless Article of the Company so provides.

## WHEN SHALL CAPITAL BE DEEMED TO BE PREFERENCE CAPITAL

Explanation to Section 43 states that the Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

- (a) that in respect of dividends, in addition to the preferential rights to the payment of dividend either fixed or at a fixed rate, it has a right to participate, whether fully or to a limited extent, with capital not

entitled to the preferential right aforesaid;

- (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the share capital paid up capital or deemed to have been paid up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Section 47(2) states that every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company:

The proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares:

Where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

Section 47 shall not apply to the private company, where memorandum or article of association of company so provides.

**PREFERENCE SHARES COMPARED WITH EQUITY SHARES**

S. No	Preference capital	Equity share capital
1	Preference shares are entitled to a fixed rate of dividend.	The rate of dividend on equity shares depends upon the amount of profit available and the funds requirements of the company for future expansion etc.
2	Dividend on the preference shares is paid in preference to the equity shares.	The dividend on equity shares is paid only after the preference dividend has been paid.
3	In case of winding up, preference share holder get preference over equity share holders with regard to the payment of capital.	In case of winding up, equity share holder get payment of capital after the payment of capital to preference shareholders.
4	Dividend on preference share may be cumulative.	The dividend on equity shares is paid only after the preference dividend has been paid and it is not cumulative.
5	The voting rights of preference shareholders are restricted. A preference shareholder can vote only when his special rights as a preference shareholder are being varied, or on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital or their dividend has not been paid for a period of two	An equity shareholder can vote on all matters affecting the company.

	years or more [section 47(2)].	
6	No bonus shares/right shares are issued to preference share holders.	A company may issue rights shares or bonus shares to the company's existing equity shareholders.
7	A company can issue preference shares which are redeemable within 20 years except in certain circumstances.	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy back of its own shares.
8	Voting right of a preference shareholders on a poll shall be in proportion to his share in the paid-up preference share capital of the company.	Voting right of an equity shareholders on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

### ISSUE OF SECURITIES AT A PREMIUM

A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value. The Companies Act, 2013, does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. However, the Companies Act does impose conditions regulating the utilization of the amount of premium collected on securities.

### Share Premium to be transferred to 'Securities Premium Account'

Section 52 (1) states that when a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

### Utilisation of Securities Premium

In accordance with the provisions of Section 52(2) of the Act, the securities premium can be utilised only for:

- (a) issuing fully paid bonus shares to members;
- (b) writing off the balance of the preliminary expenses of the company;
- (c) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company;
- (d) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

Section 52(3) further states that the securities premium account may, notwithstanding anything contained in sub-sections (1) and (2), be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

- (a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or
- (b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity



shares of the company; or

(c) for the purchase of its own shares or other securities under section 68.

Any class of Companies as provided for in Rule 3 of Companies (Share Capital and Debentures) Rules, 2014 includes all unlisted public companies; all private companies and listed companies so far as they do not contradict or conflict with SEBI regulations.

Firstly, the premium cannot be treated as profit and as such the amount of premium is not available for distribution as dividend. Secondly, the amount of premium whether received in cash or in kind must be kept in a separate account, known as the “Securities Premium Account”. Thirdly, the amount of premium is to be maintained with the same sanctity as the share capital.

Where a company issues shares at a premium, even though the consideration may be other than cash, a sum equal to the amount or value of the premium must be transferred to the securities premium account. [*Head (Henry) & Co. Ltd. v. Ropner Holding Ltd.* (1951) 2 All ER 994: (152) Ch 124 (Ch D)].

Any premium paid does not give the shareholder any preferential rights in case of a winding up. Monies in the securities premium account cannot be treated as free reserves, as they are in the nature of capital reserve [See Departmental Circular No. 3/77 dated 15.4.1977].

### PROHIBITION TO ISSUE THE SHARES AT DISCOUNT

Section 53 states that except as provided in section 54 (i.e. issue of sweat equity shares), a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be void. When a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

#### Let us Remember!

1. Issue of shares at discount is prohibited except by issue of sweat equity.
2. Share premium amount is not available for distribution of dividend.

### ISSUE OF SWEAT EQUITY SHARES

According to section 2(88), sweat equity shares mean equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

According to Explanation to Rule 8(1) of Companies (Share Capital and Debentures) Rules, 2014.

- (i) the expressions “Employee” means-
  - (a) a permanent employee of the company who has been working in India or outside India, for at least last one year; or
  - (b) a director of the company, whether a whole time director or not; or
  - (c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;
- (ii) the expression ‘Value additions’ means actual or anticipated economic benefits derived or to be

derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Section 54 permits issue of such equity shares to employees or directors in recognition of their contribution for providing know-how etc. as aforesaid. As the contribution made by employees/directors results in increased profits to the company for a number of years, sweat equity shares, provide a new form of adequate return.

### **Conditions for Issue of Sweat Equity Shares**

Section 54(1) provides that notwithstanding anything contained in Section 53, a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- (i) the issue has been authorised by a special resolution passed by the company in the general meeting.
- (ii) the following are clearly specified in the resolution:
  - (a) number of shares;
  - (b) current market price;
  - (c) consideration, if any; and
  - (d) class or classes of directors or employees to whom such equity shares are to be issued.
- (iii) as on the date of issue, at least one year should have elapsed from the date on which the company had commenced business.
- (iv) a company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the regulations made in this behalf by SEBI.
- (v) a company whose shares are not so listed should issue sweat equity shares in compliance with the rules made in this behalf by the Central Government (*i.e.*, *Rule 8 of Companies (Share Capital and Debentures) Rules, 2014*)

### **Holders of Sweat Equity Shares to be ranked *pari passu* with other Equity share holders**

Section 54(2) provides that the rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

## **COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014- ASPECTS RELATING TO SWEAT EQUITY SHARES**

### *Explanatory Statement to Special Resolution to contain certain particulars*

Rule 8(2) states that the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following particulars, namely:-

- (a) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- (b) the reasons or justification for the issue;

- (c) the class of shares under which sweat equity shares are intended to be issued;
- (d) the total number of shares to be issued as sweat equity;
- (e) the class or classes of directors or employees to whom such equity shares are to be issued;
- (f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation ;
- (g) the time period of association of such person with the company;
- (h) the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
- (i) the price at which the sweat equity shares are proposed to be issued;
- (j) the consideration including consideration other than cash, if any to be received for the sweat equity;
- (k) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;
- (l) a statement to the effect that the company shall conform to the applicable accounting standards; and
- (m) diluted Earning Per Share pursuant to the issue of sweat equity shares , calculated in accordance with the applicable accounting standards.

#### ***Validity of Special Resolution authorizing sweat equity shares***

Rule 8(3) the special resolution authorising the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

#### ***Limits on issue of sweat equity shares***

Rule 8(4) states that the company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. The issuance of sweat equity shares in the Company shall not exceed twenty five percent, of the paid up equity capital of the Company at any time.

#### ***Sweat Equity Shares to be locked for three years***

The sweat equity shares issued to directors or employees shall be locked for a period of three years from the date of allotment and the fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

#### ***Valuation aspects***

- Rule 8(6) states that the sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- Rule 8(7) states that the valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.

- Rule 8(8) states that a copy of gist along with critical elements of the valuation report obtained under Rule 8 (6) and Rule 8 (7) shall be sent to the shareholders with the notice of the general meeting.

***Sweat equity shares for non-cash consideration***

Rule (9) states that when sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-

- (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
- (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

***Sweat equity shares forming part of managerial remuneration***

Rule 8(10) states that the amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act, if the following conditions are fulfilled, namely.-

- (a) the sweat equity shares are issued to any director or manager; and
- (b) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

***Sweat equity shares and compensation aspects***

- If the sweat equity shares are not issued pursuant to acquisition of an asset,

Rule 8(11) states that in respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares(i.e fair value by Registered valuer as mentioned in Rule 6) shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

- If the shares are issued pursuant to acquisition of an asset

Rule 8(12) states that if the shares are issued pursuant to acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards and such amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

***Board's Report to disclose the details of sweat equity shares***

Rule 8(13) states that the Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares namely:-

- (a) the class of director or employee to whom sweat equity shares were issued;
- (b) the class of shares issued as Sweat Equity Shares;
- (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them , if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;

- (d) the reasons or justification for the issue;
- (e) the principal terms and conditions for issue of sweat equity shares, including pricing formula;
- (f) the total number of shares arising as a result of issue of sweat equity shares;
- (g) the percentage of the sweat equity shares of the total post issued and paid up share capital;
- (h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;
- (i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

### Maintenance of Register

Rule 8(14) The company shall maintain a Register of Sweat Equity Shares in Form No. SH.3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54. The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

#### **Let us recapitulate- Issue of Sweat Equity Shares!**

- Issue of Sweat equity shares to be authorized by special resolution at a general meeting.
- Explanatory statement to the special resolution to contain certain particulars.
- The special resolution authorizing Sweat equity shares is not valid if the allotment is made after 12 months of passing the resolution, i.e. the validity of special resolution is 12 months.
- Issue of Sweat Equity shares not to exceed fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher and twenty five percent, of the paid up equity capital of the Company at any time.
- The price of Sweat Equity shares is to be determined by a registered valuer.
- Board's Report to contain certain specified details of sweat equity shares issued.
- The company shall maintain a Register of Sweat Equity Shares in Form No. SH.3
- Issue of Sweat Equity shares to employees and directors at a discount under section 54 is outside the scope of section 53.

### SHARES WITH DIFFERENTIAL VOTING RIGHTS

While Section 43 enables companies to issue equity shares with differential rights as to dividend, voting rights etc. Rule 4 of Companies (Share Capital and Debentures) Rules, 2014 states the following conditions regarding shares with differential voting rights.

#### **Conditions for issuing shares with differential rights (Rule 4) Companies (Share Capital and Debentures) Rules, 2014**

No company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions, namely:-

- (a) the articles of association of the company authorizes the issue of shares with differential rights;
- (b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the

shareholders. When the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot ;

- (c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the company having consistent track record of distributable profits for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- (g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government; A company may issue equity shares with differential rights upon the expiry of five years from the end of the financial year in which such default was made good.
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934 , the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

***Disclosures in the explanatory statement to the notice of the meeting***

Rule 4(2) of Companies (Share Capital and Debentures) Rules, 2014 states that the explanatory statement to be annexed to the notice of the general meeting in pursuance of section 102 or of a postal ballot in pursuance of section 110 shall contain the following particulars, namely:-

- (a) the total number of shares to be issued with differential rights;
- (b) the details of the differential rights ;
- (c) the percentage of the shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the reasons or justification for the issue;
- (e) the price at which such shares are proposed to be issued either at par or at premium;
- (f) the basis on which the price has been arrived at;
- (g) (i) in case of private placement or preferential issue-
  - (a) details of total number of shares proposed to be allotted to promoters, directors and key managerial personnel;
  - (b) details of total number of shares proposed to be allotted to persons other than promoters, directors and key managerial personnel and their relationship if any with any promoter, director or key managerial personnel;
- (ii) in case of public issue - reservation, if any, for different classes of applicants including

- promoters, directors or key managerial personnel;
- (h) the percentage of voting right which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
  - (i) the scale or proportion in which the voting rights of such class or type of shares shall vary;
  - (j) the change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;
  - (k) the diluted Earning Per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;
  - (l) the pre and post issue shareholding pattern along with voting rights as per clause 35 of the listing agreement issued by Security Exchange Board of India from time to time.

***Conversion of existing equity share capital into differential voting rights and vice-versa not possible***

Rule 4(3) states that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*.

***Disclosures in the Boards' Report***

Rule 4(4) states that the Board of Directors shall, *inter alia*, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details, namely:-

- (a) the total number of shares allotted with differential rights;
- (b) the details of the differential rights relating to voting rights and dividends;
- (c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- (d) the price at which such shares have been issued;
- (e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;
- (f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;
- (g) the diluted Earning Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;
- (h) the pre and post issue shareholding pattern along with voting rights in the format specified under sub-rule (2) of rule 4.

***Rights of holders of equity shares with differential voting rights***

Rule 4(5) states that the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

***Register of Members to contain the details of equity shareholders having differential voting rights***

Rule (6) states that when a company issues equity shares with differential rights, the Register of Members

maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

The equity shares with differential rights by any company under the provisions of the Companies Act, 1956 (1 of 1956) and the rules made thereunder, shall continue to be regulated under such provisions and rules.

**Let us recapitulate the vital aspects relating to issue of shares with differential voting rights.**

- Articles of association to authorise the issue
- An ordinary resolution is to be passed at a general meeting of the shareholders. If listed, approval by shareholders through postal ballot is required.
- It shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- consistent track record of distributable profits for the last three years;
- No default in filing financial statements and annual returns for the last three financial years
- no subsisting default in the payment of a declared dividend or repayment of its matured deposits or redemption of its preference shares or debentures that have become due
- No default in repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
- Not to be penalized by Court or Tribunal during the last three years of any offence under specified legislations.
- Details of the issue to be disclosed in the Board's Report
- Register of Members to contain the details of shares with differential voting rights.

**REVIEW QUESTIONS**



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

A listed company has to obtain shareholders' approval through postal ballot or poll at a general meeting for issue of shares with differential voting rights.

**True**

**False**

***Correct answer: True***

**ISSUE AND REDEMPTION OF PREFERENCE SHARES**

**Company cannot issue irredeemable preference shares or redeemable preference shares with the redemption period beyond 20 years**

Section 55(1) states that no company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable. Section 55(2) further states that a company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.



### **Exceptions**

#### *Issue and redemption of preference shares by company in infrastructure projects*

Rule 10 states that a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

The term “infrastructure projects” means the infrastructure projects specified in Schedule VI.

#### *Other conditions attached*

Proviso to Section 55(2) states that

- (a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;
- (b) no such shares shall be redeemed unless they are fully paid;
- (c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and
- (d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed. Premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.
- (ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Section 55 (3) when a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

The capital redemption reserve account may, notwithstanding anything in this section, be applied by the Company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

## **Prescriptions under Companies (Share Capital and Debentures) Rules, 2014 with regard to issue and redemption of Preference shares**

### ***Conditions***

Rule 9(1) states that a company having a share capital may, if so authorised by its articles, issue preference shares subject to the following conditions, namely:-

- (a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
- (b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

### ***Resolution authorising preference shares to set out certain particulars***

Rule 9(2) states that a company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely:-

- (a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
- (b) the participation in surplus fund;
- (c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
- (d) the payment of dividend on cumulative or non-cumulative basis.
- (e) the conversion of preference shares into equity shares.
- (f) the voting rights;
- (g) the redemption of preference shares.

### ***Explanatory statement to special resolution to set out certain particulars***

Rule 9(3) states that the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall, inter-alia, provide the complete material facts concerned with and relevant to the issue of such shares, including-

- (a) the size of the issue and number of preference shares to be issued and nominal value of each share;
- (b) the nature of such shares i.e. cumulative or non - cumulative, participating or non - participating, convertible or non - convertible
- (c) the objectives of the issue;
- (d) the manner of issue of shares;
- (e) the price at which such shares are proposed to be issued;
- (f) the basis on which the price has been arrived at;
- (g) the terms of issue, including terms and rate of dividend on each share, etc.;
- (h) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;
- (i) the manner and modes of redemption;
- (j) the current shareholding pattern of the company;

(k) the expected dilution in equity share capital upon conversion of preference shares.

**Register of Members to contain the particulars of preference share holder(s)**

Rule 9(4) states that when a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference share holder(s).

**Redemption of preference shares**

Rule 9(6) states that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed:-

- (a) at a fixed time or on the happening of a particular event;
- (b) any time at the company's option; or
- (c) any time at the shareholder's option.

**FURTHER ISSUE OF SHARES**

Section 62 of the Companies Act provides for the issue of "Rights Shares" and states that whenever at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to the existing holders of equity shares in proportion to the paid-up share capital on their shares at the time of further issue by sending a letter of offer. For listed companies, the information as regards the quantum of such issue and the proportion in which rights shall be offered shall be supplied to the concerned Stock Exchanges in advance.

The company must give notice to each of the equity shareholders, giving him option to take the shares offered to him by the company. The shareholder must be informed of the number of shares he has opted to buy giving him at least 15 days but not more than 30 days to decide. The said notice shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least 3 days before the opening of the issue. If the shareholder does not convey to the company his acceptance of the company's offer of further shares he shall be deemed to have declined the offer. Unless the articles of the company otherwise provide, the directors must state in the notice of offer of rights shares the fact that the shareholder has also the right to renounce the offer in whole or in part, in favour of some other persons. However in case of a private company case ninety per cent. of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those specified in the said sub-clause or subsection shall apply. Accordingly time limit for acceptance of offer by existing shareholders may be less than 15 days if 90% of the members a private limited company have given their consent either in writing or through electronic mode.

If a shareholder has neither renounced in favour of another person nor accepted the shares, the Board of directors may dispose of the shares so declined in such manner which is not dis-advantageous to the shareholders and the company.

Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed. However in case of private limited companies if it passes the ordinary resolution then it will be sufficient.

Section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a

consideration other than cash, if —

- (1) the company in General Meeting passes a special resolution to this effect; and
- (2) the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

The provisions of section 62 are applicable to all types of companies except the Nidhi companies.

The restrictions contained in Section 62 of the Act regarding issue of further shares do not apply to:-

- (a) increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loans raised by the company to convert such debentures or loans into shares in the company [Section 62(3)].

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loans by a special resolution passed by the company in the general meeting.

- (b) conversion of part or whole of the debentures issued to or loans obtained from any Government in shares of the company in pursuance of a direction issued by that Government in public interest on such terms and conditions as appear to be fair and reasonable to the Government even if the terms of issue of such debentures or loans do not contain a term providing for an option for such conversion.[Section 62(4)].

Provided that where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

In determining the terms and conditions of conversion under section 62(4), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary. [Section 62(5)]

Where the Government has, by an order made under section 62(4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under section 62(4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into. [Section 62(6)]

## CASE LAWS

### Judicial Pronouncement relating to further issue of shares by a company

- (a) **Nanalal Zaver v. Bombay Life Assurance Co. Ltd., AIR 1950 SC 172: (1950) 20 Com Cases 179:** Section 81 (Corresponding to section 62 of the Companies Act, 2013) is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the directors decide to increase the capital within the authorised limit, by issue of further shares.

The above judgement was followed by the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 51 Com Cases 743 at 816: AIR 1981 SC 1298: (1982) 1

Comp LJ1. The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they do not exercise powers for the benefit of the company but simply and solely for personal aggrandisement and to the detriment of the company, the court will interfere and prevent the directors from doing so.

- (b) **See *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*** The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers or to enable it to comply with statutory requirements.

The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time.

- (c) ***Balkrishan Gupta v. Swadeshi Polytext Ltd.* (1985) 58 Com Cases 563: AIR 1985 SC 520].** Although the term 'holders of the equity shares' is used in Sub-section (1)(a) and 'members' in Sub-section (1A)(b) of Section 81 (Corresponding to section 62 of the Companies Act, 2013), the two terms are synonymous and mean persons whose names are entered in the register of members

- (d) **In *Worldwide Agencies (P) Ltd. v. Margaret T. Desor*, (1990) 67 Com Cases 607: AIR 1990 SC 737**, it was held that persons who have become entitled to the shares of a deceased member can exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not.

- (e) ***Mathalone (R) v. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385: (1954) 24 Com Cases 1.** The Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

## BONUS SHARES

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras v. A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

### **Advantages of Issuing Bonus Shares**

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

### **Sources for issue of Bonus shares**

According to section 63(1), a company may issue fully paid-up bonus shares to its members, in any manner

whatsoever, out of—

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

No issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

### **Conditions for issue of Bonus Shares**

In terms of section 63(2), no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

### **No Bonus shares in lieu of dividend**

The bonus shares shall not be issued in lieu of dividend. [Section 63(3)],

SEBI has issued regulations for Bonus Issue which are contained in Chapter IX of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to bonus issues by listed companies. Students may refer to study material 'Capital Markets and Securities Laws' for details.

### **Prescriptions under Companies (Share Capital and Debentures) Rules, 2014 with regard to issue**

Rule 14 states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

## **REVIEW QUESTIONS**



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

Bonus shares can be issued only if the articles provide for it.

**True**

**False**

**Correct answer: True**

## **EMPLOYEE STOCK OPTION SCHEME**

The term 'Employee Stock Option' (ESOP) has been defined under Sub-section (37) of Section 2 of the Companies Act, 2013, according to which “employees’ stock option” means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any,

which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

As discussed earlier, Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed. In case of private company special resolution has been substituted by ordinary resolution. Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 with regard to issue of Employee stock options covers issue of ESOPs.

**Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 with regard to issue of Employee stock options**

A company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines shall not offer shares to its employees under a scheme of employees' stock option (hereinafter referred to as "Employees Stock Option Scheme"), unless it complies with the following requirements, namely:-

- (i) the issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution (exception in case of private company where ordinary resolution is required).

**Who is an employee for the purpose of Section 62(1)(b)**

- (a) a permanent employee of the company who has been working in India or outside India; or
- (b) a director of the company, whether a whole time director or not but excluding an independent director; or
- (c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company but does not include-
  - (i) an employee who is a promoter or a person belonging to the promoter group; or
  - (ii) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

Provided that in case of a startup company, as defined in notification number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, the conditions mentioned in sub-clause (i) and (ii) shall not apply upto five years from the date of its incorporation or registration.

The Start up company as defined under notification of DIPP is as under:

An entity shall be considered as a 'startup'-

- (a) Up to five years from the date of its incorporation/registration,
- (b) If its turnover for any of the financial years has not exceeded Rupees 25 crore, and
- (c) It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property;

Provided that any such entity formed by splitting up or reconstruction of a business already in existence shall not be considered a 'startup';

*Explanation:*

1. An entity shall cease to be a startup on completion of five years from the date of its incorporation/registration or if its turnover for any previous year exceeds Rupees 25 crore.

2. Entity means a private limited company (as defined in the Companies Act, 2013), or a registered partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008).

3. Turnover is as defined under the Companies Act, 2013.

4. An entity is considered to be working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property if it aims to develop and commercialize:

- a. A new product or service or process, or
- b. A significantly improved existing product or service or process, that will create or add value for customers or workflow.

Provided that the mere act of developing: a. products or services or processes which do not have potential for commercialization, or b. undifferentiated products or services or processes, or (c). products or services or processes with no or limited incremental value for customers or workflow would not be covered under this definition.

### **Details in explanatory statement**

Rule 12(2) states that the company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-

- (a) total number of stock options to be granted;
- (b) identification of classes of employees entitled to participate in the Employees Stock Option Scheme;
- (c) the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;
- (d) the requirements of vesting and period of vesting;
- (e) the maximum period within which the options shall be vested;
- (f) the exercise price or the formula for arriving at the same;
- (g) the exercise period and process of exercise;
- (h) the Lock-in period, if any ;
- (i) the maximum number of options to be granted per employee and in aggregate;
- (j) the method which the company shall use to value its options;
- (k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
- (l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and
- (m) a statement to the effect that the company shall comply with the applicable accounting standards.

### **Free pricing in conformity with accounting policies**

Rule 12(3) states that the companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.



### **Separate resolution for granting options to employees of holding/subsidiary companies etc in certain cases**

Rule 12(4) states that the approval of shareholders by way of separate resolution shall be obtained by the company in case of-

- (a) grant of option to employees of subsidiary or holding company; or
- (b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

### **Varying the terms of ESOP requires special resolution**

Rule 12(5) the company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interests of the option holders. The notice for passing special resolution for variation of terms of Employees Stock Option Scheme shall disclose full of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.

### **Minimum one year vesting period**

Rule 12(6)(a) states that there shall be a minimum period of one year between the grant of options and vesting of option. In a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause;

### **Company has freedom to specify lock-in period**

Rule 12(6)(b) states that the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

### **No right of dividend or voting till exercise of option**

Rule 12(6)(c) states that the Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

### **Forfeiture/refund**

Rule 12(7) states that the the amount, if any, payable by the employees, at the time of grant of option-

- (a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or
- (b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

### **Conditions**

Rule 12(8) states the following conditions:

- The option granted to employees shall not be transferable to any other person.

- The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- No person other than the employees to whom the option is granted shall be entitled to exercise the option.

#### **Death/permanent disability/resignation of employees who were granted with options**

Rule 12(8) states that in the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

#### **Disclosure in the Board's Report**

Rule 12(9) states that the Board of directors, shall, *inter alia*, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

- (a) options granted;
- (b) options vested;
- (c) options exercised;
- (d) the total number of shares arising as a result of exercise of option;
- (e) options lapsed;
- (f) the exercise price;
- (g) variation of terms of options;
- (h) money realized by exercise of options;
- (i) total number of options in force;
- (j) employee wise details of options granted to:-
  - key managerial personnel;
  - any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
  - identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

#### **Maintenance of Register**

Rule 12(10) states that the company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall forthwith enter therein the particulars of option granted under clause (b) of sub-section (1) of section 62.

The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

### Listed companies has to comply with the SEBI guidelines

Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

### ISSUE OF SHARES ON PREFERENTIAL BASIS

As discussed earlier, Section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —

- (1) the company in General Meeting passes a special resolution to this effect; and
- (2) the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

***Rule 13 of Companies (Share Capital and Debentures) Rules, 2014 makes certain prescriptions with regard to issue of shares on preferential basis.***

### RULE 13 OF COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014

#### What is the meaning of Preferential offer?

- The expression 'Preferential Offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities;

#### Preferential offer by unlisted companies to comply with the rules

- When the preferential offer of shares or other securities is made by a company whose share or other securities are listed on a recognized stock exchange, such preferential offer shall be made in accordance with the provisions of the Act and regulations made by the Securities and Exchange Board, and if they are not listed, the preferential offer shall be made in accordance with the provisions of the Act and rules made hereunder and subject to compliance with the under mentioned requirements. The company may issue preferential offer, to any person whether or not they are equity shareholder or are employees of the company, such preferential issue should comply with provisions of section 42 relating to private placement.
  - (a) the issue is authorized by its articles of association;
  - (b) the issue has been authorized by a special resolution of the members;
  - (c) The company shall make the following disclosures in the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 of the Act:
    - (i) the objects of the issue;

- (ii) the total number of shares or other securities to be issued;
  - (iii) the price or price band at/within which the allotment is proposed;
  - (iv) basis on which the price has been arrived at along with report of the registered valuer;
  - (v) relevant date with reference to which the price has been arrived at;
  - (vi) the class or classes of persons to whom the allotment is proposed to be made;
  - (vii) intention of promoters, directors or key managerial personnel to subscribe to the offer;
  - (viii) the proposed time within which the allotment shall be completed;
  - (ix) the names of the proposed allottees and the percentage of post preferential offer capital that may be held by them;
  - (x) the change in control, if any, in the company that would occur consequent to the preferential offer;
  - (xi) the number of persons to whom allotment on preferential basis have already been made during the year, in terms of number of securities as well as price;
  - (xii) the justification for the allotment proposed to be made for consideration other than cash together with valuation report of the registered valuer.
  - (xiii) The pre issue and post issue shareholding pattern of the company in the prescribed format
- (d) the allotment of securities on a preferential basis made pursuant to the special resolution passed pursuant to sub-rule (2)(b) shall be completed within a period of twelve months from the date of passing of the special resolution.
- (e) if the allotment of securities is not completed within twelve months from the date of passing of the special resolution, another special resolution shall be passed for the company to complete such allotment thereafter.
- (f) the price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer;
- (g) where convertible securities are offered on a preferential basis with an option to apply for and get equity shares allotted, the price of the resultant shares pursuant to conversion shall be determined-
- (i) either upfront at the time when the offer of convertible securities is made, on the basis of valuation report of the registered valuer given at the stage of such offer, or
  - (ii) at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares:
- Provided that the company shall take a decision on sub-clauses (i) or (ii) at the time of offer of convertible security itself and make such disclosure under sub-clause (v) of clause (d) of sub-rule (2) of this rule.
- (h) When shares or other securities are to be allotted for consideration other than cash, the valuation of such consideration shall be done by a registered valuer who shall submit a valuation report to the company giving justification for the valuation;
- (i) When the preferential offer of shares is made for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company-

- (i) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
- (ii) where clause (i) is not applicable, it shall be expensed as provided in the accounting standards.

Until a registered valuer is appointed in accordance with the provisions of the Act, the valuation report shall be made by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent Chartered Accountant in practice having a minimum experience of ten years.

(3) The price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer.

(Further in case of listed companies the price of shares to be issued on a preferential basis is not required to be determined by the valuation report of a registered valuer).

In case the preferential offer is made by a company to one or more existing members only, few provisions relating to private placement in PAS-5 & offer letter in PAS-4 shall not apply.

## ISSUE OF CAPITAL

### ISSUE OF SHARES AT PREMIUM [SECTION 52]

- Share premium to be transferred to share premium account
- Utilisation of share premium account should be as prescribed in section 52

### ISSUE OF SHARES AT DISCOUNT [SECTION 53]

- Issue of shares at discount is prohibited except by issue of sweat equity shares
- Any share issued by the company at a discounted price shall be void

### ISSUE OF SWEAT EQUITY SHARES [SECTION 54]

- Special resolution – valid for only 12 months from the date of passing the resolution
- Not less than 1 year has elapsed since the date of commencement of business
- Listed companies to comply with SEBI regulations
- Explanatory statement annexed to the notice to state the particulars prescribed under rule 8(2)
- Sweat equity not to exceed 15% of paid up capital or value of 5 crore whichever is higher in a year and not to exceed 25% of paid up equity any time.

### ISSUE OF SHARES WITH DIFFERENTIAL VOTING RIGHTS [SECTION 43(a) (ii)]

- Articles to authorise the issue
- Ordinary resolution to be passed and if shares are listed then approval through postal ballot.
- Not to exceed 26% of total post issue paid up equity capital including shares with differential voting rights at any point of time
- The company not to be penalised under specified legislature in last 3 years
- No default in filing financial statements in the last 3 years.
- No default in payment of dividend

**ISSUE /  
REDEMPTION OF  
PREFERENCE  
SHARES  
[SECTION 55]**

- Issue to be authorised by special resolution
- Explanatory statement to be annexed to the notice of general meeting containing the relevant material facts
- No company shall issue irredeemable preference shares of redeemable preference shares with the redemption period beyond 20 years.
- infrastructural companies may issue preference shares for a period exceeding 20 years but not exceeding 30 years

**RIGHT ISSUE/  
FURTHER  
ISSUE OF  
SHARES  
[SECTION 62]**

- Listed companies to inform concerned stock exchanges
- Company to give notice to equity shareholder giving him 15-30 days to decide
- Company can issue shares to other than existing share holder for cash or other than cash if a special resolution is obtained
- Price to be determined by the registered valuer's report
- The provisions of section 62 are applicable to all type of companies except Nidhi companies

**BONUS  
SHARES  
[SECTION 63]**

- Authorised by articles
- Authorised on recommendation of the board in general meeting
- No default in payment of interest or principle in respect of debt securities and fixed deposits and in respect of payment to employees
- Partly paid up shares to be made fully paid up on allotment
- Listed companies to follow SEBI regulations
- Once announced by the board about bonus issue no company shall withdraw the same

**ESOP**

RULE 12 OF THE  
COMPANIES (SHARE  
CAPITAL AND  
DEBENTURE)  
RULES, 2012

- Pass special resolution
- Disclosures to be made in explanatory statement
- Free pricing in conformity with accounting policies
- Separate resolution to be obtained for granting options to employees of holding/subsidiaries
- Minimum 1 year period between grant of options and vesting of option
- Company is free to set lock-in period
- Option granted shall not be transferable, pledged, hypothecated, mortgaged in any manner
- Disclosures to be made in board report
- Register to be maintained in form SH-6
- Listed companies to comply with SEBI guidelines

**PREFERENTIAL  
ISSUE**

RULE 13 OF THE  
COMPANIES (SHARE  
CAPITAL AND  
DEBENTURES) RULES,  
2014

- Pass special resolution
- Listed company shall follow SEBI regulations
- Issue to be authorised by the articles
- Securities to be made fully paid up on allotment
- Disclosures to be made in explanatory statement to be annexed to the notice of general meeting
- Allotment to get completed within 12 months if not completed a fresh resolution is required
- Price determination by the registered valuer's report

## LESSON ROUND-UP

- Share capital of a company can be classified as:
  - (a) nominal, authorized or registered capital;
  - (b) issued and subscribed capital;
  - (c) called up and uncalled capital;
- A share is defined as a share in the share capital of a company, including stock except where a distinction between stock and shares is expressed or implied.
- The Companies Act, 2013 permits a company limited by shares to issue two classes of shares, namely equity share capital and preference share capital.
- A preference share or preference share capital is that part of share capital which carries a preferential right with respect to both dividend and capital.
- Preference shares may be of various types, namely participating and non-participating, cumulative and non-cumulative shares, redeemable and irredeemable preference shares.
- Equity share capital means all share capital which is not preference share capital.
- Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

## GLOSSARY

<b>Share Capital</b>	Funds raised by issuing shares in return for cash or other considerations. The amount of share capital a company can change over time because each time a business sells new shares to the public in exchange for cash, the amount of share capital will increase. Share capital can be composed of both common and preferred shares.
<b>Redemption of shares</b>	Where a company issues shares on terms stating that they can be bought back by the company. Not all shares can be redeemed, only those stated to be redeemable when they were issued. The payment for the shares must generally come from reserves of profit so that the capital of the company is preserved.
<b>Sweat Equity Share</b>	Sweat equity shares mean equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
<b>Rights Issue</b>	Rights issue is an issue of capital to be offered to the existing shareholders of the company through a letter of offer.
<b>Bonus Share</b>	When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares.





# Lesson 7

## Alteration of Share Capital

### LESSON OUTLINE

- Alteration of share capital of the company and power of the company to alter its capital.
- Nature of stock and difference between stock and share.
- Reduction of share capital and types of reduction of capital commonly adopted.
- Reduction of share capital without sanction of the Tribunal, reduction when company is defunct, reduction when company is unlimited.
- Diminution of share capital not treated as reduction of share capital.
- Creditor's right to object to reduction and liability of members in respect of reduced share capital.
- Power of company to purchase its own securities (buy-back of securities) and conditions for buy-back.
- Prohibition for buy-back in certain circumstances.
- Companies (Share Capital & Debentures) Rules, 2014

### LEARNING OBJECTIVES

Financial restructuring involves alteration of share capital which includes aspects such as increase of share capital, reduction of share capital, buy back of shares etc.

After reading this lesson you will be able to know about the Regulatory and Procedural aspects involved in alteration of share capital through consolidation, sub-division, reduction of share capital, buy back of shares etc.

***The students may note that the provisions relating to reduction of capital are yet to be notified, whereas provisions relating to buy-back have been notified.***

This lesson is based on Companies Act 1956, with respect to reduction of capital and Companies Act 2013 with respect to Buy-back of shares. However provisions of Companies Act 2013 relating to reduction of capital is given for information and reference.

After reading this lesson you will be able to understand the legal and procedural aspects relating to consolidation, sub-division and reduction of capital and buy-back of securities, especially unlisted securities, the procedural aspects of which are covered under Companies (Share Capital and Debentures) Rules, 2014.

## ALTERATION OF SHARE CAPITAL

**Section 61** of the Companies Act, 2013 provides that a company limited by shares or guarantee and having a share capital may, if so authorised by its articles, alter, by an ordinary resolution, its memorandum in the following ways:

- (a) It may increase the authorised share capital by such amount, as it thinks expedient;
- (b) It may consolidate and divide, all or any of its existing shares into a larger denomination than of its existing shares e.g., by consolidating ten shares of Rs. 10 each into one share of Rs. 100 each. Proviso to Section 61(1)(b) states that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;
- (c) It may convert all or any of its fully paid-up shares into stock or reconvert that stock into fully paid-up shares of any denomination.
- (d) It may sub-divide its existing shares or any of them into smaller denomination than fixed by its Memorandum but it must keep the existing proportion between the paid-up and unpaid amount e.g., one share of Rs 100 each, Rs 60 paid up and be sub-divided into ten shares of Rs 10 each, Rs 6 paid-up per share.
- (e) It may cancel shares which have not been taken up or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. However, such cancellation of shares will not be deemed to be a reduction of share capital, within the meaning of Section 66 of the Companies Act, 2013. In other words, it is cancellation of unissued share capital not being taken or agreed to be taken up by any person.

In order to alter its capital clause in the Memorandum, the company requires authority in its articles. But if the articles give no power to this effect, the articles must be amended by a special resolution before the power to alter the capital clause can be exercised by the company [*Re. Patent Invert Sugar Co.* (1885) 31 Ch. D. 166]. Further, the power to alter capital clause should be exercised *bona fide* and in the interest of the company and not for the benefit of any group. An ordinary resolution will be enough for altering capital clause in the Memorandum of Association.

## REVIEW QUESTIONS



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

Alteration of capital clause of MoA, to be authorized by AoA. If not so, AoA has to be amended.

- True
- False

**Correct answer: True**

Section 64(1) states that when—

- (a) a company alters its share capital in any manner specified in sub-section (1) of section 61;
- (b) an order made by the Government under sub-section (4) read with sub-section (6) of section 62 has

the effect of increasing authorised capital of a company; or

(c) a company redeems any redeemable preference shares,

the company shall file a notice in the prescribed form with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

*Rule 15 of Companies (Share Capital and Debentures) Rules, 2014* states that

When a company alters its share capital in any manner specified in sub-section (1) of section 61, or an order is passed by the Government increasing the authorized capital of the company in pursuance of sub-section (4) read with sub-section (6) of section 62 or a company redeems any redeemable preference shares, the notice of such alteration, increase or redemption shall be filed by the company with the Registrar in Form No. SH.7 along with the fee.

As per Section 64(2) Contravention in this case will make the company and every officer of the company who is in default liable to a fine extending up to Rs. 1000 per day during which the default continues or Rs. 5 lakh, whichever is less (Section 64).

#### Review question

Does the company require to file notice of alteration (Form No. SH7) when they redeem preference shares?

**Ans: yes.**

#### WHEN SHARE CAPITAL STANDS AUTOMATICALLY INCREASED?

Under Section 64 read with section 62 of the Companies Act, 2013 the share capital of a company stands automatically increased when any Government, by its order made under Section 62(4) of the Act, directs that any debentures issued to, or the loans obtained from the Government by a company or any part thereof shall be converted into shares in the company, on such terms and conditions as are considered by that Government to be reasonable in the circumstances.

However, where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

Where the Government has, by an order made under section 62(4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under that section or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into. [Section 62(6)].

#### CASE LAWS

##### Judicial Pronouncement about a company's power to alter its share capital

1. The powers under Section 95 of the Act [Corresponds to section 61 of the Companies Act, 2013] can be exercised by the members only if authorised by the articles. *In Re North Cheshire Brewery Co., 1920 WN 149. Re Metropolitan Cementry Co., (1934) SC 65*
2. The power should be exercised *bona fide* in the interest of the company and not for benefiting any

group. [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 1 Com Cases 743 (SC)].

3. The consent of meeting of classes of shareholders will not be required as the increase of any kind of share capital cannot be said to 'vary' or 'affect' class rights. The increased capital may consist of preference shares, provided that this is not inconsistent with rights given by the Memorandum of Association. [*Andrews v. Gas Meter Co.* (1897) 1 Ch 361: (1895) All Eng. Rep 1280 (CA)].
4. The notice convening the meeting to pass the resolution for increase must specify the amount of the proposed increase. [*Mac Connell v. E. Prill & Co. Ltd.*, (1916) 2 Ch 57 : (1916-17) All Eng. Rep Ext 1344].
5. Where shares were issued beyond the authorised amount and a resolution was subsequently passed at a general meeting ratifying the issue, it was held that although the original issue was not in accordance with the articles, the ratification was effective and the allottees were bound [*Sewell's case* (1868) 3 Ch App 131].
6. Consolidation and sub-division may be effected by the same resolution [*North Cheshire Borewery Co. Ltd.*]
7. In this case it was held that cancellation of unissued shares or of shares issued but not taken up by any person, may be effected without seeking confirmation of the Court. [*Castiglione Erskine & Co. Ltd.*, (1958) 2 All ER 455 : (1958) 28 Com Cases 452 (Ch D),
8. Under Section 94(1) [Corresponding to section 61(1) of the Companies Act, 2013] it is open to a limited company to cancel shares which have not been taken or agreed to be taken by any person but a resolution for such cancellation is required to be passed by the company in general meeting under Section 94(2) [*Surendra Maganlal Mehta v. Reliance Textile Ind. Ltd.*, (1982) 3 Comp LJ 103 (Bom)].
9. It is not the function of the Court to interfere with the Company's power to consider a resolution for cancelling the unissued portion of its share capital. The exercise of power by a company to cancel the unissued shares cannot be restrained by an injunction [*Swindon Town Football Co. Ltd*, 1990 BCLC 467 (Ch D)].
10. Fee paid to the ROC for registering increase of capital is in the nature of capital expenditure irrespective of the fact whether an increased capital will lead to increase in profits. [*Punjab State Industrial Development Corpn. Ltd. v. CIT*, (1997) 26 Corpt LA 333 : (1997)10 SCC 184]

## REVIEW QUESTIONS



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

Fee paid to ROC for registering the increase of capital is a capital expenditure.

- True
- False

**Correct answer: True**

## NATURE OF STOCK

Section 61 allows the company to convert its fully paid-up shares into stock, and it is, therefore, important to understand the nature of stock and the advantages which it may have.

Section 2(84) of the Act in defining a share, states that "share means a share in the share capital of a

company and includes stock”. Thus by converting shares into stock, a shareholder is known as a stockholder. A stockholder has the same rights as to dividends as a shareholder.

It should be noted that (i) only fully paid-up shares can be converted into stock, and (ii) no direct issue of stock by a company is lawful. It is only the conversion of fully-paid shares into stock, that is allowed by Section 61(1)(c) and not a direct issue of stock.

After shares are converted into stock, the stockholder may own Rs. 1,000 worth of stock where formerly he held one hundred shares of Rs. 10 each. Thus, though his investment in the company remains the same, the interest of the stockholder in the company is described differently.

### DIFFERENCE BETWEEN SHARE AND STOCK

S.No	Share	Stock
1	Shares in physical form bear distinct numbers	Stocks are the consolidated value of share capital
2	Shares may or may not be fully paid-up	Stock is always fully paid-up
3	Shares have a nominal value	Stock does not have any nominal value
4	All shares are of equal denomination	Denomination of stocks varies
5	It is not possible to transfer shares into fraction	Stock is divisible into any amount required. Thus, it is possible to transfer even into fractions
6	Shares comes into existence before the stock and it is issued initially	Stock comes into existence after conversion of shares into stock and on conversion of shares into stock, the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock

### REVIEW QUESTIONS



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

Only fully paid-up shares can be converted into stock.

- True
- False

Correct answer: *True*

### REDUCTION OF SHARE CAPITAL (SECTION 66)

#### REDUCTION OF CAPITAL TO BE APPROVED BY SPECIAL RESOLUTION AND CONFIRMED BY THE TRIBUNAL [SECTION 66(1)]

(1) Subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any

manner and in particular, may—

- (a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- (b) either with or without extinguishing or reducing liability on any of its shares,—
  - (i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
  - (ii) pay off any paid-up share capital which is in excess of the wants of the company,

alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

**No Reduction of Capital would be allowed in case of Arrears In the Repayment of Deposits and Interest thereon [Proviso to Section 66(1)].**

It may be noted that reduction of capital shall not be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

**NOTICE BY TRIBUNAL [SECTION 66(2)]**

The Tribunal shall give notice of every application made to it under sub-section (1) to

- the Central Government,
- Registrar
- the Securities and Exchange Board, in the case of listed companies, and
- the creditors of the company

It shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice.

If no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction [Proviso to Section 66(2)]

**CONFIRMATION OF REDUCTION OF CAPITAL [SECTION 66(3)]**

The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit:

**No sanction for reduction unless complied with accounting standards.**

Proviso to Section 66(3) provides that –

No application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

**PUBLICATION OF THE ORDER OF THE TRIBUNAL [SECTION 66(4)]**

The order of confirmation of the reduction of share capital by the Tribunal under Section 66(3) shall be published by the company in such manner as the Tribunal may direct.

**DELIVER A COPY OF ORDER OF TRIBUNAL TO REGISTRAR(SECTION 66(5))**

The company shall deliver a certified copy of the order of the Tribunal under subsection (3) and of a minute\* approved by the Tribunal showing—

- (a) the amount of share capital;
- (b) the number of shares into which it is to be divided;
- (c) the amount of each share; and
- (d) the amount, if any, at the date of registration deemed to be paid-up on each share,

to the Registrar within thirty days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

**Difference in Alteration of share capital and reduction of share capital**

<b>S.No.</b>	<b>Alteration of share capital</b>	<b>Reduction of share capital</b>
1	Alteration of share capital is governed by the provisions of section 61 of the Companies Act, 2013.	Reduction of share capital is governed by the provisions of section 66 of the Companies Act, 2013.
2	Alteration of share capital is required to be done by ordinary resolution.	Reduction of share capital is required to be done by special resolution.
3	Alteration of share capital is not required to be confirmed by the Tribunal.	Reduction of share capital is to be confirmed by the Tribunal.
4	Alteration of share capital may be done in the following manner:- <ul style="list-style-type: none"> <li>(a) Increasing its nominal capital by issuing new shares</li> <li>(b) Consolidating and dividing all or any of its share capital into shares of large denomination</li> <li>(c) Converting fully paid up shares into stock or vice versa</li> <li>(d) Sub dividing its shares or any of them into shares of smaller amount</li> <li>(e) Canceling shares which have not been taken up and diminishing the amount of share capital by the amount of the shares so cancelled.</li> </ul>	Reduction of share capital may be done in the following manner:- <ul style="list-style-type: none"> <li>(a) Extinguishing or reducing the liability of members in respect of the capital not paid up</li> <li>(b) Writing off or canceling any paid up capital which is in excess of the needs of the company</li> <li>(c) Paying off any paid up share capital which is in excess of the needs of the company</li> </ul>

**Diminution of share capital is not a reduction of capital**

**Diminution of capital** — As per section 61(1)(e) of the Companies Act, 2013 (enforced), diminution of capital is the cancellation of the unsubscribed part of the issued capital . It can be effected by an ordinary resolution provided articles of the company authorises to do so. According to section 61(2), cancellation of shares under section 61(1) shall not be deemed to be reduction of share capital. It does not need any confirmation of the Tribunal under section 66.

\* Means document submitted to Tribunal detailing the reduction and approved by the tribunal. Here the word minute has different meaning from the word minutes used for proceedings.

- (d) Redemption of redeemable preference shares.
- (e) Purchase of shares of a member by the Company on order of the Tribunal under Section 242 of Companies Act, 2013.
- (f) Buy-back of its own securities under Section 68.

In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

- (i) Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 61(1)(e) Companies Act, 2013];
- (ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 55 [Explanation to section 55(3) Companies Act, 2013];
- (iii) Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital;
- (iv) Where the company buys-back its own shares under Section 68 of the Act [Section 66(6)];
- (v) Where the reduction of share capital is effected in pursuance of the order of the Tribunal sanctioning any compromise or arrangement under section 230.

In all these cases, the procedure for reduction of capital as laid down in Section 66 is not attracted.

### CREDITORS' RIGHT TO OBJECT TO REDUCTION

According to sub-section 7, a member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

Further where the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim-

- (a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and
- (b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

## REVIEW QUESTIONS



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

Reduction of capital is to be authorized by AoA.

- True
- False

**Correct answer: True**



## CASE LAWS

### Judicial Pronouncement about reduction of Share capital of a company

1. ***SIEL Ltd., In re.* [(2008) 144 Com Cases 469 (Del)]**, the view was that reduction of the share capital of a company is a domestic concern of the company and the decision of the majority would prevail. If the majority by special resolution decides to reduce the share capital of the company, it has the right to decide to reduce the share capital of the company and it has the right to decide how this reduction should be effected. While reducing the share capital, the company can decide to extinguish some of its shares without dealing in the same manner with all other shares of the same class. A selective reduction is permissible within the frame work of law for any company limited by shares.
2. ***Indian National Press (Indore) Ltd., In re.* (1989) 66 Com Cases 387, 392 (MP)** The need for reducing capital may arise in various circumstances for example trading losses, heavy capital expenses and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a capital may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.
3. ***Elpro International Ltd., In re* [(2009) 149 Com Cases 646 (Bom.)]**, a company proposed to extinguish and cancel 8,89,169 shares held by shareholders constituting 25 per cent, of the issued and paid up share capital and return capital to such shareholders at ₹183 per equity share of ₹10 each so cancelled and extinguished in accordance with Section 100 of the Act (corresponds to section 66 of the Companies Act, 2013). According to the scheme as approved by the shareholders, the reducing of 25 percent, of the issued and paid up capital was to take place from amongst 3,835 share holders which included 112 shareholders who voted for the resolution, and 3,723 shareholders who did not object to the resolution. It was held that a selective reduction of share capital is legally permissible. The shareholders who did not cast their votes were those who had abstained from voting at the meeting. Moreover, there was no objection from any of the shareholders to the proposed reduction.
4. ***British and American Trustee and Finance Corpn. v. Couper*, (1894) AC 399, 403: (1991-4) All ER Rep 667**. The Act does not prescribe the manner in which the reduction of capital is to be effected. Nor is there any limitation of the power of the Court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured.
5. ***British and American Trustee Corpn. v. Couper*, (1894) (ibid)** When exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short the Court shall consider the following, while sanctioning the reduction:
  - (i) The interests of creditors must be safeguarded;
  - (ii) The interests of shareholders must be considered; and
  - (iii) Lastly, the public interest must be considered as well.
6. ***Borough Commercial and Bldg. Society*, (1893) 2 Ch 242. Reduction in shares capital of an unlimited company** : An unlimited company to which Section 100 (corresponds to section 66 of the Companies Act, 2013) does not apply, can reduce its capital in any manner that its Memorandum and Articles of Association allow. It is not governed by Sections 61 and 66 of the Act. Section 13 (corresponds to section 4 of the Companies Act, 2013) does not provide that its capital shall be stated in the Memorandum. However, even if its capital is stated in the Memorandum, the

Companies Act impliedly gives power to the member to alter it.

7. **Great Universal Stores Ltd., Re (1960) 1 All ER 252: (1960) Reduction of capital when company is defunct:** The Registrar of Companies has been empowered under Section 560 (corresponds to section 248 of the Companies Act, 2013) to strike off the name of the company from register on the ground of non-working. Therefore, where the company has ceased to trade, and Registrar exercises his power under Section 560 (corresponds to section 248 of the Companies Act, 2013) a reduction of capital cannot be prevented.
8. **Marwari Stores Ltd. v. Gouri Shanker Goenka, (1936) 6 Com Cases 285. Equal Reduction of Shares of One Class:** Where there is only one class of shares, *prima facie*, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalising the amount so paid-up. The same principle is to be followed where there are different classes of shares [*Bannatyne v. Direct Spanish Telegraph Co.*, (1886) 34 Ch D 287].
9. **Asian Investments Ltd. Re, (1992) 73 Com Cases 517, 523 (Mad).** It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly where reduction is not involved Section 100 (corresponds to section 66 of the Companies Act, 2013) would not be attracted.

### **REDUCTION OF SHARE CAPITAL WITHOUT SANCTION OF THE COURT**

The following are cases which amount to reduction of share capital and where no confirmation by the Tribunal is necessary:

- (a) **Surrender of shares** — “Surrender of shares” means the surrender to the company on the part of the registered holder of shares already issued. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad v. Equity Insurance Co. Ltd.*, (1948) 18 Com Cases 309: AIR 1948 Oudh 197]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from further liability on shares.

The Companies Act contains no provision for surrender of shares. Thus, surrender of shares is valid only when Articles of Association provide for the same and:

- (i) Where forfeiture of such shares is justified; or
- (ii) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. But in the former case, it is at the initiative of company and in the latter case at the initiative of member or shareholder.

- (b) **Forfeiture of shares** — A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal.

Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised *bona fide* and in the interest of the company.

**Conclusiveness of certificate for reduction of capital**

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd.*, (1903) 88 LT 792 (Ch D)]. Similarly, in a case the special resolution for reduction was an invalid one, but the company had gone through with the reduction. It was held that the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook*, (1900) 2 QB 376].

**BUY BACK OF SECURITIES (SECTION 68)****Sources**

According to Section 68(1) of the Companies Act, 2013, a company may purchase its own shares or other specified securities (hereinafter referred to as “buy-back”) out of:

- (i) its free reserves\*\*; or
- (ii) the securities premium account; or
- (iii) the proceeds of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

\*\*Explanation: As per Section 2(43) of the Act, “free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend: Provided that— (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

**Authorisation [Section 68(2)]**

The primary requirement is that the articles of association of the company should authorise buyback. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buy-back. Buy-back can be made with the approval of the Board of directors at a board meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

**Quantum [Section 68(2)]**

- (a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buy back has to be authorized by the board by means of a resolution passed at the meeting.
- (b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution upto 25% of total equity capital in that year.

**Let us remember**

- Board can authorise buy back upto 10% equity capital and free reserves in a resolution passed at the Board Meeting
- Shareholders can authorize buy back by special resolution upto 25% of the total paid-up capital and free reserves of the company and in a financial year, upto 25% of total equity capital in that year.

**Special Resolution to be accompanied by Explanatory Statement [Section 68(3)]**

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

- (a) a full and complete disclosure of all material facts;
- (b) the necessity for the buy-back;
- (c) the class of shares or securities intended to be purchased under the buy-back;
- (d) the amount to be invested under the buy-back; and
- (e) the time-limit for completion of buy-back.

**Rule 17(1) Companies (Share Capital and Debentures) Rules, 2014 states that Explanatory statement to contain certain disclosures**

Explanatory statement to the special resolution authorising buy-back, to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following disclosures:

- (a) the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
- (b) the objective of the buy-back;
- (c) the class of shares or other securities intended to be purchased under the buy-back;
- (d) the number of securities that the company proposes to buy-back;
- (e) the method to be adopted for the buy-back;
- (f) the price at which the buy-back of shares or other securities shall be made;
- (g) the basis of arriving at the buy-back price;
- (h) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed
- (i) the time-limit for the completion of buy-back;
- (j) (i) the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
- (ii) the aggregate number of equity shares purchased or sold by persons mentioned in (i) above during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
- (iii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant date;

- (k) if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back –
  - (i) the quantum of shares proposed to be tendered;
  - (ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition.
- (l) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;
- (m) a confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-
  - (i) that immediately following the date on which the general meeting is convened there will be no grounds on which the company could be found unable to pay its debts;
  - (ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
  - (iii) in forming their opinion for the above purposes, the directors have taken into account the liabilities (including prospective and contingent liabilities); as if the company were being wound up under the provisions of the Companies Act, 2013.
- (n) a report addressed to the Board of directors by the company's auditors stating that:
  - (i) they have inquired into the company's state of affairs;
  - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;
  - (iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document, and  

Where the audited accounts are more than six months old, the calculations with reference to buy back shall be on the basis of un-audited accounts not older than six months from the date of offer document which are subjected to limited review by the auditors of the company
  - (iv) the Board of directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date;

#### **Letter of Offer to be Filed with Registrar of Companies before Buy-Back [Rule 17(2)]**

The company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in **Form No SH 8**, along with the fee as prescribed. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

#### **Dispatch of letter of offer to shareholders [Rule 17(4)]**

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the

same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

**Offer for buy back open for [Rule 17(5)]**

The offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer. Where all members of a company agree, the offer for buy-back may remain open for a period less than fifteen days.

**Post buy-back debt-equity ratio not to exceed 2:1 [Section 68(2)(d)]**

The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

**Shares/Securities being Bought Back are to be Fully Paid up [Section 68(2)]**

All the shares or other specified securities for buy-back are to be fully paid-up.

**Time gap between two buybacks [Proviso to Section 68(2)]**

No offer of buy-back under Section 68(2) shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

**Time limit for completion of buyback [Section 68(4)]**

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

**Methods of buy-back [Section 68(5)]**

The buy-back under sub-section (1) may be—

- (a) from the existing shareholders or security holders on a proportionate basis;
- (b) from the open market;
- (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

**Filing Declaration of Solvency with SEBI/ROC as the case may be [Section 68(6) read with Rule 17(3) of Companies (Share Capital & Debentures) Rules, 2014]**

When a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution or board resolution as the case may be, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board (in case of listed companies), a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in Form No. SH.9 and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board.

**Extinguishment of securities bought back [Section 68(7)]**

When a company buys back its own shares or other specified securities, it shall extinguish and

physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

#### **Prohibition of further issue of shares or securities [Section 68(8)]**

When a a company completes a buy-back of its shares or other specified securities it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

#### **Register of buy-back [Section 68(9)]**

When a company buys back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

#### **Return of buyback [Section 68(10)]**

A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (in case of listed companies) a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed:

Rule 17(14) of Companies(Share Capital and Debentures) Rules, 2014 states that a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder shall be annexed to the return filed with the Registrar in Form No. SH.11.

#### **Punishments [Section 68(11)]**

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

#### **Transfer to and application of Capital Redemption Reserve Account [Section 69]**

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

#### **Circumstances prohibits buy-back [Section 70(1)]**

No company shall directly or indirectly purchase its own shares or other specified securities—

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after

the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist. [Proviso to Section 70(i)]

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92 (Annual Return), section 123(Declaration of Dividend), section 127(punishment for failure to distribute dividend) and section 129(Financial Statement).

**Test yourself:**

Can “Share premium account” be used for buy back of Shares?

**Ans: Yes.**

### LESSON ROUND-UP

- A company limited by shares or guarantee and having a share capital may alter its share capital in any of the ways provided under the Companies Act. These powers can be exercised by the members in general meeting only if authorized by the articles.
- Reduction of capital means reduction of issued, subscribed or paid-up share capital of the company. Various modes of reduction have been laid down in the Companies Act.
- A company limited by shares or a company limited by guarantee and having a share capital may, by a special resolution and subject to its confirmation by the Tribunal on application by the company, reduce its share capital. While sanctioning such reduction, interests of creditors, shareholders and public should be safeguarded.
- Surrender of shares, forfeiture of shares, diminution of capital, redemption of redeemable preference shares, purchase of shares of a member by the company on order of the Tribunal, buy-back of own shares amount to reduction of share capital but no confirmation by the Tribunal is necessary.
- Where the company has ceased to trade and Registrar exercises his power to strike off the name of the company from the register on the ground of non-working, a reduction of capital cannot be prevented.
- Where the directors are required to hold qualification shares, care must be taken that the effect of a reduction does not disqualify any director.
- The creditors having a debt or claim against the company are entitled to object in reduction. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured.
- The Registrar’s certificate on confirmation of reduction will be conclusive evidence that the requirements of the Act have been complied with.
- Certain provisions introduced in the Companies Act allow the companies to buy-back their own shares, subject to the conditions and in any of the modes provided therein. They also provide for prohibition for buy-back in certain circumstances.

### GLOSSARY

**Stock**

Stock is always fully paid-up. These are the consolidated value of share capital. They come into existence after conversion of shares into stock and on conversion of shares into stock, the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock.

**Reduction of Share**

Reduction of share capital means reduction of issued, subscribed and paid-up share



<b>Capital</b>	capital of the company. The share capital of a company may be reduced by passing a special resolution and subject to confirmation by the Tribunal on an application by the company.
<b>Surrender of Shares</b>	Surrender of shares means the surrender to the company on the part of the registered holder of shares already issued.
<b>Forfeiture of shares</b>	A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal.
<b>Diminution of capital</b>	Diminution of capital is the cancellation of the unsubscribed part of the issued capital. It can be affected by an ordinary resolution provided articles of the company authorise to do so. It does not need any confirmation of Court.
<b>Buyback of shares</b>	The repurchase of shares by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available (reducing supply), or to eliminate any threats by shareholders who may be looking for a controlling stake.
<b>Alteration of share capital</b>	Any increase, any consolidation and division, any conversion into stock or stock to shares, any sub-division or cancellation of shares is known as alteration of share capital.

**SELF-TEST QUESTIONS**

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

1. Distinguish between share and stock.
2. What are the methods for reduction of share capital of a company?
3. How can a company reduce its share capital without sanction of the Tribunal?
4. Write short notes on:
  - (i) Diminution of share capital
  - (ii) Surrender of shares
  - (iii) Forfeiture of shares
5. Explain in detail, the provisions as regards buy-back of securities by the companies.

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# Lesson 8

## Private Placement and Prospectus

### LESSON OUTLINE

- Meaning and definition of prospectus.
- Private placement
- Public offer
- Matters to be disclosed in the prospectus.
- Reports to be set out in the prospectus
- Shelf Prospectus and Red-herring prospectus.
- Liability for untrue statement.
- Remedies for misrepresentation in prospectus.
- Penalty for fraudulently inducing to invest money.
- Prohibition of personation for acquisition of securities.

### LEARNING OBJECTIVES

Prospectus is a disclosure document inviting public, to subscribe for the securities of the company, to enable the investors to take rational investment decisions and to protect their rights, by giving various material facts and prospects about the company.

Chapter III of Companies Act, 2013 covers procedural aspects as to private placement , which are dealt in Part II of Chapter III and Part I covers and procedural aspects relating to public offer which include registration of prospectus, its' format, disclosures, remedy against misstatement in prospectus, civil/criminal liabilities of directors, penalty for fraudulent inducement to purchase securities etc. The Companies (Prospectus and Allotment of Securities) Rules, 2014 cover the procedural aspects.

After reading this lesson you will be able to understand the meaning of prospectus, shelf prospectus information memorandum and red-herring prospectus along with relevant provisions under the Companies Act including disclosures, approval, penalties etc.

## MEANING AND DEFINITION OF PROSPECTUS

Section 2(70) of the Companies Act, 2013 defines a prospectus as “any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.”

On the basis of aforesaid definition, it may be said that a document should have following ingredients to constitute a prospectus:

- (a) There must be an invitation to the public;
- (b) The invitation must be made “by or on behalf of the company or in relation to an intended company”;
- (c) The invitation must be “to subscribe or purchase”;
- (d) The invitation must relate to any securities of the company.

## INVITATION TO PUBLIC

In essence, it means that a prospectus is an invitation issued to the public to offer for purchase/subscribe any securities of the company. A document is deemed to be issued to the public, if the invitation to subscribe for share capital is such as to be open to any one who brings his money and applies in prescribed form, whether the prospectus was addressed to him or not. The test is not who receives the document, but who can apply for the securities in response to the invitation contained in it.

However, an issue will not be “Public” if-

- (i) It is directed to a specified person or a group of persons, and
- (ii) It is not calculated to result in the securities becoming available to other persons.

## CASE LAWS

### Some important judicial pronouncement about an invitation to be termed as an invitation to public

- (A) Advertisement in news paper to invite application for purchase of remaining shares of a company is prospectus (*Pramatha Nath Sanyal v. Kali Kumar Dutt*, A.I.R. 1925 Cal. 714). In this case directors were penalized for not complying with the requirements of filing a copy thereof with Registrar of Companies.
- (B) A single private communication does not satisfy the term “issue” [*Nash v. Lynde* (1929) A.C. 158]. In this case, several copies of a document marked “strictly confidential” and containing particulars of a proposed issue of shares, were sent accompanied with application form by the managing director who, in turn, gave it to a client who passed it on to a relation. Thus, the document was passed on privately through a small circle of friends of the directors. The House of Lords held that there had been no issue to the public and any action for compensation by the allottee for loss sustained by reason of an omission in the document, failed.
- (C) In *Rattan Singh v. Managing Director, Moga Transport Co. Ltd.* (1959) 29 Com Cases 165 it was held that offer to buy one’s kith and kin cannot be considered to be an invitation to public. Offer to buy shares made to an individual as such is not within the definition of the word public as used in Section 67 (Corresponds to section 23 and 42 of the Companies Act, 2013).

- (D) In the case of *Govt. Stock and Other Securities Investment Co. Ltd. v. Christopher*, (1956) I.W.L.R. 237 it was held that a circular issued by a company to the shareholders of other companies to acquire their shares held in those companies and issue its own shares in exchange of those shares did not amount to be a prospectus, as there is no public issue. It was pointed out that the circular did not involve an offer for the purchase of any shares. The shares in question were unissued shares of new company, so that they could not be the subject of an offer for purchase. Thus, the circular was not a prospectus, but only the communication of an offer to exchange shares in the new company for shares in the other existing companies.
- (E) In *Re. South of England Natural Gas and Petroleum Co. Ltd.*, (1911) 1 Ch. 573 it was held that "Public" is a general word, and includes any section of the public. If a document inviting persons to buy shares is issued, for example, to all advocates, or to all doctors, or to all foreigners living in India, or to all Indian citizens, or to all shareholders in a particular company, it will still be deemed to be issued to the public within the meaning of the Act. In the aforesaid case, 3,000 copies of a document in the form of a prospectus were sent out and distributed among the members of certain gas companies only. It was held that the document so sent and distributed was a prospectus issued to the public.

## PROVISIONS OF COMPANIES ACT, 2013 WITH RESPECT TO PROSPECTUS

### Public Offer and Private Placement

Chapter III (Section 23 to Section 42) of the Companies Act, 2013 deals with prospectus and allotment of securities. It is divided into 2 parts.

- Part I deals with public offer and
- Part II deals with private placement.

According to section 23(1), a public company may issue securities—

- (a) to public through prospectus (herein referred to as "public offer") by complying with the provisions of this Part(i.e Part I); or
- (b) through private placement by complying with the provisions of Part II of this Chapter; or
- (c) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Section 23(2) lays down that a private company may issue securities—

- (a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or
- (b) through private placement by complying with the provisions of Part II of this Chapter.

As per explanation to section 23, for the purposes of Chapter III, "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

### PRIVATE PLACEMENT

As per Explanation II(ii) to Section 42(2), "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42.

### Private placement offer letter

Section 42(1) provides that without prejudice to the provisions of section 26(dealing with matters to be stated in the prospectus) a company may, subject to the provisions of this section, make private placement through issue of a private placement offer letter in Form PAS-4.(Refer to Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014) However it has been provided by MCA vide notification no. 210 (E) dated 18<sup>th</sup> March, 2015, that the provisions relating to private placement offer letters and maintenance of complete records of such offers shall not apply, where offer has been made to one or more existing shareholders of the company under Section 62 (1)(c).

The company has to issue private placement offer letter in Form PAS-4
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### Maximum number of persons to whom offer can be made and other incidental matters

As per section 42(2), the offer of securities or invitation to subscribe securities i.e. private placement, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, [excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62], in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

Rule 14(2)(b) of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year.

Any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

The limit of not more than two hundred persons in aggregate in a financial year would be reckoned individually for each kind of security that is equity share, preference share or debenture;

Rule 14(2)(c) states that the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;

Rule 14(2)(d) states that the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received.

Monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

### Private placement to be approved by special resolution

*Rule 14(2) of Companies (Prospectus and Allotment of Securities) Rules, 2014*

The rule states that a company shall not make a private placement of its securities unless -

- (a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a special resolution, for each of the offers or invitations:

In the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed.

In case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

***No fresh offer, in case of earlier offer being withdrawn, pending allotments with respect to earlier offer etc.,***

Section 42(3) states that no fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

The explanation to Rule 14(2)(b) states that the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;

MCA, vide its Notification dated 4<sup>th</sup> January, 2017 has clarified that this sub-section shall not apply to an unlisted public company licensed to operate by RBI or SEBI or IRDA from the International Financial Services Centre located in SEZ.

***Private placement under section 42 to be treated as public offer if conditions prescribed there under is not fulfilled***

Sub-section(4) of section 42 states that any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

***Mode of payment of subscription money***

Section 42(5) states that all monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

***Time limit for allotment and payment of interest/refund of subscription money otherwise***

Section 42(6) states that a company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day. For unlisted public company under IFSC, time period shall be ninety days instead of sixty days.

***Subscription money to be kept in a separate bank account***

Proviso to Section 42(6) states that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to allot securities.

***Offer to be made specifically addressing persons***

Section 42(7) states that Private Placement shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such person shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of

circulation of relevant private placement offer letter.

Rule 14(1)(b) states that a private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons in accordance with sub-section (7) of section 42:

MCA, vide its Notification dated 4<sup>th</sup> January, 2017 has clarified that this sub-section shall not apply to an unlisted public company licensed to operate by RBI or IRDA from the International Financial Services located in SEZ.

Proviso to Rule 14(1)(b) states that that no person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

### **No public advertisements for Private Placement**

Section 42(8) states that no company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

### **Return of allotment**

Section 42(9) states that whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Rule 14(4) in this context states that a return of allotment of securities under section 42 shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing-

- (i) the full name, address, Permanent Account Number and E-mail ID of such security holder;
- (ii) the class of security held;
- (iii) the date of allotment of security ;
- (iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

### **Maintenance of Record of Private Placement Offer**

Rule 14(3) of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that the company shall maintain a complete record of private placement offers in Form PAS-5. A copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter. As discussed earlier where preferential offer is made to existing shareholders then it is not required to maintain a complete record of private placement in Form PAS-5.

### **Penalty**

Section 42(10) states that if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.



## PRIVATE PLACEMENT

**An Offer or invitation for subscription to securities through issue of private placement**

- Offer Letter to be in Form No. PAS-4
- The offer letter with application form under 42(7) to be specifically addressed to persons whom the offer is made within 30 days of recording their name
- The offer shall not be made to more than 200 persons excluding QIBs and the employees of the company in a financial year under the scheme of ESOS only the person addressed in the application can apply
- All monies payable on subscription shall not be paid by cash.
- The company making invitation shall allot the securities within 60 days from the date of receipt of allotment
- If unable to allot within 60 days then repay the money in 15 days from the end of those 60 days and money shall be refunded with interest @12%p.a.
- Money received shall be kept in a separate bank account in a scheduled bank.

**Record of offer**

- Offer only to be made to those whose names are recorded by the company
- The record shall be kept in Form No. PAS-5
- A copy of record to be filed with registrar along with PAS-4 and with SEBI and the stock exchange within 30 days

**Information of the offer to be made to registrar**

Within 30 days of circulation of private placement offer letter inform Registrar

**Prohibition of advertisement of private placement offer**

The company shall not use:

- Any public advertisement
- Any media marketing or distribution channels
- Or any agents

to advertise private placement offer

**Return of allotment to be filed with Registrar**

Return of allotment of securities under section 42 in Form No. PAS-3 to be filed with registrar within 30 days along with fee

**Violation of section 42**

**Punishments for violation:**  
 Company, Promoters, and directors shall be liable for penalty which may extend to the amount involved in the offer or Rs. 2 crore, whichever is higher.  
 -Company to refund all monies to subscribers within 30 days of the order levying penalty

## PUBLIC OFFER

### What is Public Offer?

Explanation to Section 23 states that for the purposes of Chapter III, "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

### Deemed Prospectus

Section 25(1) states that when a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public,

- any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company; and
- all enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply with the modifications specified in subsections (3) and (4) and shall have effect accordingly, as if the securities had been offered to the public for subscription and as if persons accepting the offer in respect of any securities were subscribers for those securities, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof.

Section 25(2) states that unless the contrary is proved, it shall be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

- (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or
- (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

As per section 25(3); section 26 as applied by this section shall have effect as if —

- (i) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—
  - (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
  - (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;
- (ii) the persons making the offer were persons named in a prospectus as directors of a company.

Section 25(4) states that where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the abovesaid document is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be.

Unless the contrary is proved, it shall be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

- (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or

- (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

### **Matters to be stated in the prospectus**

Section 26(1) states that every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state the information, stated in the following table.

As regards to the matters prescribed in the prospectus the company has to comply with Section 26(1) read with Rule 3 of Companies (Prospectus and Allotment of Securities) Rules 2014. Accordingly the company has to comply with the disclosure requirements prescribed under Section 26(1) of the Act and Rule 3.

<b><i>What is to be disclosed in the prospectus as per Provisions of Section 26(1)?</i></b>	<b><i>What is prescribed under Rule 3 of Companies (Prospectus and Allotment of Securities) Rules, 2014 with respect to such disclosure</i></b>
(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed;	The names, addresses and contact details of the corporate office of the issuer company, compliance officer of the issuer company, merchant bankers and co-managers to the issue, registrar to the issue, bankers to the issue, stock brokers to the issue, credit rating agency for the issue, arrangers, if any, of the instrument, names and addresses of such other persons as may be specified by the Securities and Exchange Board in its regulations;
(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;	The date relating to opening and closing of issue - A declaration which shall be made by the Board or the Committee authorised by the Board in the prospectus that the allotment letters shall be issued or application money shall be refunded within fifteen days from the closure of the issue or such lesser time as may be specified by Securities and Exchange Board or else the application money shall be refunded to the applicants forthwith, failing which interest shall be due to be paid to the applicants at the rate of fifteen per cent. per annum for the delayed period.
(iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner;	A statement given by the Board that all monies received out of the issue shall be transferred to a separate bank account maintained with a Scheduled Bank:  Further, the details of all utilized and unutilised monies out of the monies collected in the previous issue made by way of public offer shall be disclosed and continued to be disclosed in the balance sheet till the time any part of the proceeds of such

	previous issue remains unutilized indicating the purpose for which such monies have been utilized, and the securities or other forms of financial assets in which such unutilized monies have been invested;
(iv) details about underwriting of the issue	<p>the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them;</p> <p>Besides Rule 13 further prescribes that the prospectus of the company shall disclose -</p> <ul style="list-style-type: none"> <li>(i) the name of the underwriters;</li> <li>(ii) the rate and amount of the commission payable to the underwriter; and</li> <li>(iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.</li> </ul>
(v) the consent in writing of the directors, the auditors, bankers to the issue, expert's opinion, if any, all the persons named in the prospectus and of such other persons, as may be prescribed;	The consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders and experts;
(vi) the authority for the issue and the details of the resolution passed therefor;	--
(vii) procedure and time schedule for allotment and issue of securities;	--
(viii) capital structure of the company in the prescribed manner;	<p>The capital structure of the company shall be presented in the following manner, namely: -</p> <ul style="list-style-type: none"> <li>(i) <ul style="list-style-type: none"> <li>(a) the authorised, issued, subscribed and paid up capital (number of securities, description and aggregate nominal value);</li> <li>(b) the size of the present issue;</li> <li>(c) the paid up capital- <ul style="list-style-type: none"> <li>(A) after the issue;</li> <li>(B) after conversion of convertible instruments (if applicable);</li> </ul> </li> <li>(d) the share premium account (before and after the issue);</li> </ul> </li> <li>(ii) the details of the existing share capital of the issuer company in a tabular form, indicating therein with regard to each allotment, the date of allotment, the number of shares allotted, the face value of the</li> </ul>

	shares allotted, the price and the form of consideration:
(ix) main objects of public offer, terms of the present issue and such other particulars as may be prescribed;	The prospectus to be issued shall contain the following particulars, namely: - <ul style="list-style-type: none"> <li>(a) the objects of the issue;</li> <li>(b) the purpose for which there is a requirement of funds ;</li> <li>(c) the funding plan (means of finance);</li> <li>(d) the summary of the project appraisal report (if any);</li> <li>(e) the schedule of implementation of the project;</li> <li>(f) the interim use of funds, if any</li> </ul>
(x) main objects and present business of the company and its location, schedule of implementation of the project;	--
(xi) particulars relating to— <ul style="list-style-type: none"> <li>(A) management perception of risk factors specific to the project;</li> <li>(B) gestation period of the project;</li> <li>(C) extent of progress made in the project;</li> <li>(D) deadlines for completion of the project; and</li> <li>(E) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company;</li> </ul>	<ul style="list-style-type: none"> <li>(i) the details of any litigation or legal action pending or taken by any Ministry or Department of the Government or a statutory authority against any promoter of the issuer company during the last five years immediately preceding the year of the issue of the prospectus and any direction issued by such Ministry or Department or statutory authority upon conclusion of such litigation or legal action shall be disclosed;</li> <li>(ii) the details of pending litigation involving the issuer, promoter, director, subsidiaries, group companies or any other person, whose outcome could have material adverse effect on the position of the issuer;</li> <li>(iii) the details of pending proceedings initiated against the issuer company for economic offences;</li> <li>(iv) the details of default and non-payment of statutory dues etc</li> </ul>
(xii) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;	--
(xiii) details of directors including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed; and	The details of directors including their appointment and remuneration, and particulars of the nature and extent of their interests in the company shall be disclosed in the following manner, namely:- <ul style="list-style-type: none"> <li>(i) the name, designation, Director</li> </ul>

	<p>Identification Number (DIN), age, address, period of directorship, details of other directorships;</p> <p>(ii) the remuneration payable or paid to the director by the issuer company, its subsidiary and associate company; shareholding of the director in the company including any stock options; shareholding in subsidiaries and associate companies; appointment of any relatives to an office or place of profit;</p> <p>(iii) the full particulars of the nature and extent of interest, if any, of every director:</p> <p>(a) in the promotion of the issuer company; or</p> <p>(b) in any immoveable property acquired by the issuer company in the two years preceding the date of the Prospectus or any immoveable property proposed to be acquired by it.</p> <p>(iv) where the interest of such a director consists in being a member of a firm or company, the nature and extent of his interest in the firm or company, with a statement of all sums paid or agreed to be paid to him or to the firm or company in cash or shares or otherwise by any person either to induce him to become, or to help him qualify as a director, or otherwise for services rendered by him or by the firm or company, in connection with the promotion or formation of the issuer company shall be disclosed.</p>
<p>(xiv) disclosures in such manner as may be prescribed about sources of promoter's contribution;</p>	<p>The sources of promoters' contribution, if any, shall be disclosed in the following manner, namely:-</p> <p>(i) the total shareholding of the promoters, clearly stating the name of the promoter, nature of issue, date of allotment, number of shares, face value, issue price or consideration, source of funds contributed, date when the shares were made fully paid up, percentage of the total pre and post issue capital;</p> <p>(ii) the proceeds out of the sale of shares of the company and shares of its subsidiary</p>

	<p>companies previously held by each of the promoters;</p> <p>(iii) the disclosure for sources of promoters contribution shall also include the particulars of name, address and the amount so raised as loan, financial assistance etc , if any, by promoters for making such contributions and in case of own sources, complete details thereof.</p>
----	<p>In the case of an initial public offer of an existing company, the details regarding individual allotment shall be given from the date of incorporation of the issuer and in the case of a listed issuer company, the details shall be given for five years immediately preceding the date of filing of the prospectus:</p> <p>The issuer company shall also disclose the number and price at which each of the allotments were made in the last two years preceding the date of the prospectus separately indicating the allotments made for considerations other than cash and the details of the consideration in each case.</p>

### Reports to be set out in the Prospectus.-

Section 26(1)(b) states that the following reports to be set out in the prospectus for the purposes of the financial information, namely:—

<b>Requirement under Section 26(1)(b)</b>	<b>Prescribed under Rule 4 and 5 of Companies (Prospectus and Allotment of Securities) Rules, 2014</b>
<p>(i) reports by the auditors of the company with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed;</p>	<p>The reports by the auditors with respect to profit and assets and liabilities - The report shall also include the amounts or rates of dividends, if any, paid by the issuer company in respect of each class of shares for each of the five financial years immediately preceding the year of issue of the prospectus, giving particulars of each class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares for any of those years:</p> <p>If no accounts have been made up in respect of any part of the period of five years ending on a date three months before the issue of the prospectus, a statement of that fact accompanied by a statement of the accounts of the issuer company in respect of</p>

	that part of the said period up to a date not earlier than six months of the date of issue of the prospectus indicating the profit or loss for that period and assets and liabilities position as at the end of that period together with a certificate from the auditors that such accounts have been examined and found correct and the said statement may indicate the nature of provision or adjustments made or which are yet to be made.
(ii) reports relating to profits and losses for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed:	The reports relating to profits and losses for each of the five financial years or where five financial years have not expired, for each of the financial year immediately preceding the issue of the prospectus shall-
In case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in such manner as may be prescribed, the reports relating to profits and losses for each of the financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries;	<p>(a) if the company has no subsidiaries, deal with the profits or losses of the company (distinguishing items of a non-recurring nature) for each of the five financial years immediately preceding the year of the issue of the prospectus; and</p> <p>(b) if the company has subsidiaries, deal separately with issuer company's profits or losses as provided in clause (a) and in addition, deal either -</p> <ul style="list-style-type: none"> <li>(i) as a whole with the combined profits or losses of its subsidiaries, so far as they concern members of the issuer company; or</li> <li>(ii) individually with the profits or losses of each subsidiary, so far as they concern members of the issuer company; or</li> <li>(iii) as a whole with the profits or losses of the company, and, so far as they concern members of the issuer company, with the combined profits or losses of its subsidiaries</li> </ul>
(iii) reports made in the prescribed manner by the auditors upon the profits and losses of the business of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus:	
In case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in the prescribed manner, the reports made by the	



auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of its business on the last date before the issue of prospectus; and	
(iv) reports about the business or transaction to which the proceeds of the securities are to be applied directly or indirectly;	

### Other matters and reports to be stated in the prospectus

Rule 5 of Companies (Prospectus and Allotment of Securities) Rules, 2014 provides for the following other matters and reports to be disclosed in prospectus, namely:-

(1) If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly –

- (a) in the purchase of any business; or
- (b) in the purchase of an interest in any business and by reason of that purchase, or anything to be done in consequence thereof, or in connection therewith; the company shall become entitled to an interest in either the capital or profits and losses or both, in such business exceeding fifty per cent. thereof, a report made by a chartered accountant (who shall be named in the prospectus) upon-
  - (i) the profits or losses of the business for each of the five financial years immediately preceding the date of the issue of the prospectus ; and
  - (ii) the assets and liabilities of the business as on the last date to which the accounts of the business were made up, being a date not more than one hundred and twenty days before the date of the issue of the prospectus;
- (c) in purchase or acquisition of any immovable property including indirect acquisition of immovable property for which advances have been paid to even third parties, disclosures regarding -
  - (i) the names, addresses, descriptions and occupations of the vendors;
  - (ii) the amount paid or payable in cash, to the vendor and, where there is more than one vendor, or the company is a sub-purchaser, the amount so paid or payable to each vendor, specifying separately the amount, if any, paid or payable for goodwill;
  - (iii) the nature of the title or interest in such property proposed to be acquired by the company; and
  - (iv) the particulars of every transaction relating to the property, completed within the two preceding years, in which any vendor of the property or any person who is, or was at the time of the transaction, a promoter, or a director or proposed director of the company had any interest, direct or indirect, specifying the date of the transaction and the name of such promoter, director or proposed director and stating the amount payable by or to such vendor, promoter, director or proposed director in respect of the transaction.

(2)(a) If -

- (i) the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or are to be applied directly or indirectly and in any manner resulting in the acquisition by the company of shares in any other body corporate; and

- (ii) by reason of that acquisition or anything to be done in consequence thereof or in connection therewith, that body corporate shall become a subsidiary of the company, a report shall be made by a Chartered Accountant (who shall be named in the prospectus) upon -
  - (A) the profits or losses of the other body corporate for each of the five financial years immediately preceding the issue of the prospectus; and
  - (B) the assets and liabilities of the other body corporate as on the last date to which its accounts were made up.

(b) The said report shall -

- (i) indicate how the profits or losses of the other body corporate dealt with by the report would, in respect of the shares to be acquired, have concerned members of the issuer company and what allowance would have been required to be made, in relation to assets and liabilities so dealt with for the holders of the balance shares, if the issuer company had at all material times held the shares proposed to be acquired; and
- (ii) where the other body corporate has subsidiaries, deal with the profits or losses and the assets and liabilities of the body corporate and its subsidiaries in the manner as provided in sub-clause (ii) of clause (a).

(3) The matters relating to terms and conditions of the term loans including re-scheduling, prepayment, penalty, default.

(4) The aggregate number of securities of the issuer company and its subsidiary companies purchased or sold by the promoter group and by the directors of the company which is a promoter of the issuer company and by the directors of the issuer company and their relatives within six months immediately preceding the date of filing the prospectus with the Registrar of Companies shall be disclosed.

(5) The matters relating to Material contracts; Time and place at which the contracts together with documents will be available for inspection from the date of prospectus until the date of closing of subscription list.

(6) The related party transactions entered during the last five financial years immediately preceding the issue of prospectus as under -

- (a) all transactions with related parties with respect to giving of loans or, guarantees, providing securities in connection with loans made, or investments made ;
- (b) all other transactions which are material to the issuer company or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer company or any of its parent companies was a party:

The disclosures for related party transactions for the period prior to notification of these rules shall be to the extent of disclosure requirements as per the Companies Act, 1956 and the relevant accounting standards prevailing at the said time.

(7) The summary of reservations or qualifications or adverse remarks of auditors in the last five financial years immediately preceding the year of issue of prospectus and of their impact on the financial statements and financial position of the company and the corrective steps taken and proposed to be taken by the company for each of the said reservations or qualifications or adverse remarks.

(8) The details of any inquiry, inspections or investigations initiated or conducted under the Companies Act or any previous companies law in the last five years immediately preceding the year of issue of prospectus in the case of company and all of its subsidiaries; and if there were any prosecutions filed (whether pending or

not); fines imposed or compounding of offences done in the last five years immediately preceding the year of the prospectus for the company and all of its subsidiaries.

(9) The details of acts of material frauds committed against the company in the last five years, if any, and if so, the action taken by the company.

(10) A fact sheet shall be included at the beginning of the prospectus which shall contain -

- (a) the type of offer document ("Red Herring Prospectus" or "Shelf Prospectus" or "Prospectus"). (explained later in this chapter)
- (b) the name of the issuer company, date and place of its incorporation, its logo, address of its registered office, its telephone number, fax number, details of contact person, website address, e-mail address;
- (c) the names of the promoters of the issuer company;
- (d) the nature, number, price and amount of securities offered and issue size, as may be applicable;
- (e) the aggregate amount proposed to be raised through all the stages of offers of specified securities made through the shelf prospectus;
- (f) the name, logo and address of the registrar to the issue, along with its telephone number, fax number, website address and e-mail address;
- (g) the issue schedule -
  - (i) date of opening of the issue;
  - (ii) date of closing of the issue;
  - (iii) date of earliest closing of the issue, if any.
- (h) the credit rating, if applicable;
  - (i) all the grades obtained for the initial public offer;
- (j) the name(s) of the recognised stock exchanges where the securities are proposed to be listed;
- (k) the details about eligible investors;
- (l) coupon rate, coupon payment frequency, redemption date, redemption amount and details of debenture trustee in case of debt securities.

### **When Section 26(1) is not applicable?**

Section 26(2) states that section 26(1) does not apply to

- (a) to the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of section 62 in favour of any other person; or
- (b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

### **Filing a copy of prospectus with registrar etc.**

Section 26(4) states that no prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, there has been delivered to the Registrar

for registration, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

Section 26(6) further states that every prospectus issued under sub-section (1) shall, on the face of it,—

- (a) state that a copy has been delivered for registration to the Registrar as required under sub-section (4); and
- (b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

Section 26(7) states that the Registrar shall not register a prospectus unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

Section 26(8) states that no prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar under sub-section (4).

### **Including a statement by an expert in the prospectus**

Section 26(5) states that a prospectus issued under sub-section (1) shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company and has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration and a statement to that effect shall be included in the prospectus.

### **Penalty for contravention of Section 26**

Section 26(9) states that if a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

#### ***Let us recapitulate Section 26***

- Section 26(1) requires certain disclosures to be made in the prospectus, certain reports to be set out in the prospectus.
- Prospectus to be delivered to the registrar before its publication
- Prospectus to be issued within 90 days after the date on which a copy thereof is delivered to the registrar.
- Prospectus issued shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management

### **Variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued**

Section 27(1) states that a company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution:

Notice in respect of resolution to shareholders, shall also published in English and in vernacular language in

the city where the registered office of the company is situated indicating clearly the justification for such variation company not to use any amount raised by it through Prospectus.

#### **Rule 7 of Companies (Prospectus and Allotment of Securities) Rules, 2014**

1. When the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot and the notice of the proposed special resolution shall contain the following particulars, namely:-
  - the original purpose or object of the Issue;
  - the total money raised;
  - the money utilised for the objects of the company stated in the prospectus;
  - the extent of achievement of proposed objects(that is fifty percent, sixty percent, etc);
  - the unutilised amount out of the money so raised through prospectus,
  - the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;
  - the reason and justification for seeking variation;
  - the proposed time limit within which the proposed varied objects would be achieved;
  - the clause-wise details as specified in sub-rule (3) of rule 3 as was required with respect to the originally proposed objects of the issue;
  - the risk factors pertaining to the new objects; and
  - the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.
2. The notice in respect of such resolution to shareholders, shall also be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation: The advertisement of notice shall be in Form PAS-1 and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders.
3. The notice shall also be placed on the web-site of the company, if any.

Further the proviso to section 27(1) also provides that the company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

#### **Dissenting shareholders to variation of terms are to be given exit option**

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

#### ***Let us recapitulate Section 27 read with Companies (Prospectus and Allotment of Securities) Rules, 2014***

- Variation of the terms of a contract referred to in the prospectus or objects for which the prospectus requires passing a special resolution through postal ballot.
- The notice in respect of such resolution to shareholders, shall also be published in the newspapers in Form PAS-1

# PROSPECTUS

## Disclosures to be made in prospectus

- ✓ Matters relating to terms and conditions of the term loans
- ✓ The aggregate number of securities of the issuer company and its subsidiary companies purchased or sold by the promoter group and by the director
- ✓ The related party transactions entered during the last five financial years
- ✓ Summary of reservations or qualifications or adverse remarks of auditors in the last five financial years.
- ✓ Inquiry, inspection or investigation initiated or conducted under the companies act or any previous company law in the last five years
- ✓ Fines imposed or

## Reports to be set out

- ✓ Reports by auditors of the company
- ✓ Reports relating to profit and loss for each of five financial years immediately preceding the issuing financial year
- ✓ Reports made by auditors upon the profit and losses of business of the company for each of five financial year immediately preceding issue and assets and liabilities of the business on the last date to which the accounts of the business were being made up but not more than 180 days.
- ✓ Reports about the Business or transactions to which the proceeds of the securities are to be applied directly or indirectly

## Other compliances

- ✓ Prospectus Shall be dated and signed
- ✓ On or before the date of publication the company shall register a copy of prospectus with registrar
- ✓ Expert's statement to be included in prospectus
- ✓ Prospectus filed with ROC is valid for 90 days from the date of filing

**For advertisement of prospectus a company shall specify:**

- Contents of memorandum, capital, objects and liability of members.
- Name of signatories to memorandum and number of shares issued to them
- Its capital structure

**Offer of Sale by Members.-**

Section 28(1) states that where certain members of a company propose, in consultation with the Board of Directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed.

Section 28(2) further states that any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

Sub-section (3) states that the members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

**Rule 8 of Companies (Prospectus and Allotment of Securities) Rules, 2014**

(1) The provisions of Part I of Chapter III namely “Prospectus and Allotment of Securities” and rules made there under shall be applicable to an offer of sale referred to in section 28 except for the following, namely:-

- (a) the provisions relating to minimum subscription;
- (b) the provisions for minimum application value;
- (c) the provisions requiring any statement to be made by the Board of directors in respect of the utilization of money; and
- (d) any other provision or information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply with such provisions.

(2) The prospectus issued under section 28 shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.

Offer of sale by members to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and Provisions of Part I of Chapter III would be applicable accordingly, with some exceptions specified in the rules.

**Dematerialisation of Securities-mandatory**

Section 29(1) states that notwithstanding anything contained in any other provisions of this Act,—

- (a) every company making public offer; and
- (b) such other class or classes of public companies as may be prescribed,

shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Section 29(2) further states that any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Rule 9 of Companies (Prospectus and Allotment of Securities) Rules, 2014, states that the promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialised form.

The entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only.

### Advertisement of Prospectus

Section 30 provides that where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the objects, the liability of members and the amount of share capital of the company, and the names of the signatories to the memorandum and the number of shares subscribed for by them, and its capital structure.

### REVIEW QUESTIONS



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

The prospectus can contain statements of experts who are interested in the formation and management of the company, as long as the consent of the expert is taken in this regard.

- True
- False

**Correct answer: True**

### SHELF PROSPECTUS

***“Shelf Prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. Accordingly as per Section 31—***

1. Any class of companies, as prescribed by the Securities and Exchange Board may file a shelf prospectus with the Registrar at the stage of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under such prospectus. Further, in respect of a second or subsequent offer issued during the period of validity of shelf prospectus, no further prospectus is required.

2. A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer and other prescribed changes, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under such prospectus.

Where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, they shall intimate the changes to such applicants. If the applicants express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days.

3. Where an information memorandum is filed, every time an offer of securities is made as aforesaid, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

The concept of shelf prospectus will save expenditure and time of the companies in issuing a new



prospectus every time they wish to issue securities to the public within a period of one year.

### **Information Memorandum to be filed before the issue of a second or subsequent offer of securities under the shelf prospectus**

Rule 10 of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

### **Red-Herring Prospectus**

***"Red Herring Prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.***

Section 32 of the Act deals with Red Herring Prospectus. It provides that—

1. As per this section, a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
2. A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.
3. A red herring prospectus shall carry the same obligations as are applicable to a prospectus. Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
4. Upon the closing of the offer of securities, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

Red herring prospectus is issued during book building process. Red herring prospectus contains either the floor price of securities offered or a price band along with the range within which the Bids can move. The applicants bid for the shares quoting the price and the quantity that they would like to bid at. SEBI (ICDR) Regulations prescribe certain disclosures to be made in the red-herring prospectus.

Once the offer for securities is closed, a final prospectus stating therein the total capital raised whether by way of debt or share capital, the closing price of the securities and any other details which are not complete in the red-herring prospectus shall be filed with SEBI in the case of listed public company and in any other case with the Registrar of companies only.

The compliances under SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 relating to shelf prospectus and red-herring prospectus is covered under chapter 'Issue of Securities' in paper Capital Markets and Securities Laws of Executive programme.

### **Application to be accompanied by abridged prospectus**

***"Abridged Prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. [Section 2(1)]***

Section 33 states that no form of application can be issued for the purchase of any securities of a company unless it is accompanied by an abridged prospectus. There are, however, four exceptions to this rule:

- (a) where the offer is made in connection with the *bona fide* invitation to a person to enter into an

- underwriting agreement with respect to such securities;
- (b) where the securities are not offered to the public;
  - (c) where the offer is made only to the existing members or debenture holders of the company with or without a right to renounce;
  - (d) where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognised stock exchange.

A copy of the prospectus shall be furnished to a person on a request being made by him before the closing of the subscription list and the offer.

If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default.

### **The Golden Rule Or Golden Legacy**

It is the duty of those who issue the prospectus to be truthful in all respects. This Golden Rule was pronounced by Kinderseley, V.C. in *New Brunswick, etc., Co. v. Muggerridge*, (1860) 3 LT 651, and has come to be known as the "golden legacy". "Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representation contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as a fact which is not so and no fact should be omitted, the existence of which might in any degree affect the nature or quality of the privileges and advantages which the prospectus holds out as inducement to take shares. In short, the true nature of the company's venture should be 'disclosed'. If concealment of any material fact has prevented an adequate appreciation of what was stated, it would amount to misrepresentation. Thus, even if every specific statement is literally true, the prospectus may be false if by reason of the suppression of other material facts, it conveys a false impression".

In *R.V. Kysant* (1932) K.B. 442, all statements in the prospectus were literally true but it failed to disclose that the dividends stated in it as paid, were not paid out of trading profits, but out of realized capital profits (secret reserves). The statement that the company had paid dividends for a number of years was true. But the company has incurred losses for all those years (1921-27) and no disclosure was made of this fact. The prospectus was held to be false in material particulars and the managing director and chairman, who knew that it was false, were held guilty of fraud.

### **Liability for Untrue Statement in Prospectus**

It is now clear that a prospectus must be complete and perfect in all details or in other words nothing should be omitted and nothing must be untrue in a prospectus.

Where an untrue statement occurs in a prospectus, there may arise (i) civil liability (ii) criminal liability. Every person who is a director of the company at the time of the issue of the prospectus, every promoter of the company and every person, including an expert, who has authorised the issue of a prospectus, shall be liable. Since the liability of these persons is to the allottee of securities, we may discuss this matter under the heading remedies for mis-statements in a prospectus.

### **What is an Untrue Statement?**

It is essential to know as to what constitutes an untrue statement. To protect the interests of prospective investors in the securities of a company, the law prescribes a wider meaning to this term. Whether a statement is untrue or not is to be judged by the context in which it appears and the totality of impression it

would create. A statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included.

Further, where any inclusion or omission of any matter in a prospectus is likely to mislead, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included.

The expression “Included” with reference to a prospectus means included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith. Even if every word included in the prospectus is true, the suppression of material facts may cause the prospectus to be fraudulent.

### Onus for Proof of Mis-statement

The burden of proof in a suit by an allottee that he has been misled by the mis-statement in the prospectus lies on the allottee. He must prove the following:

- (i) The misrepresentation was of a fact;
- (ii) It was in respect of a material fact. What is a material statement of fact will depend upon the circumstances of each case.
- (iii) He acted on the misrepresentation; and
- (iv) He suffered damages in consequence.

### Remedies for Misrepresentation in Prospectus

A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company, e.g., the Board of directors. The company is also liable for misstatement in prospectus even though the prospectus is issued by the promoters & the Board ratifies and adopts the issue of prospectus.

**The first remedy against the company is to rescind the contract.** A person who takes securities on the faith of a prospectus containing false statements, may apply to the Court for setting contract aside, and striking off his name from the register of members. He may also claim his money back. But the allottee must act within a reasonable time, before any proceedings to wind up the company have been commenced, and before he does anything after notice of misrepresentation which is inconsistent with the right to rescind.

**The second remedy against the company is to sue for damages for deceit.** This suit is founded on the tort of deceit, and is not a case of fraud on the part of directors or promoters. The allottee may recover damages from the company for any loss he may have suffered if the invitation to take securities is emanating from the company and the persons making it on behalf of the company have fraudulently mis-represented material facts. The allottee cannot both retain the securities and get damages against the company. In actual practice, however, suits for damages against the company are rarely filed. Damages are generally claimed from the directors, promoters and other persons who authorised the issue of the prospectus.

### Remedies against Directors or Promoters

A person who subscribed for shares on the faith of a false prospectus may claim from directors or promoters:

- (i) damages for fraudulent misrepresentation,
- (ii) Compensation under Section 35 of the Act,
- (iii) Damages for non-compliance with the requirements of Section 26 of the Act.

#### ***(i) Damages for fraudulent misrepresentation***

An allottee may sue the director for damages for deceit, if there are fraudulent misrepresentations in the

prospectus. But the directors will not be liable for damages for mis-statement if they believed them to be true [Derry v. Peek, (1889) 14 AC 337].

***(ii) Compensation for untrue Statement***

An allottee is also entitled to claim compensation from directors, promoters and any other persons who authorised the issue of the false prospectus, for damages sustained by reason of any untrue statement in it. As per section 35(1), where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company, then, the following persons are liable to pay compensation to every person who has sustained loss or damage by reason of untrue statement included in a prospectus:

- (a) every person who is a director of the company at the time of the issue of the prospectus;
- (b) every person who has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- (c) every person who is a promoter of the company;
- (d) every person who has authorised the issue of the prospectus; and
- (e) is an expert referred to in sub-section (5) of section 26

The above stated liability shall be without prejudice to any punishment to which any person may be liable under section 36.

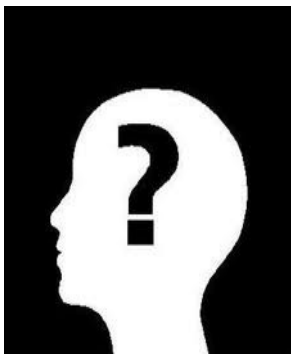
*When civil liability can be avoided [Section 35(2)]*

No person referred above shall be liable for civil action if he proves:

- (i) that having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- (ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

Further an expert may also escape the liability, if he proves that having given his consent under Section 26 to the issue of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration to the Registrar.

## REVIEW QUESTIONS



**Choose the correct answer**

A person who acted upon the false prospectus, may claim the following damages:

- (a) Damages for fraudulent misrepresentation
- (b) Compensation for untrue statement.
- (c) Damages for non-compliance with the requirements of section 26 of the Act.
- (d) All of the above

### Criminal Liability for Mis-statements in Prospectus

According to Section 34 of the Companies Act, 2013, where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under section 447. Section 447 provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

However, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years

However, where a person who has authorised the issue of prospectus proves, either that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary may be relieved from the criminal liability.

### Action by affected persons

Section 37 states that a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

This above provision provides for filing class action suits by a persons or group of persons or association of persons affected by misleading statements.

### Who is entitled to remedies?

The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has “subscribed” for securities on the faith of the prospectus containing untrue statement. The word ‘subscribed’ denotes that the shares were acquired directly from the company by allotment. A subsequent purchaser of shares in the open market has no remedy against the company or the directors or promoters. Also, a subscriber to the memorandum cannot seek relief, as the company cannot be said to be in existence when he signed the memorandum, and he cannot be said to have been influenced by any statement, in the prospectus. Again, liability under a prospectus can only arise when the prospectus has been issued, and only in favour of persons who subscribe for securities in response to it and relied upon the statement made therein.

If, however, a prospectus is issued with the object of inducing persons to buy securities in the open market, any person who buys on the strength of the false representation made in it, has a right of action for fraudulent misrepresentation against the company. But the purchaser must have been directly induced by the false statement in the prospectus and nothing else. Two cases may be noted:

### CASE LAWS

- (i) In *Peek v. Gurney* (1873) 43 L.J. Ch. 19, a deceitful prospectus was issued by the directors on behalf of the company. P received a copy of it but did not take any shares originally in the company. The allotment of shares to applicants was completed, and several months afterwards he bought 2,000 shares on the stock exchange. His action against the directors for deceit was rejected. It was observed by the Court that the office of a prospectus is to invite persons to become allottees, and, allotment having been completed, such office is exhausted and liability to allottees does not follow

the shares into the hands of subsequent transferees.

- (ii) In *Andrews v. Mockford* (1869) I.Q.B. 372, the directors sent to A, a prospectus of the company which they knew would be a sham in order to induce A to purchase shares therein. A did not subscribe for the shares at that time. The prospectus, having produced but a scanty subscription for shares, the directors thereupon fraudulently published a telegram in newspaper. A believing in the truth of the telegram was induced to purchase shares in the open market. The directors were held liable for the systematic fraud. "The function of the prospectus was not exhausted, and the false telegram was brought into play by defendants to reflect back upon and countenance the false statements in the prospectus."

Further, by reason of the decision of the House of Lords in *Hedley Byrne Co. v. Hellers & Partners*, (1964) A.C. 465, a person may become liable for holding out a false statement to any one whom he knew or ought to have known would act in reliance upon the statement.

## REVIEW QUESTIONS



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

The allottee can both retain the securities and get damages against the company, for untrue statement in prospectus.

- True
- False

**Correct answer: False**

The allottee cannot both retain the shares and get damages against the company.

## Penalty For Fraudulently Inducing to Invest Money

Section 36 provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into,—

- (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or
- (b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
- (c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution,

shall be liable for action under section 447.

## Prohibition of personation for acquisition etc. of securities

As per Section 38(1) any person who—

- (a) makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or
- (b) makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

- (c) otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name,

shall be liable for action under section 447.

### **Section 38(2)**

The provisions of section 38(1) shall be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

### **Section 38(3)**

Where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person.

### **Section 38(4)**

The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

## LESSON ROUND-UP

- Prospectus has been defined as any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.
- One of the ingredients of a prospectus is to make invitation to the public to subscribe for securities of a body corporate which is construed as including a reference to any section of the public, whether selected as members or debenture-holders of the company or as clients of the person issuing the prospectus. However, there are exceptions to it.
- All public companies making public offer issue a prospectus.
- Shelf prospectus means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.
- Red herring prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
- Companies Act and SEBI guidelines provide for contents and disclosures required in a prospectus.
- No application form can be issued for securities unless it is accompanied by a memorandum containing such salient features of prospectus as may be prescribed.
- A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company. The company is also liable if though the prospectus is issued by the promoters, the Board ratifies and adopts the issue.
- A person who subscribed for securities on the faith of a false prospectus may claim from directors or promoters damages for fraudulent misrepresentation, compensation, damages for non-compliance with the requirements of the Act.
- Where a prospectus includes any untrue statement, every person who has authorised the issue of the prospectus shall be punishable with imprisonment, fine or both.

- The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has subscribed for securities on the faith of the prospectus containing untrue statement.
- Penalty is also leviable under the Act for fraudulently inducing a person to invest money.
- Impersonation for the acquisition of securities has been made an offence under the Companies Act, punishable with imprisonment.

## GLOSSARY

<b>Shelf prospectus</b>	A Prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over certain period without the issue of a further Prospectus.
<b>Red Herring Prospectus</b>	Red herring prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
<b>Abridged Prospectus</b>	Abridged Prospectus is usually a shorter form of the Prospectus and possesses all the significant features of a Prospectus. This accompanies the application form of public issues.

## SELF-TEST QUESTIONS

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

1. What is a prospectus? Is the issue of a prospectus compulsory on the part of a company?
2. What amounts to a misstatement in a prospectus? What are the remedies available to a subscriber who has taken shares on the basis of a misstatement in a prospectus?
3. Discuss the liability of a company for untrue statements or omissions in its prospectus.
4. Discuss the civil as well as criminal liability of persons who authorise the issue of a false prospectus.
5. Explain the legal provisions relating to issue and registration of a prospectus?
6. What are the remedies open to an allottee of securities who have had applied for them on the faith of a false and misleading prospectus and what are the defenses available to the directors of the company who have issued such a prospectus?
7. Discuss in detail the contents and the form of a prospectus.
8. Who is deemed to be an expert in relation to the prospectus of a company? What conditions must be satisfied before a report by an expert can be published therein? Is there any remedy available to the allottee of the securities who has been induced to take securities on the faith of an untrue statement of an expert in the prospectus?
9. 'Prospectus is the window through which company is displayed without distortion'. — Comment.
10. Write short notes on:
  - (a) Abridged prospectus;







# Lesson 9

## Debt Capital

### LESSON OUTLINE

- Borrowing power of the company
- Unauthorized or ultra vires borrowing
- Intra vires borrowing but outside the scope of agent's authority
- Distinction between debenture and shares
- Special resolution to issue convertible debentures
- Creation of Debenture Redemption Reserve
- Debenture Trust Deed
- Secured debenture to comply with certain conditions
- Public sector bonds and foreign bonds, brokerage
- Developments in corporate debt financing

### LEARNING OBJECTIVES

The provisions to issue debentures are covered under Section 71 of the Companies Act 2013 and Rule 18 of Companies (Share Capital and Debentures) Rules 2014. The listed companies are additionally governed by listing agreement and SEBI (Issue and Listing of Debt Securities) Regulations, 2008. Further the borrowing powers of the board are regulated by Section 179 which mandates that power to borrow has to be through properly convened board meeting.

After going through this lesson you will be able to understand the provisions of Companies Act and rules made there under, with respect to debentures including creation of debenture redemption reserve, trust deed, appointment of trustees, shareholders approval through special resolution for issue of convertible debentures, way of securing debentures etc., Besides, you will get a broad over view of public sector bonds, foreign bonds, money market instruments etc.,

## BORROWING

In order to run a business effectively/successfully, adequate amount of capital is necessary. In some cases capital arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. External Commercial borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits etc. Thus, borrowing is a mechanism used whereby the money is arranged through external resources with an implied or expressed intention of returning money.

### Power of Company to Borrow

The power of the company to borrow is exercised by its directors, who cannot borrow more than the sum authorized. The powers to borrow money and to issue debentures whether in or outside India can only be exercised by the Directors at a duly convened meeting. Pursuant to Section 179(3) (c) & (d) directors have to pass resolution at a duly convened Board Meeting to borrow moneys. The power to issue debentures cannot be delegated by the Board of directors. However, the power to borrow monies can, be delegated by a resolution passed at a duly convened meeting of the directors to a committee of directors, managing director, manager or any other principal officer of the company. The resolution must specify the total amount up to which the moneys may be borrowed by the delegates. Often the power of the company to borrow is unrestricted, but the authority of the directors acting as its agents is limited to a certain extent. For example, Section 180(1)(c) of the Act prohibits the Board of directors of a company from borrowing a sum which together with the monies already borrowed exceeds the aggregate of the paid-up share capital of the company and its free reserves apart from temporary loans obtained from the company's bankers in the ordinary course of business unless they have received the prior sanction of the company by a special resolution in general meeting.

Explanation to section 180(1)(c) provides that the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

It is further provided in proviso to Section 180(1)(c) that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be borrowing of monies by the banking company within the meaning of clause (c) of Sub-section (1) of Section 180. It is important at this stage to distinguish between, borrowing which is *ultra vires* the company and borrowing which is *intra vires* the company but outside the scope of the director's authority.

The provisions of Sub-section (5) of Section 180 clearly lay down that debts incurred in excess of the limit fixed by clause (c) of Sub-section (1) shall not be valid unless the lender proves that he lent his money in good faith and without knowledge of the limit imposed by Sub-section (1) being exceeded.

With recent exemption notification no 464(E) Private Companies have been exempted to comply the entire provisions of Section 180 of the Companies Act 2013, resultantly special resolution is not required to exercise powers under section 180.

### Unauthorized or Ultra Vires Borrowing

Where a company borrows without the authority conferred on it by the articles or beyond the amount set out

in the Articles, it is an *ultra vires* borrowing. Any act which is *ultra vires* the company is void. In such a case the contract is void and the lender cannot sue the company for the return of the loan. The securities given for such *ultra-vires* borrowing are also void and inoperative. *Ultra vires* borrowings cannot even be ratified by a resolution passed by the company in general meeting. However, equity assists the lender where the common law fails to do so. If the lender has parted with his money to the company under an *ultra vires* borrowing, and is, therefore, unable to sue for its return, or enforce any security granted to him, he nevertheless has, in equity, the following remedies:

- (A) **Injunction and Recovery:** Under the equitable doctrine of restitution he can obtain an injunction provided he can trace and identify the money lent, and any property which the company has bought with it. Even if the monies advanced by the lender cannot be traced, the lender can claim repayment if it can be proved that the company has been benefited thereby.
- (B) **Subrogation:** Where the money of an *ultra vires* borrowing has been used to pay off lawful debts of the company, he would be subrogated to the position of the creditor paid off and to that extent would have the right to recover his loan from the company. Subrogation is allowed for the simple reason that when a lawful debt has been paid off with an *ultra vires* loan, the total indebtedness of the company remains the same. By subrogating the *ultra vires* lender, the Court is able to protect him from loss, while debt burden of the company is in no way increased.
- (C) **Suit against Directors:** In case of *ultra vires* borrowing, the lender may be able to sue the directors for breach of warranty of authority, especially if the directors deliberately misrepresented their authority [*Executors v. Himpheys* (1866) QBD 64].

### Intra vires Borrowing but outside the Scope of Agents' Authority

A distinction should always be made between a company's borrowing powers and the authority of the directors to borrow. Where the directors borrowed money beyond their authority and the borrowing is not *ultra vires* the company, such borrowing is called *Intra vires* borrowing but outside the Scope of Agents' Authority. The company will be liable to such borrowing if the borrowing is within the directors' ostensible authority and the lender acted in good faith or if the transaction was ratified by the company.

Where the borrowing is *intra vires* the company but outside the authority of the directors e.g. where the articles provide that the directors shall have the power only up to Rs. 100 lacs and prior approval of the shareholders would be required to borrow beyond Rs. 100 lacs; any borrowing beyond Rs.100 lacs without shareholders approval i.e. *intra vires* borrowing by the company but outside authority of directors can be ratified by the company and become binding on the company. The company would be liable, particularly if the money has been used for the benefit of the company. Here the legal position is quite clear. The company has power or capacity to borrow, but the authority of the directors is restricted either by the articles of the company or by the statute, and they have exceeded it. The company may, if it wishes, ratify the agent's act in which case the loan binds the company and the lender as if it had been made with company's authority in the first place.

On the other hand, the company may refuse to ratify the agent's act. Here the normal principles of agency apply. The doctrine of Indoor Management (also known as rule in *Royal British Bank v. Turquand* (1856) 11 Q.B. 273) shall protect the lender, provided he can establish that he advanced the money in good faith. A third-party who deals with an agent knowing that the agent is exceeding his authority has no right of action against the principal. Bearing in mind that the memorandum and articles are public documents, the contents of which the third-party is deemed to know, he will obviously have no right of action against the company if the agent's lack of authority is obvious from reading them. But a third-party is not affected by secret restrictions on the agent's authority, as the lack of authority is not clear from the public documents and the lender can not be aware of it from some other source. Therefore, the company will be liable.

## CASE LAWS

### Judicial Pronouncement relating to borrowing power of a company

- (A) '**Borrowing**' necessarily implies repayment at some time and under some circumstances [*Re. Southern Brazilian Rio* (1905) 2 Ch. 78].
- (B) Where the directors mortgaged the company's property exceeding the limits of their authority, it was held that the lending bank was entitled to retain possession and to claim institution before it could be compelled to surrender possession [*Deonarayan Prasad Bhadani v. Bank of Baroda Ltd.* (1957) 27 Com Cases 223, 239 (Bom.)].
- (C) The behaviour of the directors, as the company's agents, can have no effect whatsoever on the validity of the loan for no agent can have more capacity than his principal. No agent can have a power which is not with the principal. If, therefore, the borrowing is *ultra vires* the company so that the company has no capacity to undertake it, the lender can have no rights at common law. No debt is created and any security which may have been created in respect of the borrowing is also void. The lender cannot sue the company for the repayment of the loan. [*Sinclair v. Brougham* (1914) 88 LJ Ch 465].
- (D) The power of a company to borrow money is implied in the case of all trading companies. [*General Auction Estate Co. v. Swith* (1891) Ch 432].
- (E) A power to borrow money cannot be implied [*Baroness Wenlock v. River Dee* (1885) 10 App Cas 354].
- (F) If the borrowing by the directors is *ultra vires* their powers, the directors may, in certain circumstances, be personally liable for damages to the lender, on the ground of the implied warranty given by them, that they had power to borrow [*Firbank's Executors v. Humphreys*, (1886) 18 QBD 54; *Garrard v. James*, 1925 Ch. 616].
- (G) Sometimes it happens that a power to borrow exists but is restricted to a stated amount, in such a case if by a single transaction an amount in excess is borrowed, only the excess would be *ultra vires* and not the whole transaction [*Deonarayan Prasad Bhadani v. Bank of Baroda*, (1957) 27 Com Cases 223 (Bom.)].
- (H) The acquiescence of all shareholders in excess loans contracted by directors beyond their powers but not *ultra vires* the powers of the company would be sufficient to validate such excess debts. [*Sri Balasaraswathi Ltd. v. Parameswara Aiyar*, (1956) 26 Com Cases 298, 308: AIR 1957 Mad 122].
- (I) If the borrowing is unauthorized, the company will be liable to repay, if it is shown that the money had gone into the company's coffers [*Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.*, (1957) 27 Com Cases 660: AIR 1957 All 311].
- (J) In *V.K.R.S.T Firm v. Oriental Investment Trust Ltd.*, AIR 1944 Mad 532 under the authority of the company, its managing director borrowed large sums of money and misappropriated it. The company was held liable stating that where the borrowing is within the powers of the company, the lender will not be prejudiced simply because its officer have applied the loan to unauthorised activities provided the lender had no knowledge of the intended misuse.
- (K) In *T.R. Pratt. (Bom) Ltd. v. E.D. Sassoon and Co. Ltd.*, (1936) 6 Com Cases 90, there was no limit on the borrowing for business in the memorandum of the company. But the directors could not borrow beyond the limit of the issued share capital of the company without the sanction of the general meeting. The directors borrowed money from the plaintiff beyond their powers. It was held

that the money having been borrowed and used for the benefit of the principal either in paying its debts, or for its debts, or for its legitimate business, the company cannot repudiate its liability on the ground that the agent had no authority from the company to borrow. When these facts are established a claim on the footing of money had been received would be maintainable. It was also held that under the general principle of law when an agent borrows money for a principal without the authority of the principal, but if the principal takes benefit of the money so borrowed or when the money so borrowed have gone into the coffers of the principal, the law implies a promise to repay. In that connection it was observed that there appears to be nothing in law which makes this principle inapplicable to the case of a joint stock company and even in cases where the directors or the managing agent had borrowed money without there being authorization for the company, if it has been used for the benefit of the company, the company cannot repudiate its liability to pay.

- (L) In *Equity Insurance Co. Ltd. v. Dinshaw & Co.*, AIR 1940 Oudh 202, it was held that “where the managing agent of a company who is not authorised to borrow, has borrowed money which is not necessary, neither *bona fide*, nor for the benefit of the company, the company is not liable for the amount borrowed”.
- (M) In *Suraj Babu v. Jaitly & Co.* AIR 1946 All 372, P & Co., were the managing agents of L & Co., which was in liquidation. P the manager borrowed a sum of money from J in his own name. In one letter to J he indicated that the loan was for a requirement of L & Co. and that company had actually benefited. It was held that there was no intention to bind the company. “The mere fact that the company had benefited was not in itself sufficient to bind the company”.
- (N) In *Krishnan Kumar Rohatgi and Others v. State Bank of India and Others*, (1980) 50 Com Cases 722, the company borrowed an amount of Rs. 5 lakhs from the Bank under a Promissory Note. The repayment was guaranteed by a person by executing a guarantee in favour of the company. The company used to make payments towards loan and the promissory note used to be renewed from time to time. In the suit for recovery, the company contended that the pro-note was executed by the Chairman without there being a resolution of the Board of directors authorizing the Chairman to execute the pro-note as required under Section 292(1)(c) of the Act, 1956 [Corresponds to section 179(1)(d) of the Companies Act, 2013]. Rejecting these contentions the Patna High Court held that in cases where the directors borrow funds without their having authorization from the company and if the money has been used for the benefit of the company, the company cannot repudiate its liability to repay. Under the general principles of law, when an agent borrows money for a principal without the authority of the principal but the principal takes the benefit of the money so borrowed or when the money so borrowed has gone into the coffers of the principal, the law implies a promise to be paid by the principal.

*Ultra vires* borrowings cannot even be ratified by a resolution passed by the company in a general meeting.

## TYPES OF BORROWINGS

A company uses various kinds of borrowing to finance its operations. The various types of borrowings can generally be categorized into: 1) Long term/short term borrowing, 2) Secured/unsecured borrowing, 3) Syndicated/ Bilateral borrowing, 4) Private/Public borrowing.

- 1A. **Long Terms Borrowings** - Funds borrowed for a period ranging for five years or more are termed as long-term borrowings. A long term borrowing is made for getting a new project financed or for making big capital investment etc. Generally Long term borrowing is made against charge on fixed Assets of the company.

- 1B. **Short Term Borrowings** - Funds needed to be borrowed for a short period say for a period up to one year or so are termed as short term borrowings. This is made to meet the working capital need of the company. Short term borrowing is generally made on hypothecation of stock and debtors.
- 1C. **Medium Term Borrowings** - Where the funds to be borrowed are for a period ranging from two to five years, such borrowings are termed as medium term borrowings. The commercial banks normally finance purchase of land, machinery, vehicles etc.
- 2A **Secured/unsecured borrowing** – A debt obligation is considered secured, if creditors have recourse to the assets of the company on a proprietary basis or otherwise ahead of general claims against the company.
- 2B **Unsecured debts comprise** financial obligations, where creditors do not have recourse to the assets of the company to satisfy their claims.
- 3A **Syndicated borrowing** – if a borrower requires a large or sophisticated borrowing facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. The borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate loans, each with different terms and conditions.
- 3B **Bilateral borrowing** refers to a borrowing made by a company from a particular bank/financial institution. In this type of borrowing, there is a single contract between the company and the borrower.
- 4A **Private borrowing** comprises bank-loan type obligations whereby the company takes loan from a bank/financial Institution.
- 4B **Public borrowing** is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter, with few if any restrictions i.e. Debentures, Bonds etc.

### **Borrowing on Security of Property**

The power to borrow includes the power to give security, which may take the form of a mortgage, a charge, hypothecation, lien, guarantee, pledge etc. The creditor's position becomes safer when security is given, for he will not only be able to sue the company for the amount of money which he has lent to it, but he will also be able to enforce his security, i.e., claim that the property charged belongs to him to the extent of the total amount due to him.

A loan taken by a company may be secured by any of the following:

- (a) A legal mortgage of specific part of its property;
- (b) An equitable mortgage by deposit of title deeds;
- (c) A mortgage of movable property;
- (d) Issuing Bonds;
- (e) Issuing Promissory notes and bills of exchange;
- (f) A charge on uncalled capital;
- (g) A charge on calls made but not paid;
- (h) A floating charge on the assets of the company;



- (i) Issuing debentures or debenture stock;
- (j) A mortgage of book debts (but not of book);
- (k) A charge on a ship or any share in a ship;
- (l) A charge on goodwill or a patent or a license under a patent, or a trade mark, or on a copyright;
- (m) A pledge of goods.

### Charge on Uncalled Capital

A company does not have implied power of charging its uncalled share capital and a company may charge its uncalled capital if its articles or memorandum authorise it to charge it. The memorandum may give an express power to charge uncalled capital, or the power may be so wide that it can be inferred by implication. For example, in *Newton v. Debenture holders of Anglo-Australian Investment Co.*, (1895) A.C. 224, the memorandum authorised the company to borrow “upon any security of the company”. It was held that the power was wide enough to include a charge on uncalled capital. However, a company cannot mortgage or charge any part of its “reserve capital”, i.e., such portion (if any) of its uncalled share capital as is incapable of being called up except in the event of winding up of the company.

### REVIEW QUESTIONS



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

A company has implied power to mortgage its uncalled share capital.

- True
- False

**Correct Answer: False**

### 3. DEBENTURES

According to Section 2(30) of Companies Act 2013 “debenture” includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not; It is evident from the definition that the term debentures covers both secured and unsecured debentures.

#### Kinds of Debentures

Debentures are generally classified into different categories on the basis of: (1) Convertibility of the Instrument (2) Security of the Instrument (3) Redemption ability (4) Registration of Instrument

1. On the basis of convertibility, Debentures may be classified into following categories:
  - (A) **Non Convertible Debentures (NCD):** These instruments retain the debt character and can not be converted into equity shares.
  - (B) **Partly Convertible Debentures (PCD):** A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.
  - (C) **Fully convertible Debentures (FCD):** These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.

- (D) **Optionally Convertible Debentures (OCD):** The investor has the option to either convert these debentures into shares at price decided by the issuer/agreed upon at the time of issue.
2. On the basis of Security, debentures are classified into:
- (A) **Secured Debentures:** These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails on payment of either the principal or interest amount, his assets can be sold to repay the liability to the investors. Section 71(3) of the Companies Act, 2013 provides that secured debentures may be issued by a company subject to such terms and conditions as may be prescribed by the Central Government through rules.
- (B) **Unsecured Debentures:** These instrument are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor has to be along with other unsecured creditors of the company, they are also said to be naked debentures.
3. On the basis of Redeemability, debentures are classified into:
- (A) **Redeemable Debentures:** It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice, or under a system of periodical drawings. Debentures are generally redeemable and on redemption these can be reissued or cancelled. The person who has been re-issued the debentures shall have the same rights and priorities as if the debentures had never been redeemed.
- (B) **Perpetual or Irredeemable Debentures:** A Debenture, in which no time is fixed for the company to pay back the money, is an irredeemable debenture. The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation. *However, after the commencement of the Companies Act, 2013, now a company cannot issue perpetual or irredeemable debentures.*
4. On the basis of Registration, debentures may be classified as
- (A) **A Registered Debentures:** Registered debentures are made out in the name of a particular person, whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders. Such debentures are transferable in the same manner as shares by means of a proper instrument of transfer duly stamped and executed and satisfying the other requirements specified in Section 56 of the Companies Act, 2013.
- (B) **Bearer debentures:** Bearer debentures on the other hand, are made out to bearer, and are negotiable instruments, and so transferable by mere delivery like share warrants. The person to whom a bearer debenture is transferred become a “holder in due course” and unless contrary is shown, is entitled to receive and recover the principal and the interest accrued thereon. [*Calcutta Safe Deposit Co. Ltd. v. Ranjit Mathuradas Sampat* (1971) 41 Com Cases 1063].

### ***Pari Passu* Clause in case of Debentures**

Debentures are usually issued in a series with a *pari passu* clause and it follows that they would be on an equal footing as to security and should the security be enforced, the amount realised shall be divided pro-rata, i.e. they are be discharged rateably. In the event of deficiency of assets, they will abate proportionately. The expression '*pari passu*' implies with equal step, equally treated, at the same rate, or at par with. When it is said that existing debentures shall be issued *pari passu* clause, it implies that no difference will be made between the old and new debentures.

If the words *pari passu* are not used, the debentures will be payable according to the date of issue, and if

they are all issued on the same day, they will be payable accordingly to their numerical order. However, a company cannot issue a new series of debentures so as to rank *pari passu* with prior series, unless the power to do so is expressly reserved and contained in the debentures of the previous series.

### Debenture Stock

A company, instead of issuing debentures, each in respect of separate and distinct debt, may raise one aggregate loan fund or composite stock known as 'debenture stock'. Accordingly, a debenture stock is a borrowed capital consolidated into one mass for the sake of convenience. Instead of each lender having a separate bond or mortgage, he has a certificate entitling him to a certain sum being a portion of one large loan. It is generally secured by a trust deed. As in the case of shares, a person may subscribe for, or transfer any amount even a fraction amount. Debenture stock is the indebtedness itself, and the debenture stock certificate furnishes evidence of the title or interest of the holder in the indebtedness. Debenture is the document which furnishes evidence of the debt. Debenture stock must be fully paid, while debenture may or may not be fully paid.

**Difference between Debenture and Debenture Stock** – Debenture is the description of an instrument, while 'debenture stock' is the description of a debt or sum secured by an instrument. In the words of LORD LINDLEY, it is "borrowed capital consolidated into one mass for the sake of convenience".

**Distinction between Debenture and Loan** – A debenture means a document which creates or acknowledges a debt. A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money [*Ram Ratan Karmarkar v. Amulya Charan Karmarkar*, 56 CWN 728 at p. 729].

### Distinction Between Debentures and Shares

S. No	Debentures	Shares
1	Debentures constitute a loan.	Shares are part of the capital of a company.
2	Debenture holders are creditors.	Shareholders are members/owners of the company.
3	Debentures holder gets fixed Interest which carries a priorities over dividend.	Shareholder gets dividends with a varying rate.
4	Debentures generally have a charge on the assets of the company.	Shares do not carry any such charge.
5	Debentures can be issued at a discount without restrictions.	Shares cannot be issued at a discount.
6	The rate of interest is fixed in the case of debentures.	Whereas on equity shares the dividend varies from year to year depending upon the profit of the company and the Board of directors decision to declare dividends or not.
7	Debentureholders do not have any voting right.	Shareholders enjoy voting right.
8	Interest on debenture is payable even if there are no profits i.e. even out of	Dividend can be paid to shareholders only out of the profits of the company and not otherwise.

	capital.	
9	Interest paid on debenture is a business expenditure and allowable deduction from profits.	Dividend is not allowable deduction as business expenditure.
10	Return of allotment is not required for allotment of debentures.	Return of allotment in e-Form No. 2 is to be filed for allotment of shares.

## REGULATORY FRAMEWORK FOR DEBT SECURITIES

- (a) SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009
- (b) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- (c) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- (d) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
- (e) The Companies Act 2013
- (f) Companies (Share Capital and Debentures) Rules, 2014.

### (a) SEBI (ICDR) Regulations 2009

Under SEBI (ICDR) Regulations 2009, “specified securities” means equity shares and convertible securities. The “convertible security” has been defined to mean a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instrument and convertible preference shares. Thus, the conditions specified under these regulations for Equity shares are equally applicable to public issue of convertible debt instruments also.

Additionally, the issuer of convertible debt instruments has to comply with the following.

- (a) obtain credit rating from one or more credit rating agencies;
- (b) appoint one or more debenture trustees in accordance with the provisions of Section 117B of Companies Act, 1956 [new section 71(5) of the Companies Act, 2013] and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;
- (c) create debenture redemption reserve in accordance with the provisions of Section 117C of Companies Act, 1956 [new section 71(4) of the Companies Act, 2013]
- (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
  - such assets are sufficient to discharge the principal amount at all times;
  - such assets are free from any encumbrance;
  - where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
  - the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

The issuer shall redeem the convertible debt instruments in terms of the offer document. These regulations also deal with Roll over of non convertible portion of partly convertible debt instruments.

### **(b) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**

These regulations cover aspects of disclosure mechanism to stock exchanges which are routine and non-routine and other listing compliances including corporate governance aspects.

### **(c) SEBI (Issue and Listing of Debt Securities) Regulations, 2008**

These regulations deals with compliances with respect to non-convertible debt instruments and are applicable to (a) Public issue of debt securities and (b) listing of debt securities issued through public issue or on private placement basis on a recognized stock exchange. It deals with aspects which include filing of offer documents, disclosures, price discovery mechanism through book building and other routine public issue aspects.

### **(d) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations 2008**

Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.

Securitised Debt Instrument means any certificate or instrument by whatever name called, of the nature referred to in sub-clause (ie) of clause (h) of Section 2 of SCRA.

These regulations are principle based and have been made taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction.

## **Provisions of Companies Act 2013- Issue of Debentures**

*Issue of Debentures to be approved by special resolution*

Section 71(1) states that a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

### **No debenture shall carry voting rights**

*Section 71(2) states that no company shall issue any debentures carrying any voting rights.*

*Secured Debentures to comply with terms and conditions prescribed*

*Section 71(3) states that Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.*

*Rule 18(1) of Companies (Share Capital and Debentures) Rules, 2014, prescribes the following conditions;*

(1) The company shall not issue secured debentures, unless it complies with the following conditions, namely:-

- (a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;

- (b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;
- (c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and
- (d) the security for the debentures by way of a charge or mortgage shall be treated in favour of the debenture trustee on-
  - (i) any specific movable property of the company (not being in the nature of pledge); or
  - (ii) any specific immovable property wherever situate, or any interest therein.

In case of a non-banking financial company, the charge or mortgage may be created on any movable property.

Further in case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, there is no requirement for creation of charge under this sub-rule.

In case of any loan taken by a subsidiary company from any bank or financial institution the charge or mortgage may also be created on the properties or assets of the holding company.

Let us remember!

The date of Redemption of debenture shall not exceed 10 years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures upto redemption period of thirty years.

### **Creation of debenture redemption reserve account**

Section 71(4) states that when debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

*Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions:*

The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

- (a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- (b) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:-
  - (i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.
  - (ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act,

1997, and for housing finance companies registered with the national housing bank] 'the adequacy' of DRR will be 25% of the value of outstanding debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.

- (iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of outstanding debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of outstanding debentures.

Provided that where a company intends to redeem its debentures prematurely, it may provide for transfer of such amount in Debenture Redemption Reserve as is necessary for redemption of such debentures even if it exceeds the limits specified in this sub-rule.

- (c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-
  - (i) in deposits with any scheduled bank, free from any charge or lien;
  - (ii) in unencumbered securities of the Central Government or of any State Government;
  - (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
  - (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
  - (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above: Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen percent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;
- (d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.
- (e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

### Appointment of Debenture Trustees

Section 71(5) states that no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

*Rule 18(2) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions*

The company shall appoint debenture trustees under sub-section (5) of section 71, after complying with the following conditions, namely:-

- (a) the names of the debenture trustees shall be stated in letter of offer inviting subscription for

debentures and also in all the subsequent notices or other communications sent to the debenture holders;

- (b) before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;
- (c) A person shall not be appointed as a debenture trustee, if he-
  - (i) beneficially holds shares in the company;
  - (ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;
  - (iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
  - (iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
  - (v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;
  - (vi) has any pecuniary relationship with the company amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
  - (vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.
- (d) the Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act.

When such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

- (e) any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

### **Duties of debenture trustees**

Section 71(6) A debenture trustee shall take steps to protect the interests of the debentureholders and redress their grievances in accordance with such rules as may be prescribed.

*Rule 18(3) of Companies (Share Capital and Debentures) Rules, 2014, prescribes the following conditions*

It shall be the duty of every debenture trustee to-

- (a) satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;
- (b) satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;
- (c) call for periodical status or performance reports from the company;
- (d) communicate promptly to the debenture holders defaults, if any, with regard to payment of interest



- or redemption of debentures and action taken by the trustee therefor;
- (e) appoint a nominee director on the Board of the company in the event of-
    - (i) two consecutive defaults in payment of interest to the debenture holders; or
    - (ii) default in creation of security for debentures; or
    - (iii) default in redemption of debentures.
  - (f) ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;
  - (g) inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;
  - (h) ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;
  - (i) ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
  - (j) do such acts as are necessary in the event the security becomes enforceable;
  - (k) call for reports on the utilization of funds raised by the issue of debentures-
    - (l) take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;
  - (m) ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;
  - (n) perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

### Exemptions clauses in the trust deed

Section 71(7) states that any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion. The liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than threefourths in value of the total debentures at a meeting held for the purpose.

Section 71(12) states that a contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

## CASE LAWS

### Judicial Pronouncement about Debentures

The following kinds of documents have been held to be treated as debentures:

- (A) A legal mortgage of freehold and leasehold land [*Knightsbridge Estates Trust Ltd. v. Byrne*, 1940 AC 613; (1940) 2 All 401];

- (B) A series of income-bonds by which a loan to the company was repayable only out of its profits [*Lemon v. Austin Friars Investment Trust Ltd.* 1926 Ch 1 (CA)];
- (C) A note by which a company undertook to pay a loan but gave no security [*British India Steam Navigation Co. v. IRC*, (1881) 7 QBD 165];
- (D) A receipt or a certificate for a deposit made with a company (other than a bank) when the deposit was repayable after a fixed period after it was made, [*United Dominions Trust Ltd. v. Kirkwood*, (1966) 2 QB 43].
- (E) The definition of debenture is so wide as to include any security of a company whether constituting a charge on the company's assets or not [*Cf. Pearl Assurance Co. Ltd. v. West Midlands Gas Board*, (1950) 2 All ER 844 (ChD)].

## REVIEW QUESTIONS



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

A debenture is necessarily secured by a charge.

- True
- False

**Correct Answer: False**

## REGISTER OF DEBENTUREHOLDERS

Section 88(1)(b) of the Companies Act, 2013 requires every company to keep a register of debenture-holders. The register of debenture-holders shall also include an index of the names included therein. The register shall be in the form prescribed by the Central Government and contain the prescribed particulars. Further the Central Government may prescribe separate registers for each type of debentures. The register can be closed by the company after giving at least 7 days previous notice by advertisement for a period not exceeding 45 days in a year but not exceeding 30 days at a time. However, the Securities and Exchange Board may prescribe lesser notice period for listed companies or companies which intend to get their securities listed in the prescribed manner. As per section 94(2), the register and its indices, except when they are closed under the provisions of the Act is open to inspection by the members and debenture holders, other security holder or beneficial owner during business hours without payment of any fees and by any other person on payment of nominal charges.

## REMEDIES OPEN TO DEBENTUREHOLDERS

Pursuant to Sub-section (8) of Section 71, the company is bound to pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Under Sub-section (10) of section 71, if a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

Sub-section (11) of section 71 provides that if any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.

This remedy is made available to the holders of debentures whether they are secured or unsecured. Any

debentureholder can apply to the Tribunal for passing an order of payment the company which has defaulted. The Tribunal shall, while issuing order to the company, take into account the circumstances under which it has failed to redeem the debentures and the order of the Tribunal shall mention about the ways and means for redemption of the debentures by the company.

Besides, Section 164(2)(b) imposes a disqualification on the directors of a company which has failed to redeem its debentures on due date and such failure continues for one year or more. Such person shall not be eligible to be re-appointed as a director of that company or appointed as a director of any other public company for period of five years from the date from which the company has failed to redeem the debentures.

Secondly, the unsecured debentures amount to deposits under Section 73 of the Act. Section 186(8) provides that no company, which has defaulted in the repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon shall give any loan or give guarantee or provide any security or make an acquisition till such default is subsisting.

## FOREIGN BONDS

Indian company can, with the approval of the Ministry of Finance, issue American Depository Receipts/Global Depository Receipts/ Foreign Currency Convertible Bonds.

In case of any offer of foreign currency convertible bonds or foreign currency bonds issued in accordance with the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or regulations or directions issued by the Reserve Bank of India, the provisions of Rule 18 of Companies (Share Capital and Debenture) Rules, 2014 relating to debentures shall not apply unless otherwise provided in such Scheme or regulations or directions.

## RECENT TRENDS IN CORPORATE DEBT FINANCING

The instruments used by the corporate sector to raise funds are selected on the basis of—

- (i) Investor's preference for a given instrument;
- (ii) the regulatory framework, where under the company has to issue the security.

Convertible debenture is the most popular instrument in the current scenario to raise funds from the markets. The tax liability of the company, the purpose for which the funds are required, debt servicing ability and willingness to broad base the shareholding of the company, all influence the choice of the instrument.

The salient features of new financial instrument which have emerged in the financial markets in recent years are given below:—

- (1) **Convertible capital issue:** - means the issue made in the form of partly or wholly convertible issue, with varying conversion terms and premium on par value of equity.
- (2) **Zero coupon bonds:** - refer to those bonds which are sold at a discount from its eventual maturity value and have zero interest rate.
- (3) **Shares with differential rights:** - signifies a share with differential right to vote, dividend etc. The investor is compensated for renouncing the voting right through a higher rate of dividend than that on the conventional voting share.
- (4) **Secured Premium Notes with Detachable Warrants:** - SPN, which is issued along with detachable warrant, is redeemable after a notified period, say 4 to 7 years. The warrants attached to it ensure the holder the right to apply to get allotted equity shares, provided SPN is fully paid.
- (5) **Non-convertible Debentures with Detachable Equity Warrants:** - The holder of NCDs with detachable equity warrants is given an option to buy a specific number of shares from the company

at a predetermined price within a definite time frame.

- (6) **Zero Interest Fully Convertible Debentures:** - The investors in zero interest fully convertible debentures will not be paid any interest.
- (7) **Equity Shares with Detachable Warrants:-** In this category, along with fully paid equity shares, detachable warrants are issued which will entitle the warrant holder to apply for a specified number of shares at a predetermined price.
- (8) **Fully Convertible Cumulative Preference Shares (Equipref):-** Equipref is a recent introduction in the market. It has two parts: A and B. Part A, is convertible into equity shares automatically and compulsorily on the date of allotment without any further act or application by the allottee and Part B will be redeemed at part-converted into equity shares after a lock-in-period at the option of the investors.
- (9) **Preference shares with warrants attached:-** Under this instrument, each preference share should carry certain number of warrants entitling the holder to apply for equity shares for cash at 'premium' at any time in one or more stages between the third and fifth year from the date of allotment. If the warrant holder fails to exercise his option, the unsubscribed portion will lapse.
- (10) **Secured Zero Interest Partly Convertible Debentures with Detachable and Separately Tradeable Warrants:-** The instrument has two parts - Part A is convertible into equity shares at a fixed amount on the date of allotment and Part B - non-convertible to be redeemed at par at the end of a specific period from the date of allotment. Part B will carry a detachable and separately tradeable warrant which will provide an option to the warrant holder to receive equity share for every warrant held at a price as worked out by the company.
- (11) **Fully Convertible Debentures with interest (optional):-** This instrument will not yield any interest for a short period, say 6 months. After this period, option is given to the holders of FCDs to apply for equities at 'premium' for which no additional amount needs to be payable. This option needs to be indicated in the application form itself. However, interest on FCDs payable at a determined rate from the date of first conversion to second/final conversion and in lieu of it equity shares will be issued.
- (12) **Deep Discount Bond:-** It refers to those bonds which are sold at discount value by the company and on maturity face value is paid to the investors.
- (13) **Option Bonds:-** It covers those cumulative and non-cumulative bonds where interest is payable on maturity periodically and redemption premium is offered to attract investors.
- (14) **Global Depository Receipts:-** It is a form of depository receipt on certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investor against the issue of ordinary shares on foreign currency convertible bonds of issuing company.  
It is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world.
- (15) **External Commercial Borrowings -** are defined to include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds etc. credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington, ADB, AFIC, CDC etc). It is permitted by the Government as a source of finance for Indian corporates for expansion of existing capacities and fresh investments.
- (16) **Derivatives:** Derivatives are contracts which derive their values from the value of one or more other assets known as underlying assets. Some of the most commonly traded derivatives are futures, options and swaps.

- (a) **Futures:** Futures is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.
- (b) **Options:** An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time. The right to buy is referred to as a 'call option' whereas the right to sell is known as 'put option'.

### Instruments in Money Market

- (1) **Certificate of Deposit:** Certificate of deposit is a document of title to a time deposit. Being a bearer document, CDs are readily negotiable and are attractive, both to the banker and to the investors in that, the banker is not required to encash the deposits prematurely, while the investor can sell the same in the secondary market. This ensures ready liquidity. Minimum size of issue of a CD is Rs. 1 lakh.
- (2) **Commercial Paper:** CP refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis. It can be issued in denominations of Rs. 5 lakh or multiples thereof.

Rule 18 of Companies (Share Capital and Debenture) Rules, 2014 is not applicable in case of amount received by a company against issue of commercial paper or any other similar instrument issued in accordance with the guidance or regulations or notifications issued by the Reserve Bank of India.

### LESSON ROUND-UP

- All companies are given power to borrow by their articles which fix the maximum limit of borrowings.
- The power to borrow monies and to issue debentures (whether in or outside India) can only be exercised by the Directors at a duly convened meeting.
- Where the company borrows without the authority conferred on it by the Articles or beyond the amount set out in the Articles, it is an ultra vires borrowing and hence void. Ultra vires borrowings cannot even be ratified by a resolution passed by the company in general meeting. In case of ultra vires borrowings the lender has the following remedies: (a) Injunction and Recovery, (b) Subrogation, (c) Suit against Directors.
- A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge.
- Debentures may be of different kinds, viz. redeemable debentures, registered and bearer debentures, secured and unsecured or naked debentures, convertible debentures.
- A debenture stock is a borrowed capital consolidated into one mass for the sake of convenience.
- A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money.
- A debenture trust deed is one of the several instruments required to be executed to secure redemption of debentures and payment of interest on due dates.
- Section 71(4) of the Act required every company to create a debenture redemption reserve account to which adequate amount shall be credited out of its profits available for payment of dividend until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only.
- Certificate of deposit is a document of title to a time deposit.
- Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis.
- The convertible debentures are regulated by SEBI (ICDR) Regulations, 2009.
- The non-convertible debentures are regulated by SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

## GLOSSARY

<b>Ultra Vires</b>	Beyond the powers
<b>Intra vires</b>	Within the powers
<b>Pari passu</b>	On equal footing or proportionately
<b>Bonds</b>	A bond is an instrument of indebtedness of the bond issuer to the holders. It is a debt security, under which the issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay them interest (the coupon) and/or to repay the principal at a later date, termed the maturity. Interest is usually payable at fixed intervals (semiannual, annual, sometimes monthly). Very often the bond is negotiable, i.e. the ownership of the instrument can be transferred in the secondary market.

## SELF-TEST QUESTIONS

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

1. What are the restrictions imposed on the borrowing powers of the Board of directors? If a company borrows beyond its powers, examine the remedies open to such creditor:
  - (i) When the money has not been spent;
  - (ii) When the money has been spent to pay the debts of the company.
2. What is the difference between debenture and a loan? Is fixed deposit a Debenture or Loan?
3. What is debenture? What are the kinds of debentures?
4. What is a convertible debenture? What are the provisions of the Companies Act, 2013 regarding convertible debentures or loans?
5. Is it compulsory to maintain a Debenture Redemption Reserve Account? If yes, how?
6. Write short notes on the following:
  - (i) Ultra vires borrowings
  - (ii) Intra vires borrowings
  - (iii) Security for borrowings
  - (iv) Types of borrowings
  - (v) Raising loans from financial institutions.
7. Who is a debenture trustee? Why is it compulsory to appoint a trustee in connection with the issuance of debentures? What are the duties of a trustee?

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# Lesson 10

## Creation and Registration of Charges

### LESSON OUTLINE

- Definition of charge
- kinds of a charge viz. fixed charge, floating charge
- Judicial pronouncements on different types of charges
- Crystallization of floating charge
- Registration of charges
- Condonation of delay by Registrar
- Register of charges
- Satisfaction of charges
- Modification of charges
- Purchase or Acquisition of a Property Subject to Charge
- Condition of delay by Central Government.
- Application for Registration of charge by charge holder.

### LEARNING OBJECTIVES

Borrowings by companies are often backed by securities on the strength of which loans are given by the banks or FIs. A charge is created when security is given for securing loans or debentures by way of a mortgage on the assets of the company. The charge may be fixed or floating. The Companies Act covers the provisions relating to registration, modification, satisfaction of charges, consequences of failure in Registration, delay if any in this regard etc.

The purpose of registration of a charge is to give notice to the Registrar of Companies ("RoC") and to people who intend to advance money to the company about the encumbrance created on the assets of the company. The lender may inspect the RoC files in the MCA Portal. Non registration of charges does not make the transaction invalid, but such charge shall not be taken into account by the liquidators and any other creditors of the company. Section 77-87 read with Companies (Registration of Charges) Rules 2014 deals with Regulatory and Procedural aspects covering registration of charges, condonation of delay by Central Government/ Registrar etc. Maintenance of Register of Charges etc.

After reading this lesson you will be able to understand the procedure of creation of charges, their registration, modification, satisfaction etc., and their registration aspects.

## DEFINITION OF A CHARGE

A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. A company, like a natural person, can offer security for its borrowings. Normally, the debentures and other borrowings of the company are secured by a charge on the assets of the company. Where property, both existing and future, is agreed to be made available as a security for the repayment of debt and creditors have a present right to have it made available, there is a charge created. The legal right of the creditor can only be enforced at some future date if certain conditions governing the loan are not met. The creditor gets no legal right either absolute or special to the property charged. He only gets the right to have the security made available/enforced by an order of the Court.

According to Section 2(16) of the Act, "charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Charge also includes a lien and an equitable charge whether created by an instrument in writing or by the deposit of title deed (*Dublin City Distillery Co. v. Deherty, 1914 AC 823*).

## Kinds of Charges

A charge on the property of the company as security for debts may be of the following kinds, namely:

- (i) Fixed or specific charge;
- (ii) Floating charge.

## Fixed or Specific Charge

A charge is called fixed or specific when it is created to cover assets which are ascertained and definite or are capable of being ascertained and defined, at the time of creating the charge e.g., land, building, or plant and machinery. A fixed charge, therefore, is a security in terms of certain specific property, and the company gives up its right to dispose off that property until the charge is satisfied. In other words, the company can deal with such property, subject to the charge so that the charge holder's interest in the property is not affected and the charge holder gets priority over all subsequent transferees except a *bona fide* transferee for consideration without notice of the earlier charge. In the winding-up of the company, a debenture holder secured by a specific charge will be placed in the highest ranking class of creditors.

## REVIEW QUESTIONS



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

*A charge secured against stock-in-trade is called a fixed charge*

- True
- False

**Correct Answer: False. It is a floating charge as stock keeps varying.**

## Floating Charge

A floating charge, as a type of security, is peculiar to companies as borrowers. A floating charge is not attached to any definite property but covers property of a fluctuating type e.g., stock-in-trade and is thus necessarily equitable. A floating charge is a charge on a class of assets present and future which in the ordinary course of business is changing from time to time and leaves the company free to deal with the property as it sees fit until the holders of charge take steps to enforce their security. "The essence of a



floating charge is that the security remains dormant until it is fixed or crystallised". But a floating security is not a future security. It is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder of such charge cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor i.e. the company can deal with them without the concurrence of the mortgagee.

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged. The company may sell, mortgage or lease such property in the ordinary course of its business if it is authorised by its memorandum of association.

## CASE LAWS

### Some Judicial pronouncements about different types of charges

1. **Official Liquidator v. Sri Krishna Deo, (1959) 29 Com Cases 476: AIR 1959 All 247 and Roy & Bros. v. Ramnath Das, (1945) 15 Com Cases 69, 75 (Cal)].** The plant and machinery of a company embedded in the earth or permanently fastened to things attached to the earth became a part of the company's immovable property and therefore apart from the registration under the Companies Act, registration under the Indian Registration Act would also be necessary to make the charge valid and effective.
3. **Cosslett (Contractors) Ltd., Re, (1996) 1 BCLC 407 (Ch D)** A construction company's washing machine which was in use at the site was declared under the terms of the contract to be the employer's property during the period of construction. This was held to have created a fixed charge and not a floating charge on the machine because the machine was only one fixed item and was not likely to change.
4. A "floating security", observed **Lord Macnaghten in Government Stock Investment Company Ltd. v. Manila Rly. Company Ltd., (1897) A.C. 81**, "is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes".
5. **Illingworth & Another v. Holdsworth & Another, (ibid).** "A floating charge is ambulatory and shifting in its nature hovering over and so to speak floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.
6. **Maturi U. Rao v. Pendyala A.I.R. 1970 A.P. 225** When the floating charge crystallizes it becomes fixed and the assets comprised therein are subject to the same restrictions as the fixed charge.
7. **Wheatly v. Silkstone & High Moor Coal Co. Ltd., (1885) 54 L.J. Ch 78.** Unless specifically precluded, the company can create fixed charge subsequent to floating charges over the same property.
8. **[In Smith v. Bridgend County Borough Council (2002) 1 BCLC 77 (HC),** the agreement was held to constitute a floating charge, in so far as it allowed the employer, in various situations of default by the contractor, to sell the contractor's plant and equipment and apply the proceeds in discharge of its obligations. A right to sell an asset belonging to a debtor and appropriate the proceeds to payment of the debt could not be anything other than a charge. It was a floating charge because the property in question was a fluctuating body of assets which could be consumed or removed from the site in the ordinary course of the contractor's business.

9. *An assignment of book debts as scrutiny is a mortgage requiring registration. (Ranjit Ray v. David (1935) 5 Comp. Cas 281 (cal)*
10. *Absolute assignment of future debt is not a charge. (Ashby Warner & Co. v. Simmons (1938) 8 Com Cases 111 (CA)*

## REVIEW QUESTIONS



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

1. The security remains dormant in case of a floating charge until it is crystallized.
2. The owner of a property secured against a floating charge can not deal with the property.
  - True
  - False

**Correct Answer: 1. True 2. False**

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged.

## Crystallisation of Floating Charge

A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets over which a floating charge has been created till the happening of some event which determines this right. A floating charge crystallises and the security becomes fixed in the following cases:

- (a) when the company goes into liquidation;
- (b) when the company ceases to carry on its business;
- (c) when the creditors or the debenture holders take steps to enforce their security e.g. by appointing receiver to take possession of the property charged;
- (d) on the happening of the event specified in the deed.

In the aforesaid circumstances, the floating charge is said to become fixed or to have crystallised. Until the charge crystallises or attaches or becomes fixed, the company can deal with the property so charged in any manner it likes.

Although a floating charge is a present security, yet it leaves the company free to create a specific mortgage on its property having priority over the floating charge. In *Government Stock Investment Co. Ltd. v. Manila Railway Co. Ltd., (1897) A.C. 81*, the debentures were secured by a floating charge. Three months' interest became due but the debenture holders took no steps and so the charge did not crystallize but remained floating. The company then made a mortgage of a specific part of its property. Held, the mortgagee had priority. The security for the debentures remained merely a floating security as the debenture holders had taken no steps to enforce their security.

## Effect of Crystallisation of a Floating Charge

On crystallization, the floating charge converts itself into a fixed charge on the property of the company. It has priority over any subsequent equitable charge and other unsecured creditors. But preferential creditors

who have priority for payment over secured creditors in the winding-up get priority over the claims of the debenture holders having floating charge.

### Postponement of a Floating Charge

The creation of a floating charge leaves the company free to create a legal and equitable mortgage on the same property until the floating charge crystallises. Where such a mortgage is created it has priority over the floating charge which gets postponed. The floating charge is postponed in favour of the following persons if they act before the crystallization of the security:

- (a) a landlord who distrains for rent;
- (b) a creditor who obtains a garnishee order absolute\*;
- (c) a judgement creditor who attaches goods of the company and gets them sold (But if the goods are not sold and the debenture holders take action in the meantime, the floating charge has priority);
- (d) the employees of the company, as well as other preferential creditors in the event of winding-up of the company;
- (e) the supplier of goods to the company under a hire-purchase agreement on terms that goods are to remain the property of the seller until they are paid for in full, has priority over the floating charge, whether such hire-purchase agreement is made before or after the issue of the debentures with a floating charge.

Debenture-holders with a floating charge do not, therefore, enjoy the same rights as the secured creditors, for claims against the company. The deed creating the floating charge may, however, contain a clause restricting the power of the company to create charges in priority to or *pari passu* with it. But even in such a case a person who takes mortgage without notice of floating charge gets priority. But such a contingency can be safeguarded by registering the charge. In terms of Section 80 of the Act, where a mortgage or charge on any property or assets of a company or any of its undertakings required to be registered under Section 77 of the Act has been so registered, any person acquiring such property, assets, undertakings or any part thereof or any interest or share therein shall be deemed to have notice of the charge as from the date of such registration.

### Restraint on the Power to Create Charges with Priority to a Floating Charge

As the floating charge allows wide powers to the company to deal with its property subject to the floating charge, it is common to insert a clause restricting the powers of the company to create charge with priority to or *pari passu* with it. Thus, if the company creates a mortgage in favour of any person who has notice of the floating charge and restriction, such person ranks after the floating charge. But a person who obtains a valid mortgage, and can show either (i) that he was not aware of the existence of the floating charge; (ii) that though he was aware of the charge, he was not aware of the restriction, is entitled to priority by virtue of the legal estate. Furthermore, where a specific charge is created expressly subject to a floating charge, the specific charge is postponed as from the date when the floating charge crystallises by the appointment of a receiver.

### Invalidity of Floating Charge

A floating charge remains afloat until a winding up commences, unless it has already crystallised through the intervention of the debenture holders or the creditors. Also, a floating charge is valid only against the unsecured

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\* A garnishee order absolute is an order directed at the garnishee, requiring him to release to the judgement creditor any moneys which he owes the judgement debtor.

creditors, whether in a winding-up or otherwise. But the Act prevents an unsecured creditor to get priority over the other creditors by obtaining a floating charge when he learns that the company's liquidation is imminent.

Accordingly, Section 332 of the Companies Act, 2013, provides that a floating charge on the undertakings or property of the company, which is created within 12 months immediately preceding the commencement of the winding up proceedings of a company, shall be invalid, unless it is proved that the company was solvent immediately after the creation of the charge. But the charge will be valid to the extent of the amount of any cash paid to the company at the time of or after the creation of, and in consideration for the charge, together with interest on that amount at 5 per cent per annum or such other rate as may be notified by the Central Government.

## REVIEW QUESTIONS



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

Floating charge which is created within 12 months immediately preceding the commencement of winding up proceedings of the company shall be invalid though the company was solvent immediately after the creation of charge.

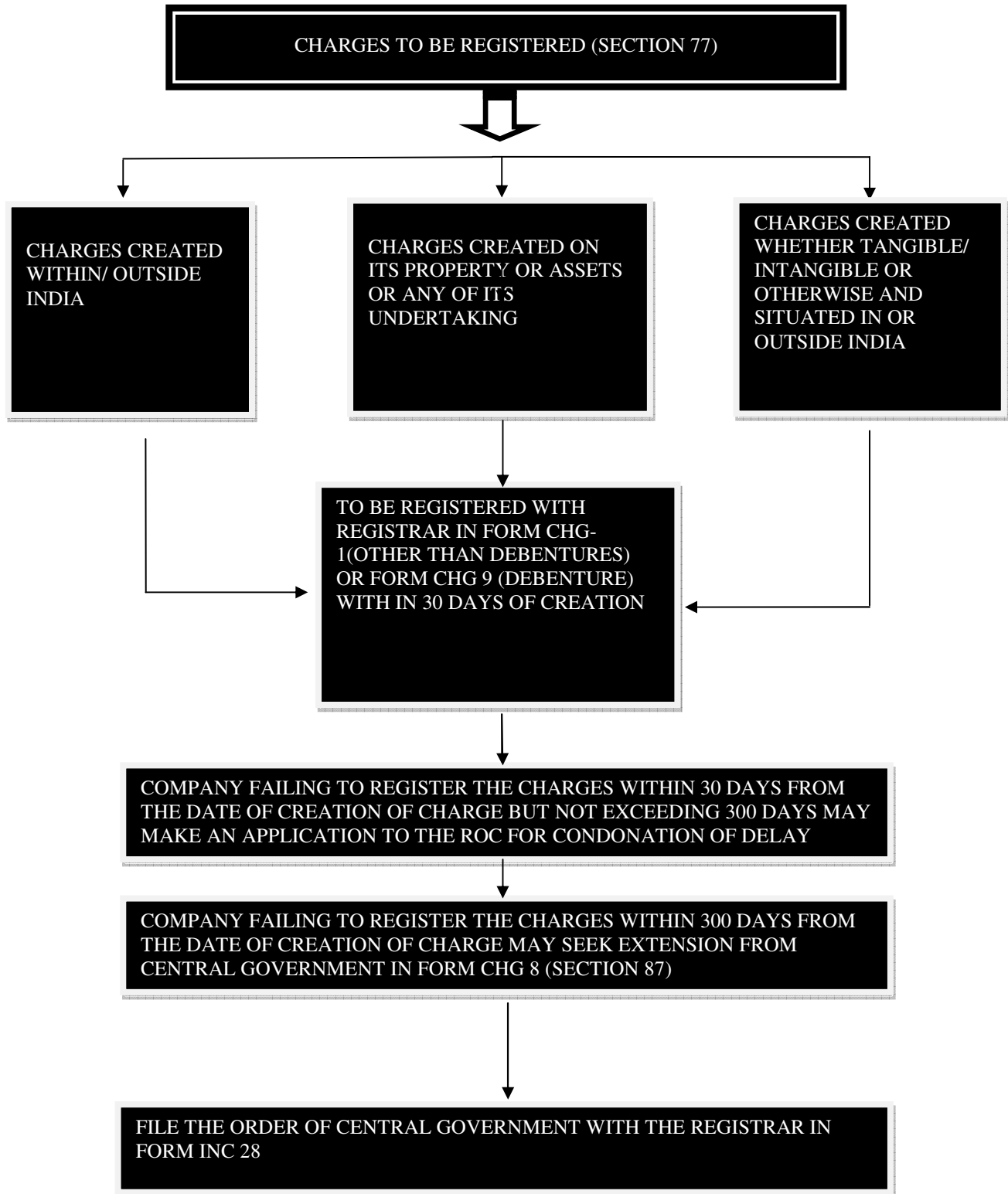
**Correct Answer: False**

Debenture holders with a floating charge do not enjoy the same rights as the secured creditors for claims against the company.

## Difference between Mortgage and Charge

S.No	Mortgage	Charge
1	A mortgage is created by the act of the parties.	A charge may be created either through the act of parties or by operation of law.
2	A mortgage requires registration under the Transfer of Property Act, 1882.	A charge created by operation of law does not require registration. But a charge created by act of parties requires registration.
3	A mortgage is for a fixed term.	The charge may be in perpetuity.
4	A mortgage is a transfer of an interest in specific immovable property.	A charge only gives a right to receive payment out of a particular property.
5	A mortgage is good against subsequent transferees.	A charge is good against subsequent transferees with notice.
6	A simple mortgage carries personal liability unless excluded by express contract.	In case of charge, no personal liability is created. But where a charge is the result of a contract, there may be a personal remedy.
7	A mortgage is a transfer of an interest in a specific immovable property.	There is no such transfer of interest in the case of a charge. Charge does not operate as transfer of an interest in the property and a transferee of the property gets the property free from the charge provided he purchases it for value without notice of the charge.

**REGISTRATION OF CHARGES- PROVISIONS OF COMPANIES ACT 2013**



### **Registration of charges- To be filed with the registrar within 30 days of creation**

Section 77(1) states that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation.

#### **Points to be remembered**

- (i) Any charge created
  - (a) within or outside India,
  - (b) on its property or assets or any of its undertakings,
  - (c) whether tangible or otherwise, and situated in or outside India
 Shall be registered.
- (ii) Particulars of charges that is being filed with Registrar of Companies is to be signed by the company creating the charge and the charge holder in form CHG-1 or Form CHG-9 as the case may be.
- (iii) The Charge has to be registered within 30 days of its creation.

According to Rule 3 of Companies (Registration of Charges) Rules, 2014 e-forms prescribed for the purpose of creating or modifying the charge is Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification).

### **Condonation of delay by Registrar- within 300 days from the date of creation of charge/its modification**

Proviso to Section 77(1) states that the Registrar may on an application by the company allow registration of charge within three hundred days of creation or modification of charge on payment of additional fee. The Registrar may, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within a period of thirty days of the date of creation of the charge, allow the registration of the same after thirty days but within a period of three hundred days of the date of such creation of charge or modification of charge on payment of additional fee.

The application for delay shall be made and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company.

### **Condonation of delay by the Central Government beyond 300 days from the date of creation**

If company fails to register the charge even within this period of three hundred days, it may seek extension of time in accordance with Section 87 from the Central Government.

Section 87(1) states that the Central Government on being satisfied that—

- (i) (a) the omission to file with the Registrar the particulars of any charge created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or
- (b) the omission to register any charge within the time required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time

required under this Chapter; or

- (c) the omission or mis-statement of any particular with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made, was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company; or

- (ii) on any other grounds, it is just and equitable to grant relief,

it may on the application of the company or any person interested and on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

Section 87 (2) states that when the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

#### ***Rule 12 of Companies (Registration of Charges) Rules, 2014***

When the instrument creating or modifying a charge is not filed within a period of three hundred days from the date of its creation (including acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

The application for condonation of delay and for such other matters covered in sub-clause (a),(b) and (c) of clause (i) of sub-section (1) of section 87 of the Act shall be filed with the Central Government in Form No.CHG-8 along with the fee.

The order passed by the Central Government under sub-section (1) of section 87 of the Act shall be required to be filed with the Registrar in Form No.INC-28 along with the fee as per the conditions stipulated in the said order.

### **SUBSEQUENT REGISTRATION SHALL NOT PREJUDICE ANY RIGHT**

Third Proviso to Section 77(1) states that any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

### **Application for registration of charge by the charge-holder, when company fails to register a charge**

According to Section 78 where a company fails to register the charge within the period specified above, the person in whose favour the charge is created may apply to the Registrar for registration of the charge alongwith the instrument created for the charge in **Form No. CHG-1** or **Form No. CHG-9**, as the case may be, duly signed along with fee.

The registrar may, on such application, give notice to the company about such application. The company may either itself register the charge or shows sufficient cause why such charge should not be registered.

On failure on part of the company, the Registrar may allow registration of such charge within fourteen days after giving notice to the company shall allow such registration.

Where registration is affected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company, the amount of any fee or additional fees paid by him to the Registrar for the purpose of registration of charge.

### **Certificate of Registration of Charge**

According to Section 77(2) read with rule 6 of Companies (Registration of Charges) Rules, 2014, when a charge is registered with the Registrar, Registrar shall issue a certificate of registration of charge in Form No.CHG-2 and for registration of modification of charge in Form No.CHG-3 to the company and to the person in whose favour the charge is created.

The certificate issued by the Registrar whether in case of registration of charge or registration of modification, as the case may be shall be conclusive evidence that the requirements of Chapter VI of the Act (Registration of Charges) and the rules made thereunder as to registration of creation or modification of charge, as the case may be, have been complied with.

Further Section 77(3) of the Act provides that no charge created by the company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016, as the case may be, or any other creditor unless it is duly registered and a certificate of registration is given by the Registrar. However, this does not prejudice any contract or obligation for the repayment of the money secured by a charge.

### **Acquiring Property under Charge and Modification of Charge**

Section 79 of the Act makes it clear that the requirement of registering the charge shall also apply to a company acquiring any property subject to charge or any modification in terms and conditions of any charge already registered.

It provides that the provisions of Section 77 relating to registration of charge shall apply to:

- (a) A company acquiring any property subject to a charge within the meaning of that section; or
- (b) any modification in the terms or conditions or the extent or operation of any charge registered under that section.

The provisions relating to condonation of delay shall apply, mutatis mutandis, to the registration of charge on any property acquired subject to such charge and modification of charge under section 79 of the Act.

### **Verification of Instruments**

According Rule 3(4), a copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar in pursuance of section 77, 78 or 79 shall be verified as follows-

- (a) where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal if any of the company, or under the hand of any director or company secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;
- (b) where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

### **Satisfaction of Charges**

According to section 82 read with the rules, the company shall give intimation to the Registrar of the payment or satisfaction in full of any charge within a period of thirty days from the date of such payment or satisfaction in Form No.CHG-4 along with the fee. Where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government, which is discussed earlier in this chapter.



On receipt of such intimation, the Registrar shall issue a notice to the holder of the charge calling a show cause within such time not exceeding fourteen days, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges maintained by the registrar under section 81 and shall inform the company. If the cause is shown to the registrar shall record a note to that effect in the register of charges and shall inform the company accordingly.

However the aforesaid notice shall not be sent, in case intimation to the registrar is in specified form and is signed by the holder of charge. [Proviso to Section 82(2)]

### **Power of registrar to make entries of satisfaction in absence of intimation from the company:**

There may be times where a company may fail to send intimation of satisfaction of charge to the Registrar but according to section 83 of the Act, registrar may on receipt of satisfactory evidence of satisfaction register memorandum of satisfaction. The evidences may be –

- (a) The debt for which the charge was given has been paid or satisfied in whole or in part; or
- (b) Part of the property or undertaking charged has been released from the charge;
- (c) Part of the property or undertaking ceased to form part of the company's property or undertaking.

The Registrar may enter in the register of charges a memorandum of satisfaction.

Section 83(2) states that the Registrar shall inform affected parties within thirty days of making the entry in the register of charges.

Certificate of registration of satisfaction of charge: Where the Registrar enters a memorandum of satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge in **Form No. CHG-5**.

### **Notice of Charge**

According to section 80, where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration. The section clarifies that if any person acquires a property, assets or undertaking for which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date the charge is registered.

### **Register of Charges Maintained in ROC's Office**

In accordance with section 81 and the rules the Registrar of Companies shall maintain a register containing particulars of the charges registered in respect of every company. The particulars of charges maintained on the Ministry of Corporate Affairs portal ([www.mca.gov.in/MCA21](http://www.mca.gov.in/MCA21)) shall be deemed to be the register of charges for the purposes of section 81 of the Act.

This charge register shall be open to inspection by any person on payment of fee for each inspection.

### **Intimation of appointment of receiver or manager**

Section 84 provides that if any person obtains an order for the appointment of a receiver of, or of a person to manage, the property, subject to a charge, of a company or if any person appoints such receiver or person under any power contained in any instrument, he shall, within a period of thirty days from the date of the passing of the order or of the making of the appointment, give notice of such appointment to the company

and the Registrar along with a copy of the order or instrument and the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

Section 84(2) states that any person so appointed shall, on ceasing to hold such appointment, give to the company and the Registrar a notice to that effect and the Registrar shall register such notice.

As per Rule 9 the notice of appointment or cessation of a receiver of, or of a person to manage, the property, subject to charge, of a company shall be filed with the Registrar in Form No. CHG.6 along with fee.

### **Company's Register of Charges**

Section 85 read with rule 10 provides that every company shall keep at its registered office a register of charges in Form No. CHG.7 which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed.

The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.

Such register of charges shall contain the particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

All the entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company.

A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

**Inspection of Charges:** The register of charges and instrument of charges shall be kept open for inspection during business hours by members, creditors or any other person subject to reasonable restriction as the company by its article impose. The register of charges and the instrument of charges kept by the company shall be open for inspection- (a) by any member or creditor of the company without fees; (b) by any other person on payment of fee.

Liquidator or any other creditor take into account the unregistered charges.

Section 77(3) states that notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator or any other creditor unless it is duly registered under Sub-section (1) of Section 77 and a certificate of registration of such charge is given by the Registrar.

### **LESSON ROUND-UP**

- The power of the company to borrow includes the power to give security also. A charge is a security given for securing loans or debentures by way of a mortgage on assets of the company.
- There are two kinds of charges, fixed or specific charge and floating charge.
- A charge is fixed when it is made to cover assets which are ascertained and definite or capable of being ascertained and defined at the time of creating charge. Whereas floating charge is not attached to any definite

property but covers property of a fluctuating type.

- When floating charge crystallizes, it becomes fixed.
- The floating charge allows wide powers to the company to deal with its property until such charge crystallizes.
- The particulars of charge is to be registered within 30 days of its creation
- The registrar can condone the delay till 300 days from the date of creation of charges.
- If the company fails to register particulars of charges within 300 days of its creation, it should make an application to Central Government for condonation of delay.
- The particulars of charges are to be signed by the company and the charge holder. If the company fails to register the charge, the charge holder can register the charge.
- The registrar can make entries for satisfaction of charge in absence of information from the company.

## GLOSSARY

<b>Garnishee</b>	An individual who holds money or property that belongs to a debtor subject to an attachment proceeding by a creditor.
<b>Charge</b>	A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. As mentioned earlier, the power of the company to borrow includes the power to give security also.
<b>Crystallization of Floating Charge</b>	A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets having a floating charge till the happening of some event which determines this right.
<b>Mortgage</b>	A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an agreement which may give rise to pecuniary liability.

## SELF-TEST QUESTIONS

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

1. Define mortgage. State the various types of mortgages.
2. What are the essentials of a mortgage?
3. What is a charge? Enumerate the statutory provisions for their registration. State the circumstances under which certain charges may be void against the liquidator or the creditors of company.
4. What information must be entered in the register of charges maintained by the company? What is the effect of a failure to register a charge?
5. Can a floating charge become a fixed charge? If so, under what circumstances?
6. Distinguish between :



# Lesson 11

## Allotment of Securities and Issue of Certificates

### LESSON OUTLINE

- Allotment of securities
- General principles regarding allotment
- Judicial pronouncements relating to allotment of shares
- Statutory provisions regarding allotment
- Return of allotment
- Share certificate
- Issue of duplicate share certificate
- Calls and forfeiture
- Requisite of a valid call
- Reissue of forfeited shares
- Surrender of shares

### LEARNING OBJECTIVES

Allotment is an act of appropriation of certain number of securities to those persons who have applied for it. The Certificate conveys the title to the security and is issued subsequent to allotment. The Companies Act, 2013, SEBI (Issue of Capital and Disclosure Requirements), Regulations, 2009 (“SEBI ICDR Regulations”), Securities (Contracts) Regulations, etc. provide for procedural aspects as to allotment and issue of Certificates for securities.

In fact, in the present era of compulsory Dematerialization, physical share certificate is a rare phenomenon especially for listed companies which are also governed by Securities and Exchange Board of India (“SEBI”) Regulations, SEBI (Listing Obligations and Requirements) Regulations, 2015 etc. Companies Act 2013(the Act) also mandates public offer of companies and such class of companies as may be prescribed should issue securities only in dematerialized form.

After reading this lesson, you will be able to understand the concepts, regulatory and procedural aspects relating to allotment and issue of certificates in the light of Companies Act 2013 read with Companies (Prospectus and Allotment of Securities) Rules, 2014 and Companies (Share Capital and Debentures) Rules, 2014.

## SECURITIES

According to 2(81) of Companies Act, 2013 “securities” means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

According to 2(84) of the Act, “share” means a share in the share capital of a company and includes stock.

As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956 “securities” include—

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

[*Explanation.--* For the removal of doubts, it is hereby declared that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938(4 of 1938).]

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receiveable including mortgage debt, as the case may be;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;

Thus, the word “securities” includes shares and other instruments.

## GENERAL PRINCIPLES REGARDING ALLOTMENT

“Allotment” of shares means the act of appropriation by the Board of directors of the company out of the previously un-appropriated capital of a company of a certain number of shares to persons who have made applications for shares (In Re Calcutta Stock Exchange Association, AIR 1957 Cal. 438). It is on allotment that shares come into existence.

The following general principles should be observed with regard to allotment of securities:

(1) **The allotment should be made by proper authority**, i.e. the Board Directors of the company, or a committee authorised to allot securities on behalf of the Board.

(2) **Allotment of securities must be made within a reasonable time** (As per Section 6 of the Indian

Contract Act, 1872, an offer must be accepted within a reasonable time). What is a reasonable time is a question of fact in each case. An applicant may refuse to take securities if the allotment is made after a long time. (As per Section 56 within a period of two months from the date of allotment in the case of allotment of any of its shares.)

- (3) **The allotment should be absolute and unconditional.** Securities must be allotted on same terms on which they were applied for and as they are stated in the application for securities. Allotment of securities subject to certain conditions is also not valid. Similarly, if the number of securities allotted is less than those applied for, it cannot be termed as absolute allotment.
- (4) **The allotment must be communicated.** As mentioned earlier posting of letter of allotment or allotment advice will be taken as a valid communication even if the letter is lost in transit.
- (5) **Allotment against application only** — Section 2(55) of the Act requires that a person should agree in writing to become a member.
- (6) **Allotment should not be in contravention of any other law** — If securities are allotted on an application of a minor, the allotment will be void.

## CASE LAWS

### Judicial pronouncement relating to allotment

- (A) Allotment made without proper authority will be invalid. Allotment of shares made by an irregularly constituted Board of directors shall be invalid [Changa Mal v. Provisional Bank (1914) ILR 36 All 412].
- (B) It is necessary that the Board should be duly constituted and should pass a valid resolution of allotment at a valid meeting [Homes District Consolidated Gold Mines Re (1888) 39 Ch D 546 (CA)].
- (C) An allotment may be valid even if some defect was there in the appointment of directors but which was subsequently discovered. (Section 290 and the Rule in Royal British Bank v. Turquand (1856) 6 E & B 327 : (1843-60) All ER Rep 435)
- (D) An allotment by a Board irregularly constituted may be subsequently ratified by a regular Board [Portugese Consolidated Copper Mines, (1889) 42 Ch. D 160 (CA)].
- (E) A director who has joined in an allotment to himself will be estopped from alleging the invalidity of the allotment [Yark Tramways Co. v. Willows, (1882) 8 QBD 685 (CA)].
- (F) The interval of about 6 months between application and allotment was held unreasonable [Ramsgate Victoria Hotel Company v. Montefione (1866) LR 1 EX 109].
- (G) Grant applied for certain shares in a company, the company dispatched letter of allotment to him which never reached him. It was held that he was liable for the balance amount due on the shares. [Household Fire And Carriage Accident Insurance Co. Ltd. Grant (1879) 4 E.D. 216]
- (H) The mere entry of a shareholder's name in the company's register is insufficient to establish that an allotment was in fact made [Official Liquidator, Bellary Electric Supply Co. v. Kanni Ram Ramwoothmal (1933) 3 Com Cases 45; AIR 1933 Mad 320].
- (I) There can be no proper allotment of shares unless the applicant has been informed of the allotment [British and American Steam Navigation Co. Re. (1870) LR 10 Eq 659].
- (J) A formal allotment is not necessary. It is enough if the applicant is made aware of the allotment. [Universal Banking Corpn. Re. Gunn's Case (1867) 3 Ch App 40].

## Provisions relating to allotment of securities – Companies Act 2013

### *Allotment of Securities – Conditions*

Section 39(1) states that no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

### *Minimum Application Money [Section 39(2)]*

The amount payable on application on every security shall not be less than five per cent. of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

### *Money to be returned if minimum application money is not received*

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount so received shall be returned within 15 days from the closure of the issue. If any such money is not so repaid within such period the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at 15% P.A.

### *Company to file Return of allotment*

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in Form PAS-3.

### *Companies (Prospectus and Allotment of Securities) Rules, 2014- Rules relating to allotment of securities*

- Rule 12 states that whenever company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form PAS-3, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014. There shall be attached to the Form PAS-3 a list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form PAS-3 as being complete and correct as per the records of the company.

Further, in the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form PAS-3 a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration. When a contract is not reduced to writing, the company shall furnish along with the Form PAS-3 complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899 (2 of 1899), and the Registrar may, as a condition of filing the particulars, require that the stamp duty payable thereon be adjudicated under section 31 of the Indian Stamp Act, 1899. Further a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract of sale if relating to property or an asset or a contract for services, as the case may be.

- In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form PAS-3.



- In case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form PAS-3, the valuation report of the registered valuer.

Explanation.- Pending notification of sub-section (1) of section 247 of the Act and finalisation of qualifications and experience of valuers, valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.

**Let us remember!**

*Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in Form PAS-3 within thirty days from the date of allotment.*

*Penalty for default*

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

## CASE LAWS

### Judicial Pronouncement about return of Allotment

1. In *Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd.* 1963-(033)-Com Cases-0862-SC, the Supreme Court held that the exchange was not liable to file any return of the forfeited shares under Section 75(1) of the Companies Act, 1956 [Corresponds to section 39 of the Companies Act, 2013] when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital and approved the observations of Harries C.J. in *S.M. Nandy's* case that: "On such forfeiture all that happened was that the right of the particular shareholder disappeared but the shares considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it".
2. *Alote Estate v. R.B. Seth Hiralal Kalyanmal Kasliwal* [1970] 40 Com Cases 1116 (SC), In case of inadequacy of consideration, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full, unless the contract is fraudulent.
3. *Harmony and Montage Tin and Copper Mining Company; Spargo's case* (1873) 8 Ch. App. 407. Any payment which is presently enforceable against the company such as consideration payable for property purchased, will constitute payment in cash.
4. *Chokkalingam v. Official Liquidator* AIR 1944 Mad. 87. Allotment of shares against promissory notes shall not be valid.

## ISSUE OF CERTIFICATES

### What is a share certificate?

A share certificate is a certificate issued to the members by the company, specifying the number of shares held by him and the amount paid on each share. According to Section 45 of the Companies Act, 2013 each share of the share capital of the company shall be distinguished with a distinct number for its individual

identification. However, such distinction shall not be required, as per proviso to Section 45, if the shares are held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

In terms of Section 46(1) of the Act, a certificate under the common seal, if any, of the company or signed by two directors or by a director and the company secretary, wherever, the company has appointed a company secretary, is *prima facie* evidence of the title of the person to the shares specified therein. The certificate is the only documentary evidence of title in the possession of the shareholder. But it is not a warranty of title by the company issuing it.

### **When can a company issue Duplicate Share Certificate?**

Section 46(2) states that a duplicate certificate of shares may be issued, if such certificate —

- (a) is proved to have been lost or destroyed; or
- (b) has been defaced, mutilated or torn and is surrendered to the company.

### **Manner of issuing share certificates/ Duplicate Share Certificates**

Section 46(3) states that notwithstanding anything contained in the articles of a company, the manner of issue of

- a certificate of shares or
- the duplicate thereof,

the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

## SHARE CERTIFICATES

### ISSUE OF SHARE CERTIFICATE RULE 5 OF THE COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014

- Pass board resolution
- Letter of allotment or fractional coupons of requisite value, must be surrendered to company. In case the letter of allotment is lost or destroyed the board may impose reasonable terms.
- Certificate shall be issued in Form No. SH-1 and shall specify the name of person in whose favour the certificate is issued, shares to which it relates and the amount paid-up thereon.
- Certificate shall be issue under the common seal, if any, of the company or signed by two directors or by a director and the CS, wherever, the company has appointed a CS.
- The certificate shall be signed by –
  - Two directors duly authorized by the board or committee of Board. if the composition of board permits at least one of the aforesaid two directors shall be a person other than managing or whole time director
  - The secretary or any person authorized by the board
- Particulars of shares certificates to be entered in the Register of Members.

### ISSUE OF RENEWED OR DUPLICATE SHARE CERTIFICATE RULE 6 OF THE COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014

- Renewal to be made only on surrender of old certificate
- Company may charge fee for duplicate share certificate as the board decides but not exceeding Rs. 50 per certificate.
- Company shall not issue any duplicate share certificate in lieu of those lost or destroyed without the prior consent of Board (the committee of directors may exercise such powers subject to any regulation imposed by the Board in this regard.)
- If the company is listed then the duplicate share certificates shall be issued within 45 days and if the company is unlisted it shall issue the certificates in 3 months from the date of submission of complete documents.
- The particulars of renewed and duplicate share certificate to be entered in Form No. SH.2
- The register to be kept at registered office of the company
- On fraudulent issue the company shall be punishable with: fine which shall not be less than five times the face value of shares involved which may extend to ten times
- Officer in default shall be liable under section 447

## **Rule 5 of Companies (Share Capital and Debentures) Rules, 2014, relating to Issue of Certificates**

Rule 5 and Rule 6 of Companies (Share Capital and Debentures) Rules, 2014 provides the following, relating to issue of Securities:

### ***What is prescribed relating to issue of share certificates?***

#### ***(a) Certificate of shares (where shares are not in demat form)[ (Rule 5(1))]-***

(1) Where a company issues any share capital, no certificate of any share or shares held in the company shall be issued, except-

- (a) by passing a Board resolution and
- (b) on surrender to the company of the letter of allotment or fractional coupons of requisite value, except in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares:

If, the letter of allotment is lost or destroyed, the Board may impose such reasonable terms, if any, as to seek supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating evidence, as it may think fit.

#### ***(b) Share Certificate Format [Rule 5(2)]***

Every certificate of share or shares shall be in Form No. SH.1 or as near thereto as possible and shall specify the name(s) of the person(s) in whose favor the certificate is issued, the shares to which it relates and the amount paid-up thereon.

#### ***(c) Share certificate to be issued under the seal, if any, of the company and where the company doesnot have a seal then the signatories to share certificates shall sign the certificate [Rule 5(3)]***

As discussed earlier the section 46(1) provides that the a share certificate shall bear a seal, if any, of the company or shall be signed by two directors or by a director and the company secretary, wherever, the company has appointed a company secretary

As per the rule every share certificate shall be issued under the seal, if any, of the company, which shall be affixed in the presence of, and signed by-

- (a) two directors duly authorized by the Board of Directors of the company for the purpose or the committee of the Board, if so authorized by the Board; and
- (b) the secretary or any person authorised by the Board for the purpose:

In case a company does not have a common seal, the share certificate shall be signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

If the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than a managing director or a whole-time director.

Further in case of a One Person Company, every share certificate shall be issued under the seal, if any, of the company, which shall be affixed in the presence of and signed by one director or a person authorised by the Board of Directors of the company for the purpose and the Company Secretary, or any other person authorised by the Board for the purpose, and in case the One Person Company does not have a common seal, the share certificate shall be signed by the persons in the presence of whom the seal is required to be affixed in this proviso.

A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

**(d) Particulars of Share certificates to be entered in the Register of Members [Rule 5(4)]**

The particulars of every share certificate issued shall be entered in the Register of Members maintained in accordance with the provisions of section 88 along with the name(s) of person(s) to whom it has been issued, indicating the date of issue.

*Rule 6 of Companies (Share Capital and Debentures) Rules, 2014 relating to issue of duplicate certificates*

**Issue of renewed or duplicate share certificate (Rule 6).-**

(1) The certificate of any share or shares shall not be issued either in exchange for those which are sub-divided or consolidated or in replacement of those which are defaced, mutilated, torn or old, decrepit, worn out, or where the pages on the reverse for recording transfers have been duly utilised, unless the certificate in lieu of which it is issued is surrendered to the company:

- (a) The company may charge such fee as the Board thinks fit, not exceeding fifty rupees per certificate issued on splitting or consolidation of share certificate(s) or in replacement of share certificate(s) that are defaced, mutilated, torn or old, decrepit or worn out:
- (b) when a certificate is issued in any of the circumstances specified in this sub-rule, it shall be stated on the face of it and be recorded in the Register maintained for the purpose, that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation" and also that no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government:
- (c) A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered subject to compliance with the rules.

(2) (a) The duplicate share certificate shall not be issued in lieu of those that are lost or destroyed, without the prior consent of the Board and without payment of such fees as the Board thinks fit, not exceeding rupees fifty per certificate and on such reasonable terms, such as furnishing supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating the evidence produced. The Ministry of Corporate Affairs vide a circular dated June 12, 2014 clarified that a committee of directors may exercise such powers, subject to any regulations imposed by the Board in this regard.

- (b) when a certificate is issued in any of the circumstances specified in this sub-rule, it shall be stated prominently on the face of it and be recorded in the Register maintained for the purpose, that it is "duplicate issued in lieu of share certificate No.....". and the word "duplicate" shall be stamped or printed prominently on the face of the share certificate:
- (c) In case unlisted companies, the duplicate share certificates shall be issued within a period of three months and in case of listed companies such certificate shall be issued within forty-five days, from the date of submission of complete documents with the company respectively.

**Register of renewed and duplicate share certificates**

- (3) (a) The particulars of every share certificate issued in accordance with sub-rules (1) and (2) shall be entered forthwith in a Register of Renewed and Duplicate Share Certificates maintained in

Form No.SH.2 indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column.

- (b) The register shall be kept at the registered office of the company or at such other place where the Register of Members is kept and it shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose.
- (c) All entries made in the Register of Renewed and Duplicate Share Certificates shall be authenticated by the company secretary or such other person as may be authorised by the Board for the purposes of sealing and signing the share certificate under the provisions of sub-rule (3) of rule 5.

***Let us Remember !***

***Register of renewed and duplicate share certificates shall be maintained in Form SH2.***

***Maintenance of share certificate forms and related books and documents.-(Rule 7)***

(1) All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and the blank form shall be consecutively machine-numbered and the forms and the blocks, engravings, facsimiles and hues relating to the printing of such forms shall be kept in the custody of the secretary or such other person as the Board may authorise for the purpose; and the company secretary or other person aforesaid shall be responsible for rendering an account of these forms to the Board.

(2) The following persons shall be responsible for the maintenance, preservation and safe custody of all books and documents relating to the issue of share certificates, including the blank forms of share certificates referred to in sub-rule (1), namely:—

- (a) the committee of the Board, if so authorized by the Board or where the company has a company secretary, the company secretary; or
- (b) where the company has no company secretary, a Director specifically authorised by the Board for such purpose.

(3) All books referred to in sub-rule (2) shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently, and all certificates surrendered to a company shall immediately be defaced by stamping or printing the word "cancelled" in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf:

Provisio to Rule 7(3) provides that nothing in this sub-rule shall apply to cancellation of the certificates of securities, under sub-section (2) of section 6 of the Depositories Act, 1996 (22 of 1996), when such certificates are cancelled in accordance with sub-regulation (5) of regulation 54 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996, made under section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) read with section 25 of the Depositories Act, 1996 (22 of 1996).

### Record of depository is prima facie evidence for shares in depository form

Section 46(4) states that where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

### Issuing duplicate share certificates to defraud

According to Section 46(5), if a company with an intention to defraud, issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447, for fraud.

### Time of issue of Certificate of Securities

Under Section 56(4) of the Act, every company, (unless prohibited by any provision of law or any order of any Court, Tribunal or other authority) must deliver the certificates of all securities allotted, transferred or transmitted:-

- (a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
- (b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
- (c) within a period of one month from the date of receipt by the company of the instrument of transfer or, as the case may be, of the intimation of transmission, in the case of a transfer or transmission of securities;
- (d) within a period of six months from the date of allotment in the case of any allotment of debenture.

However, where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. [See proviso to Section 56(4)].

Where any default is made in complying with the above provisions, the company shall be punishable with fine which shall not be less than Rs 25,000 but which may extend to Rs 5 lakh and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs 10,000 but which may extend to Rs.1,00,000. [Section 56(6)]

### Significance of Share Certificate

A certificate of shares is evidence to the effect that the allottee is holding a certain number of shares of the company showing their nominal and paid-up value and distinctive numbers. This certificate is a prime facie evidence of title to the shares in the possession of shareholders. [*Society Generale De Paris v. Walker, (1885) 11A AC 20, 29*].

Moreover, when the company issues a certificate, it holds that the facts contained therein are true. Any person acting on the faith of the share certificate of the company, can compel the company to pay compensation for any damage caused by reason of any misstatement in the share certificate as the company is bound by any statements made in the certificate.

Share certificate is the only documentary evidence of title and that the share certificate is a declaration by the company that the person in whose name the certificate is issued is a shareholder in the company. [*Ghanshyam Chhaturbhuj v. Industrial Ceramics (Pvt.) Ltd. (1995) 4 Com LJ 51*].

Also the company cannot dispute the amount mentioned on the certificate as already paid. [*Bloomenthal v. Ford* (1897) AC 156 (HL)].

### **Damages against Company and Directors for wrong certificates**

As already mentioned, a person acting on the share certificate issued by the company may recover compensation for the damages suffered by him. The measure of damage is the value of the shares at the time of the refusal by the company to recognise him as a shareholder together with interest from that date. [*Bahla and San Francisco Rly. Co.*, (1868) LR 3 QB 584].

Where directors issue a certificate of title of shares which the company has no power to issue, they may be held personally liable to damages on an implied warranty of authority to any person who acts on such certificate.

### **Split Certificate**

A split certificate means a separate certificate claimed by a shareholder for a portion of his holding. The advantages of a split certificate are that the shareholder may benefit in case of a transfer by way of sale or mortgage in small lots and the right to multiply the certificates into as many shares held by the shareholder.

### **Purpose and Form of Share Certificate**

With the help of a share certificate a member of a company may deal with his shares in the market whether it is one of sale, mortgage or pledge by showing a good *prima facie* marketable title to the shares. A share certificate is a documentary evidence of title to shares in the possession of the shareholder. It is a *prima facie* evidence of his title to the shares.

Section 46(4) provides that where a share is held in depository form, the record of the depository is the *prima facie* evidence of the interest of the beneficial owner.

#### ***Let us Remember !***

*Every certificate of share or shares shall be in Form No. SH.1 or as near thereto as possible.*

*The particulars of every share certificate issued shall be entered forthwith in a Register of Renewed and Duplicate Share Certificates maintained in Form No.SH.2*

### **Whether Share Certificate an Official Publication**

The question whether a share certificate is an official publication within the meaning of Section 12(3)(c) was considered by the Department of Company Affairs (Now, Ministry of Corporate Affairs) and the Department has clarified vide Circular No. 3/73[8/10(47)]/72-CL-V dated 3.2.1973 as follows:

“It will be seen that in terms of Section 82 [Corresponds to section 44 of the Companies Act, 2013], the shares in a company are movable property transferable in the manner provided in the articles of the company.

Section 84 [Corresponds to section 46 of the Companies Act, 2013] provides that a certificate under the common seal of the company specifying any share held by any member shall be *prima facie* evidence of the title of the member to such share.(with the Companies (Amendment) Act, 2015 coming into force the common seal is no more mandatory, The implications and signatories have been discussed earlier)

Thus, shares are movable property transferable in the manner provided in the articles of the company and



that the share certificates are certificates of title and are movable property but are not publications in the nature of prospectus, balance sheet, profit and loss account, notice or advertisement.

The conclusion reached, therefore, is that the share certificate is not an official publication within the meaning of Section 12(3)(c) of Companies Act, 2013.

### Legal Effect of Share Certificate

We have already stated that a share certificate is *prima facie* evidence to the title of the person whose name is entered on it. It means that the share certificate is a statement by the company that the moment when it was issued, the person named in it was the legal owner of the shares specified in it, and those shares were paid-up to the extent stated. It does not constitute title but it is merely evidence of title. It is, however a statement of considerable importance, for it is made with the knowledge that other persons may act upon it in the belief that it is true and this fact brings into operation the doctrine of estoppel. As a result, a share certificate once issued by the company binds it in two ways, namely:

- (a) by estoppel as to title, and
- (b) by estoppel as to payment.

**Estoppel as to Title:** A share certificate once issued binds the company in two ways. In the first place, it is a declaration by the company to the entire world that the person in whose name the certificate is made out and to whom it is given is a shareholder in the company. In other words the company is estopped from denying his title to the shares.

**Estoppel as to Payment:** If the certificate states that on each of the shares full amount has been paid, the company is estopped as against a *bona fide* purchaser of the shares, from alleging that they are not fully paid.

If a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company *Barrow case (1880) 14 Ch D 432: 42LT 891CA*.

Despite everything, a certificate must be issued by someone who has the authority. For example, where the secretary forged the signature of two directors in a company, the company had refused to register the holder of shares as a member. Further a certificate is not evidence as to the equitable interest in shares. Also, where an individual is aware of the false statements in a certificate, he will not be entitled to claim an estoppel.

### Personation of Shareholder

Section 57 of the Companies Act provides that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

## CALLS AND FORFEITURE

### Calls

A company issuing shares to its members may call the money due on shares at intervals depending upon the requirements for funds for implementing the project and the shareholders also prefer to pay the nominal value on their shares in installments as and when demanded by the company.

A call is a demand, by the company in pursuance of a Board resolution and in accordance with the articles of the company, upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted or held by them made at any time during the life of the company. A call may also be made by the liquidator in the course of winding up of the company. The amount payable in application on each share shall not be less than five per cent of the nominal amount of the share. The balance may be payable as and when called for in one or more calls. The prospectus and the articles of a company generally specify the amount payable at different times, as call(s).

Under Section 10(2) of the Act all moneys payable by any member to the company on the shares held by him under the memorandum or articles is a debt due from him to the company. In the event of default in payment of a valid call, the company can enforce payment of such moneys by legal process and forfeit the shares in case the call is not paid. The liability of members is enforceable only after a proper notice which is called 'call letter' or call notice as 1st, 2nd and final or so on, is given to him in accordance with the articles.

## **Requisites of a Valid Call**

### **1. Board of Directors to make call(s) on shares**

The power to make calls is exercised by the Board in its meeting by means of a resolution [Section 179(3)(a)]. The Board, in making a call, must observe the provisions of the articles, otherwise the call will be invalid, and the shareholder is not bound to pay. A proper notice must be given, and the notice must specify the amount called up and manner i.e. the date for payment and place and to whom it is to be paid. It may be emphasised that the time and place at which the call is to be paid are essential ingredients of a valid call.

Apart from this rule, "in making call, care must be taken that the directors making it are duly appointed and qualified; the meeting of the directors has been duly convened; proper quorum was present, and that the resolution making the call was duly passed and specifies the amount of the call, the time and place of payment.

### **2. Call(s) to be made bonafide in the interest of the company**

The power to make call is in the nature of trust and must be exercised only for the benefit of the company, and not for the private ends of the directors. If the call is made for the personal benefit of directors, the call will be invalid. In *Alexander v. Automatic Telephone Co.*, (1900) 2 Ch. 56, the directors of the company paid nothing on their shares but did not disclose this fact to the shareholders and called on them to pay certain amount partly as allotment money and partly as call money. The directors were held guilty of breach of trust and the call was held invalid.

### **3. Call(s) must be made on uniform basis**

According to Section 49 of the Act, calls on same class of shares must be made on a uniform basis. Hence a call cannot be made only on some of the members unless they constitute a separate class. In other words, there cannot be any discrimination between shareholders of the same class as regards amount and time of payment of call.

### **4. Notice of call(s)**

The notice of call must specify the exact amount and time of payment. In *Shackleyford & Co. Dangerfield* (1868) (R3 CP 407) the notice had specified the time and amount to be paid as a call, it will be a valid call inspite of the fact that the form of notice was an inaccurate one. A call must be made by serving upon member formal notice in accordance with the provisions of Section 53 of Companies Act, 1956 (Corresponding to Section 20 of Companies Act, 2013).

### 5. Time limitations for receiving the call money

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue.

Usually Articles of association of companies provide for the manner in which calls should be made. They follow the pattern set out in Regulations 13 to 18 of Table-F of Schedule-I appended to the Companies Act, 2013:-.

- (a) For each call at least 14 days notice must be given to members.
- (b) An interval of one month is required between two successive calls and not more than one-fourth of the nominal value of shares can be called at one time. However, companies may have their own articles and raise the limit.
- (c) The Board of directors has the power to revoke or postpone a call after it is made.
- (d) Joint shareholders are jointly and severally liable for payment of calls.
- (e) If a member fails to pay call money he is liable to pay interest not exceeding the rate specified in the articles or terms of issue or such lower rate, as the Board may determine. The directors are free to waive the payment of interest wholly or in part.
- (f) If any member desires to pay the call money in advance, the directors may at their discretion accept and pay interest not exceeding the rate specified in the articles.
- (g) A defaulting member will not have any voting right till call money is paid by him.

**Interest on calls due but not paid** — A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table F, in this regard provides:

- "16(i) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest thereon from the day appointed for payment thereof to the time of actual payment at 10% per annum or at such lower rate, if any, as the Board may determine.
- (ii) The Board shall be at liberty to waive payment of any such interest wholly or in part."

### Acceptance of uncalled capital

Section 50(1) states that if authorized by its articles, a company may accept from any member the whole or part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up.

Where section 50(2) provides that a member who has paid the whole or part of the amount remaining unpaid on the shares held by him even though the company has not made a call for it is not entitled for any voting right at a general meeting on the amount so paid until that amount has been called up

### Quantum and Interval between two calls

Proviso to Regulation 13(i) to the Table 'F' of Schedule I of the Companies Act, 2013 provides that no call shall exceed 25% of the nominal value of the share or be payable at less than one month from the date fixed for the payment of the last proceeding call.

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue and if any applicant fails to pay

the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited. However, it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 16 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Regulation 16 of ICDR provides that if the issue size exceeds five hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer. However, nothing contained in this clause shall apply to an offer for sale or an issue of specified securities made by a bank or public financial institution or an insurance company.

### Forfeiture of Shares

Forfeiture may be termed as penalty for violation of terms of contract. Forfeiture of shares means taking back of shares by the company from the shareholders. If the shareholder makes default in payment of calls on shares, then the company can use the option of forfeiting the shares. For a valid forfeiture, satisfaction of following conditions is necessary: -

1. **Articles of Association must authorise the forfeiture of shares.** Where power is given in the articles, it must be exercised in accordance with the regulation regarding notice, procedure and manner stated therein; otherwise the forfeiture will be void. The power of forfeiture must be exercised *bona fide* and in the interest of the company. It should not be collusive or fraudulent. If Articles authorise, the forfeiture shall include forfeiture of all dividends declared in respect of the forfeited shares and such dividend is not actually paid before the forfeiture of the shares.
2. **Resolution for Forfeiture** - Article 30 of the Table F provides that if the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors may pass a resolution forfeiting the shares.
3. **Proper Notice** - Before the shares of a member are forfeited, a proper notice to that effect must have been served. Regulation 29 of Table F provides that a notice shall name a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. The notice must also mention that in the event of non payment, the shares will be liable to be forfeited.
4. **Power of forfeiture must be exercised bona fide and for the benefit of the company** - The power to forfeit be exercised *bona fide* and for the benefit of the company. The power must be used in order to coerce reluctant shareholders into paying their calls. The power of forfeiture cannot be exercised to relieve unwilling shareholders from the liability of making the payment. Such a shareholder continues to be responsible for the unpaid part of the shares.

### REVIEW QUESTIONS



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

Articles of Association must authorize forfeiture of shares.

- True
- False

**Correct Answer: True**

When forfeiture of shares takes place, shareholder ceases to be a member and the forfeited shares become the property of the company. Regulation 32(ii) of Table F further provides that the liability of a person whose shares have been forfeited ceases if and when the company receives payment in full of all such monies in

respect of the shares forfeited. If liquidation takes place, the original holder shall remain liable as a past member to pay calls within one year of forfeiture. However, a company cannot recover from him more than the difference between the amount payable and the amount received on forfeited shares.

In case, the defaulting shareholder approaches the Board to cancel the forfeiture, the Board is empowered to cancel such forfeiture and claim the due amount with interest.

## CASE LAWS

### Some Legal Pronouncement about forfeiture of shares

1. *Shah J. in Naresh Chandra Sanyal v. Calcutta Stock Exchange Assn. Ltd.* AIR 1971 SC 422, As per Regulation 29 of Table A [Corresponds to Regulation 28 of Table F of Schedule I to the Companies Act, 2013], shares can be forfeited only against non-payment of any call, or instalments of a call. The Articles of a company may, however, lawfully incorporate any other grounds of forfeiture.
2. *Linkmen Services (P.) Ltd. v. Tapas Sinha* (2008) 83 SCL 143 (CAL), a company amended its articles of association for the purpose of (i) forfeiting the shares of any defaulting member and (ii) expelling member who desert the company by not doing business with it. The respondents challenged the above amendments on the grounds of oppression. The CLB (Replaced by the Tribunal under the Companies Act, 2013) held that the articles of company could not empower to forfeit the shares on account of dues other than unpaid calls. The appellant company appealed to the High Court. Allowing the appeal the Court held that forfeiture on grounds as mentioned in the articles of company is not alien to corporate jurisprudence as the CLB found in the impugned judgment. It is a power that the articles can confer.
3. *Hope v. International Finance Society* (1876) 4 Ch. D 598. Where the articles authorise the directors to forfeit the shares of a shareholder, who commences an action against the company or the directors, by making a payment of the full market value of his shares, it was held that such a clause was invalid as it was against the rights of a shareholder.
4. *Re Exparto Trading Co.* [1879] 12 Ch. D 191 Where two directors were allotted qualification shares, without any payment, and these shares were forfeited by a Board resolution passed at the request of those two directors, the forfeiture was held to be invalid and the directors were held liable to pay the nominal value of the shares.
5. *Public Passenger Services Ltd. v. M.A. Khader* 1966 1 Comp LJ 1: A proper notice is a condition precedent to the forfeiture, and even the slightest defect in the notice will invalidate the forfeiture.
6. *Johnson v. Lyttle's Iron Agency* 1877 Ch D 687. The notice should mention that the payment of interest should be made from the date of the call.
7. *Sparks v. Liverpool Water Works Co.*, 1807 13 Ves 428. Accidental non receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected.
8. *Sha Mulchand & Co. v. Jawahar Mills Ltd.* 1953 23 Com Cases 1 (SC). Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void. The aggrieved shareholder may bring an action for setting aside the forfeiture as well as for damages. Mere waiver or acquiescence would not deprive him of his rights against an invalid forfeiture of his shares.
9. *Sha Mulchand & Co. v. Jawahar Mills (supra)*. After shares have been forfeited, no further notice intimating forfeiture is required.

## Re-issue of Forfeited Shares

Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board. This is done by a Board resolution. After the money due is received from the new member(s), the company executes a transfer deed and issues a share certificate, and if the original holder has already surrendered the share certificate, it is duly transferred, otherwise after a public notice in a newspaper, a new share certificate is issued.

If the shares are re-issued at a price more than the face value, the excess of the proceeds of sale is not payable to the former owner, if the articles provide otherwise (*Calcutta Stock Exchange Assn. Ltd Re AIR 1957 Cal 438*). The excess of the proceeds so retained shall constitute a premium and must therefore be transferred to the securities premium account. However, in the case of *Naresh Chandra Sanyal v. Calcutta Stock Exchange Ass. Ltd., AIR 1971 SC 422*, Supreme Court held that, where the articles are silent with regard to such surplus, the right of a company upon the forfeiture and sale of forfeited shares is to use the proceeds for discharging the liability for which the forfeiture was effected and if there is any balance, it belongs to the defaulter and cannot be appropriated by the company.

Where the forfeited shares are re-issued, the new shareholders will not only be liable for the balance amount remaining on the shares but he will also not be entitled to voting rights so long as calls payable by the original shareholder remain unpaid, if the company's articles so provide, as stated in Section 106.

A listed company for reissuing forfeited shares should comply with the relevant clause of the listing agreement and due approval of the regional stock exchange and others as well.

## Surrender of shares

A company cannot accept a surrender of its shares "as every surrender of shares, whether fully paid-up or not involves a reduction of capital which is unlawful...forfeiture is a statutory exception and is the only exception". [*Bellerby v. Rowland and Marwood's S.S. Co. Ltd., (1902) 2 Ch 14*]. But a surrender may be dealt with in the manner indicated in *Re Castiglione's Willtrusts, Hunter v. Mackenzie, (1958) 1 All ER 480* viz., directing that the shares be held in the name of a nominee as trustee for the company. However, a surrender can be accepted in circumstances absolutely parallel to the requirements of a forfeiture, the only difference being that instead of going to the length of the formalities of a forfeiture, the company accepts in good faith in its own interest the shares which the shareholder is voluntarily surrendering. The other advantage to the company is that the shareholder becomes estopped from questioning the validity. [*Collector of Moradabad v. Equity Insurance Co. Ltd., AIR 1948 Oudh 197*].

## LESSON ROUND-UP

- Allotment means the act of appropriation by the Board of directors of the company of a certain number of securities to persons who have made applications for securities.
- The allotment should be made by proper authority, within a reasonable time, should be absolute and unconditional, must be communicated, should be against application only and should not be in contravention of any other law.
- The Companies Act lays down certain conditions under various sections to be fulfilled before a company can proceed to allot securities such as making an application for getting the securities listed u/s 40, filing prospectus before allotment, minimum subscription,
- If the allotment is made without complying with the conditions as discussed above, allotment is said to be irregular and it will result to the consequences depending upon the nature of irregularity.
- After allotment of securities, a return of allotment in the Form PAS-3 is required to be filed with Registrar of

Companies within 30 days of allotment of securities.

- A share certificate shall be issued under the common seal, if any, of the company or signed by two directors or by a director and the company secretary, wherever, the company has appointed a company secretary, is *prima facie* evidence of the title of the person to the shares specified therein. Every share certificate shall be issued under the common seal, if any, of the company affixed in presence of and signed by two directors duly authorized by the Board of Directors and the secretary or any person authorized by the Board for the purpose.
- Share certificate is not an official publication within the meaning of Section 12(3)(c) of the Act.
- A call is a demand by the company upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted, made at any time during the life of the company.
- If a member fails to pay a valid call within the stipulated time, the company may exercise the power to forfeit the shares.
- Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board.

## GLOSSARY

<b>Allotment of Securities</b>	“Allotment” of securities means the act of appropriation by the Board of directors of the company out of the previously un-appropriated capital of a company of a certain number of securities to persons who have made applications for securities.
<b>Irregular Allotment</b>	An allotment is irregular if it is made without complying with the conditions precedent to a regular allotment.
<b>Share Certificate</b>	A share certificate is a certificate issued to the members by the company under its common seal specifying the number of shares held by him and the amount paid on each share.
<b>Split Certificate</b>	A split certificate means a separate certificate claimed by a shareholder for a portion of his holding.
<b>Call on Share</b>	A call is a demand, by the company in pursuance of a Board resolution and in accordance with the articles of the company, upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted or held by them made at any time during the life of the company.

## SELF-TEST QUESTIONS

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

1. What is the significance of a Share Certificate?
2. What do you mean by a Split Certificate?
3. A share certificate is lost. What are the provision under the Companies Act, 2013 for the issue of a duplicate share certificate?
4. Explain the legal effects of a share certificate citing case laws.
5. Is the share certificate an official publication? Give reasons for your answer.
6. What is allotment? State the statutory provision regarding allotment? Can allotment be made on an oral application?





# Lesson 12

## Membership in a Company

### LESSON OUTLINE

- Definition of member
- Modes of acquiring membership
- Subscribers to memorandum
- Allotment/transfer/transmission etc.
- Who may become member?
- Minimum number of members
- Cessation of membership
- Expulsion of members
- Personation and Penalty
- Register of members
- Power of the Central Government to Investigate into the Ownership of Company
- Rights of members
- Variation of Member's Rights
- Liabilities of members

### LEARNING OBJECTIVES

The membership in a company is obtained through subscribing to the memorandum, through allotment/transfer/transmission etc. The membership rights enable the member to participate into the affairs of the company through general meeting.

The Companies Act 2013 prescribes aspects as to the mode of acquisition of membership, eligibility criteria, minimum number of members, rights and liabilities of members.

After reading this lesson you will be able to understand the status of members, membership rights, modes of acquisition of membership, register and records to be maintained, consequences of Regulatory non-compliances etc.

## WHO ARE MEMBERS?

A company is composed of members, though it has its own separate legal entity. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity.

In the case of a company limited by shares, the shareholders are the members. The terms “members” and “shareholders” are usually used interchangeably, being synonymous, as there can be no membership except through the medium of shareholding. Thus, generally speaking every shareholder is a member and every member is a shareholder. However, there may be exceptions to this statement, e.g., a person may be a holder of share(s) by transfer but will not become its member until the transfer is registered in the books of the company in his favour and his name is entered in the register of members. Similarly, a member who has transferred his shares, though he does not hold any shares yet he continues to be member of the company until the transfer is registered and his name is removed from the register of members maintained by the company under Section 88 of the Companies Act, 2013.

In *Herdilia Unimers Ltd. v. Renu Jain* [1995] 4 Comp. LJ. 45 (Raj.), it was held that the moment the shares were allotted and share certificate signed and the name entered in the register of members, the allottee became the shareholder, irrespective of whether the allottee received the shares or not.

In a company limited by guarantee, the persons who are liable under the guarantee clause in its Memorandum of Association are members of the company.

In an unlimited company, the members are the persons who are liable to the company, each in proportion to the extent of their interests in the company, to contribute the sums necessary to discharge in full, the debts and liabilities of the company, in the event of its being wound-up.

### Definition of ‘Member’

According to Section 2(55) of the Companies Act, 2013, member, in relation to a company, means,

- (1) The subscribers to the memorandum of a company who shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members;
- (2) Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall, be a member of the company;
- (3) Every person holding shares of a company and whose name is entered as a beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.

Accordingly, there are two important elements which must be present before a person can acquire membership of a company viz., (i) agreement to become a member; and (ii) entry of the name of the person so agreeing, in the register of members of the company. Both these conditions are cumulative. [*Balkrishan Gupta v. Swadeshi Polytex Ltd.* (1985) 58 Com Cases 563].

The person desirous of becoming a member of a company must have the legal capacity of entering into an agreement in accordance with the provisions of the Indian Contract Act, 1972. Section 11 of the Indian Contract Act lays down that

Every person is competent to contract who:-

- (i) is of the age of majority according to the law to which he is subject.
- (ii) is of sound mind.
- (iii) is not disqualified from contracting by any law to which he is subject.

## MODES OF ACQUIRING MEMBERSHIP

As per Section 2(55) of the Companies Act, 2013, a person may acquire the membership of a company:

- (a) by subscribing to the Memorandum of Association (deemed agreement); or
- (b) by agreeing in writing to become a member:
  - (i) by making an application to the company for allotment of shares; or
  - (ii) by executing an instrument of transfer of shares as transferee; or
  - (iii) by consenting to the transfer of share of a deceased member in his name; or
  - (iv) by acquiescence or estoppel.
- (c) by holding shares of a company and whose name is entered as beneficial owner in the records of a depository (Under the Depositories Act, 1996)

and on his name being entered in the register of members of company. Also every such person holding shares of the company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be the member of the concerned company.

### LET US REMEMBER!

**The holder of shares of the company whose name has been entered as beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.**

#### **(a) Subscribers to the Memorandum**

In the case of a subscriber, no application or allotment is necessary to become a member. By virtue of his subscribing to the memorandum, he is deemed to have agreed to become a member and he becomes *ipso facto* member on the incorporation of the company and is liable for the shares he has subscribed.

A subscriber to the memorandum cannot rescind the contract for the purchase of shares even on the ground of fraud by the promoters. *In Re. Metal Constituents Co., (1902) 1.Ch. 707.*

In accordance with the provisions of Section 10(2) of the Companies Act, 2013, all monies payable by any member to the company under the memorandum or articles shall be debt due from him to the company. Further, a subscriber to the memorandum must pay for his shares in cash even if the promoters have promised him the shares for services rendered in connection with the promotion of the company. Again, he must take the shares directly from the company, and not through transfer from other member(s). When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfills the obligation. His liability remains right up to the time when the company goes into liquidation and he is bound to bring the money for which he is liable to pay to the creditors of the company.

#### **(b) Agreement in Writing**

##### **(i) By an application and allotment**

A person who applies for shares becomes a member when shares are allotted to him, a notice of allotment is issued to him and his name is entered on the register of members. The general law of contract applies to this transaction. There is an offer to take shares and acceptance of this offer when the shares are allotted. An application for shares may be absolute or conditional. If it is absolute, an allotment and its notice to the applicant will be sufficient acceptance. On the other hand, if the offer is conditional, the allotment must be

made according to be condition as contained in the application. If there is conditional application and unconditional allotment, there is no contract.

### **(ii) By transfer of shares**

Shares in a company are movable property as provided in Section 44 of the Companies Act, 2013 and are transferable in the manner as provided in the articles of the company and as provided in Section 56 of the Companies Act, 2013. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company, i.e. by getting his name entered in the register of members of the company.

### **(iii) By transmission of shares**

A person may become a member of a company by operation of law i.e. if he succeeds to the estate of a deceased member. Membership by this method is a legal consequence. On the death of a member, his executor or the person who is entitled under the law to succeed to his estate, gets the right to have the shares transmitted and registered in his name in the company's register of members. No instrument of transfer is necessary in this case. If the legal representative of deceased member desires to be registered as a member in place of the deceased member, the company shall do so or in the alternative he may request the company to transfer the shares in the name of another person of his choice. The Official Assignee or Official Receiver is likewise entitled to be a member in place of the shareholder, who has been adjudged insolvent.

### **(iv) By acquiescence or estoppels**

A person is deemed to be a member of a company if he allows his name, without sufficient cause, to be on the register of members of the company or otherwise holds himself out or allows himself to be held out as a member. In such a case, he is estopped from denying his membership. He can, however, escape his liability by taking prompt action for having his name removed from the register of members on permissible grounds.

### **(c) Holding Shares as Beneficial Owner in the Records of Depository.**

Every person holding shares of the company and whose name is entered as a beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

## **WHO MAY BECOME A MEMBER**

Subject to the Memorandum and Articles, any *sui juris* (a person who is competent to contract) except the company itself, can become a member of a company. However, it is important to note the following points in relation to certain organizations and persons:

(a) **Company as a member of another company:** A company is a legal person and so is competent to contract. Therefore, it can become a member of any other company. However, it must be authorised by its Memorandum of Association to invest in the shares of that company or any other company. Also a company cannot become a member of itself. As per section 19 of the Companies Act, 2013, a subsidiary company cannot become a member of its holding company. However, a subsidiary can hold shares in its holding company only under the following exceptional circumstances—

- (i) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

- (ii) where the subsidiary company holds such shares as a trustee; or
- (iii) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

(b) **Partnership firm as a member:** A partnership firm is not a legal person and as such it cannot, in its own name, become a member of a company except in company registered u/s 8 of Companies Act, 2013.

(c) **Limited Liability Partnership,** being an incorporated body under the statute, can become a member of a company.

(d) **Section 8 Company:** A non-profit making company licensed under Section 8 of the Companies Act, 2013 can become a member of another company if it is authorised by its Memorandum of Association to invest into shares of the other company.

(e) **Foreigners as members:** A foreigner may take shares in an Indian company and become a member subject to the provisions of the Foreign Exchange Management Act, 1999, but in the event of war with his country, he becomes an alien enemy and his power of voting and his rights to receive notices are suspended.

(f) **Minor as member:** A member who is not a *sui juris* e.g., a minor, is wholly incompetent to enter into a contract and as such cannot become a member of a company. Consequently, an agreement by a minor to take shares is void *ab-initio*.

It has been held by the Company Law Board (replaced by the Tribunal under the Companies Act, 2013) that an agreement in writing for a minor to become a member may be signed on behalf of the minor by his lawful guardian and the registration of transfer of shares in the name of the minor, acting through his or her guardian, especially where the shares are fully paid cannot be refused on the ground of the transferee being a minor [*Miss Nandita Jain v. Bennett Coleman and Co. Ltd.*, Appeal No. 27 of 1972 dated 17.2.78].

After attaining majority, the minor, if he does not want to be a member, must repudiate his liability on the shares on ground of minority, and if he does so, the company can not plead estoppel on the ground of his having received dividends during his minority or that he had fraudulently misrepresented his age in his application for shares [*Sadiq Ali v. Jai Kishori*, (1928) 30 Bom. L.R. 1346].

If shares are transferred to a minor, the transferor will remain liable for all future calls on such shares so long as they are held by the minor even if the transferor was ignorant of his minority. If the company knows of his minority it may refuse to register the transfer, unless the transfer was made through the guardian.

(g) **Insolvent as member:** An insolvent may be a member of a company as long as he is on the register of members. He is entitled to vote, but he loses all beneficial interest in the shares and company will pay dividend on his shares to the Official Assignee or Receiver [*Morgan v. Gray*, (1953) All E.R. 213].

(h) **Pawnee:** A pawnee has no right of foreclosure since he never had the absolute ownership at law and his equitable title cannot exceed what is specifically granted by law. In this sense, a pledge differs from a mortgage. In view of the above, a pawnee cannot be treated as the holder of the shares pledged in his favour, and the pawner continues to be a member and can exercise the rights of a member [*Balakrishna Gupta v. Swadeshi Polytext Ltd.*, (1985) 58 Com Cases 563 (S.C.)].

(i) **Receiver:** A receiver whose name is not entered in the register of members cannot exercise any of the membership rights attached to a share unless in a proceeding to which company is a party and an order is made therein. Mere appointment of a receiver in respect of certain shares of a company without more rights cannot, deprive the holder of the shares whose name is entered in the register of members of the company,

the right to vote at the meeting of the company [*Balakrishna Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Com Cases 563 (S.C.)].

(j) **Persons taking shares in fictitious names:** A person who takes shares in the name of a fictitious person, becomes liable as a member besides incurring criminal liability under Section 38 of the Act, wherein punishment is provided for commission of fraud. As per section 447, any person who is found guilty of fraud, is punishable with imprisonment which shall not be less than six months but which may extend to ten years and also liable to pay fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. However, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

(k) **Trade Union as member:** A trade union registered under the Trade Union Act, can be registered as a member and can hold shares in a company in its own corporate name [*All India Bank Officers Confederation v. Dhanlakshmi Bank Ltd.*, (1997) 90 Com Cases 225].

### LET US REMEMBER!

**Partnership cannot become a member of a company, whereas Limited Liability Partnership, being an incorporated body can become member of a company.**

### Clarification regarding status of a holder of Global Depository Receipts (GDRs):

It is clarified by the Ministry of Corporate Affairs, vide Circular No.1/2009 No.17/67/2009 CL-V dated 16/6/2009 that:

(a) As per section 41(1) and (2) of the Companies Act, 1956, [Corresponds to section 2(55) (i) & (ii) of the Companies Act, 2013] a person is a member of the company, (i) who is a subscriber to the Memorandum or (ii) whose name has been entered in the register of members. Since, holder of Global Depository Receipts is neither the subscriber to the Memorandum nor a holder of the shares, his name cannot be entered in the Register of Members. Therefore, a holder of Global Depository Receipts cannot be called a member of the company.

(b) As per Section 41(3) of the Companies Act, 1956, [Corresponds to section 2(55) (i) & (ii) of the Companies Act, 2013] a person holding a share capital of the company and whose name is entered as beneficial owner in the records of the depository, is deemed to be a member of the company. Since the Overseas Depository Bank as referred in the 'Scheme' is neither the Depository as defined in the Companies Act, 1956 and the Depository Act, 1996 nor holding the share capital, therefore, it cannot be deemed to be a member of the company.

(c) A holder of Global Depository Receipts may become a member of the company only on transfer/redemption of the GDR into underlying equity shares after following the procedure provided in the "Scheme"/ provisions of the Companies Act.

(d) Since the underlying shares are allotted in the name of Overseas Depository Bank, the name of such Overseas Depository Bank is to be entered in the Register of Members of the issuing company. However, until transfer/redemption of such GDR's into underlying shares, Overseas Depository Bank cannot be considered a nominee of the holder of GDR for the purpose of Section 42 read with Section 41 of the Companies Act, 1956 [Corresponds to section 19 read with section 2(55) of the Companies Act, 2013].

### LET US REMEMBER!

**When the holder of GDR redeems the same into underlying shares, he/she becomes the member.**

### Joint Members

If more than one person apply for shares in a company and shares are allotted to them, each one of such

applicant becomes a member (*Narandas v. India Mfg. Co.*, A.I.R. 1953 Bom. 433]. Unless the Articles of the company otherwise provide, joint members can insist on having their names registered in any order they may require. They may also have their holding split into several joint holdings with their names in different orders so that all of them may have a right to vote as first named holding in one or the other joint holdings. *Burns v. Siemens Brothers Dynamo Works Ltd.* (1919) 1 Ch. 225.

### Registration of Shares in the name of Public Office

The Companies Act, 2013 contains no provisions with regard to the registration of shares in the name of a public office. Shares cannot, therefore, be registered in the names of public offices like the Collector of Central Excise or the Commissioner of Income-tax etc. Similar observations apply to the holder of any other public office which is not a corporation sole constituted by statute, e.g., the Administrators General Act, 1963) (Clarification issued by the Department of Company Affairs now Ministry of Corporate Affairs).

Section 2(55)(ii) provides that a 'person' (other than a subscriber of the memorandum) can become a member. The term 'person' has been held to include, among others, a corporation sole.

A "corporation sole" is a corporation constituted in a single person who in the right of some office or function and has corporate status. The object of corporation sole is to make it possible to distinguish the holder of an office or function in his official and in his private capacity. By this fiction of law, it is possible to attach rights and duties to the holder, for the time being, of the office or functions to convey real or personal property to him in his official name and style. In short, a corporation sole has the same characteristics of perpetual succession and separation of rights and duties of the corporate body from those of the corporate as all corporations possess.

## REVIEW QUESTIONS



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

Shares can be registered in the name of Public Offices.

- True
- False

Correct answer: *False*

## MINIMUM NUMBER OF MEMBERS

Section 3(1) of the Companies Act, 2013 provides that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company; or two or more persons, where the company to be formed is to be a private company; or one person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

## Restriction on Membership

By virtue of Section 2(68)(ii) of the Companies Act, 2013, the maximum number of members of a private company except in the case of One Person Company is limited to two hundred excluding the present and past employees of the company who continue to be members of the company. There is no restriction with regard to the maximum number of members of a public company.

**LET US REMEMBER!**

**The maximum number of members in case of a private company is limited to two hundred.**

**REVIEW QUESTIONS**

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

A public company does not have any restriction regarding the maximum number of members.

- True
- False

**Correct answer: True**

**5. CESSATION OF MEMBERSHIP**

A person ceases to be a member of a company when his name is removed from its register of members, which may occur in any of the following situations:

- (a) He transfers his shares to another person, the transfer is registered by the company and his name is removed from the register of members;
- (b) His shares are forfeited;
- (c) His shares are sold by the company to enforce a lien;
- (d) He dies; (his estate, however, remains liable for calls);
- (e) He is adjudged insolvent and the Official Assignee disclaims his shares;
- (f) His redeemable preference shares are redeemed;
- (g) He rescinds the contract of membership on the ground of fraud or misrepresentation or a genuine mistake;
- (h) His shares are purchased either by another member or by the company itself under an order of the Tribunal under Section 242 of the Companies Act, 2013;
- (i) The member is a company which is being wound-up in India, and the liquidator disclaims the shares;
- (j) The company is wound up; or

Though one ceases to be a member, he remains liable as a contributory and is also entitled to share in the surplus, if any.

**Expulsion of a Member**

A controversy had arisen as to whether a public limited company had powers to insert an article in its Articles of Association relating to expulsion of a member by the Board of Directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company.

The Department of Company Affairs (now, Ministry of Corporate Affairs) clarified that an article for expulsion of a member is opposed to the fundamental principles of the Company Jurisprudence and is *ultra vires* the company, the reason being that such a provision against the provisions of the Companies Act relating to the rights of a member in a company, the powers of the Central Government as an appellate authority under



Section 111 of the Act and the powers of the Court under Sections 107, 395 and 397 of the Companies Act, 1956. [These sections correspond to sections 58, 48, 235 and 241 of the Companies Act, 2013 respectively.]

According to Section 6 of the Companies Act, 2013, the Act overrides the Memorandum and Articles of Association and any provision contained in these documents repugnant to the provisions of the Companies Act, is void.

The Department of Company Affairs (now MCA) has, therefore, clarified that any assumption of the powers by the Board of Directors to expel a member by alteration of Articles of Association shall be illegal and void.

The Supreme Court in the case of *Bajaj Auto Ltd. v. N.K. Firodia* [1971] 41 Com Cases 1 has laid down the law as to the conditions on the basis of which directors could refuse a person to be admitted as a member of the company. The principles laid down by the Supreme Court in this case, even though pertain to the refusal by a company to the admission of a person as a member of the company, are applicable even with greater force to a case of expulsion of an existing member. As, under Article 141 of the Constitution, the law declared by the Supreme Court is binding on all courts within the territory of India, any provision pertaining to the expulsion of a member by the management of a company which is against the law as laid down by the Supreme Court will be illegal and *ultra vires*. In the light of the aforesaid position, it is clarified that assumption by the Board of directors of a company of any power to expel a member by amending its articles of association is illegal and void [Circular: Letter No. 32/75, dated 1.11.1975].

## PERSONATION AND PENALTY

Section 57 of the Companies Act, 2013 provides for penalty for personation of a shareholder. The section reads:

“If any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees..”

The punishment provided by Section 57 is for obtaining or attempting to obtain or receiving or attempting to receive a security, interest in a company, share warrant, coupon due to the rightful owner. According to the criminal law, personation is one of the means of cheating.

The offence is committed whether the individual personated is a real or imaginary person”.

## REGISTER OF MEMBERS ETC.

Section 88 of the Companies Act, 2013 lays down:

(1) Every company shall keep and maintain the following registers namely:—

- (a) register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India;
- (b) register of debenture-holders; and
- (c) register of any other security holders.

(2) Every register maintained under sub-section (1) shall include an index of the names included therein.

(3) The register and index of beneficial owners maintained by a depository under section 11 of the

Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

(4) Foreign register.

(5) If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2), the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues.

### **Rule 3 of Companies (Management and Administration) Rules, 2014**

Every company limited by shares shall from the date of its registration maintain a register of its members in Form No. MGT-1.

In the case of a company not having share capital, the register of members shall contain the following particulars, in respect of each member, namely:-

- (a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/Mother's/Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;
- (b) date of becoming member;
- (c) date of cessation;
- (d) amount of guarantee, if any;
- (e) any other interest if any; and
- (f) instructions, if any, given by the member with regard to sending of notices etc:

### **Rule 5 of Companies (Management and Administration) Rules, 2014**

(1) The entries in the registers maintained under section 88 is to be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

(2) The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.

(3) Consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.

(4) If any change occurs in the status of a member or debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or

due to any other reason, entries thereof explaining the change shall be made in the respective register.

(5) If any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.

(6) If any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.

(7) In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.

(8) If promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within fifteen days from such an event.

### **Rule 8 of Companies (Management and Administration) Rules, 2014**

The entries in the registers maintained under section 88 and index included therein shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose, and the date of the board resolution authorising the same shall be mentioned.

The entries in the foreign register shall be authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

## **CASE LAW**

### **Judicial Pronouncement relating to register of members**

1. A person who claims to have purchased the shares of a member will be entitled to have his name entered in the register by satisfying the requirement of either Section 108 or 109 [Corresponds to section 56 of the Companies Act, 2013]. [Lalithamba Bai v. Harrisons Malayalam Ltd., (1988) 2 Comp LJ 41 (Ker)].
2. No company should enter in the register a statement that it has a lien on the shares of a member, [W. Key & Son Ltd., (1902) 1 Ch 467].
3. A company cannot insist upon putting in the register anything except that which is required by the section to be inserted in it. [T.H. Saunders & Co. Ltd. Re, (1908) 1 Ch 415].
4. In a voluntary winding up, the liquidator may accept share transfers and alter the register accordingly. [Taylor, Phillips and Richard's Case, (1897) 1 Ch 298].
5. A firm in its own name cannot be registered as a member, as a firm is not a legal person like a company incorporated under the Act. Only the partners can be recognised and registered as joint holders. [See Re Vagliano & Anthracite Collieries Ltd., (1910) 79 LJ Ch 769].

### **Index of Members**

Section 88(2) of the Companies Act, 2013 requires that every register maintained under section 88(1) shall include an index of the names included therein.

## **Rule 6 of Companies (Management and Administration) Rules, 2014**

### **Index of names to be included in Register**

Every register maintained under sub-section (1) of section 88 shall include an index of the names entered in the respective registers and the index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found:

The maintenance of index is not necessary, in case, the number of members is less than fifty.

The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

### **Place of keeping and inspection of the Registers**

Section 94 of the Companies Act, 2013 fixes the place for maintaining a company's registers, returns etc. and for allowing their inspection.

According to Section 94(1), the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company:

Such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company and the Registrar has been given a copy of the proposed special resolution in advance.

## **Companies (Management and Administration) Rules, 2014**

A copy of the proposed special resolution in advance to be filed with the registrar as required in accordance with first proviso of sub-section (1) of section 94, shall be filed with the Registrar, at least one day before the date of general meeting of the company in Form No.MGT-14.(Also refer to Rule 5(2) which was already discussed).

### **LET US REMEMBER!**

**To keep the Register of Members at any other place (instead of the registered office of the company) in India in which more than one-tenth of the total number of members entered in the register of members reside:-**

- (i) Special Resolution is required, and**
- (ii) Registrar has to be given advance copy of the proposed Special Resolution atleast one day before in MGT-14.**

### **Inspection of Registers**

According to section 94(2) states that the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be specified in the articles of association of the company but not exceeding Rs. 50 for each inspection.

As per Section 94(3) any such member, debenture-holder, other security holder or beneficial owner or any other person may—

- (a) take extracts from any register, or index or return without payment of any fee; or

- (b) require a copy of any such register or entries therein or return on payment of such fees as may be specified in the Articles of Association of the company but not exceeding Rs 10 for each page.

#### **Rule 14 of Companies (Management and Administration) Rules, 2014**

(1) The registers and indices maintained pursuant to section 88 and copies of returns prepared pursuant to section 92, shall be open for inspection during business hours, at such reasonable time on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding fifty rupees for each inspection.

Explanation.- For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

(2) Any such member, debenture holder, security holder or beneficial owner or any other person may require a copy of any such register or entries therein or return on payment of such fee as may be specified in the articles of association of the company but not exceeding ten rupees for each page. Such copy or entries or return shall be supplied within seven days of deposit of such fee.

#### **Let us Remember!**

**Every company limited by shares shall, from the date of its registration, maintain a register of its members in Form No. MGT-1**

#### ***Copies of the registers and annual return.-***

Rule 16 provides copies of the registers maintained under section 88 or entries therein and annual return filed under section 92 shall be furnished to any member, debenture-holder, other security holder or beneficial owner of the company or any other person on payment of such fee as may be specified in the Articles of Association of the company but not exceeding rupees ten for each page and such copy shall be supplied by the company within a period of seven days from the date of deposit of fee to the company.

#### ***Consequences if inspection is refused***

According to Section 94(4), if any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.

Further section 94(5) provides that “the Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.”

#### **Register *prima facie* evidence**

Section 95 of the Companies Act, 2013 provides that the registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be *prima facie* evidence of any matter directed or authorised to be inserted therein by or under this Act.

A register of members is *prima facie* evidence of the truth of its contents. Accordingly, if a person's name, to his knowledge, is there in the register of members of a company, he shall be deemed to be a member and onus lies on him to prove that he is not a member. He must promptly appeal to the Tribunal or a competent

court outside India specified by the Central Government by notification, in respect of foreign members or debenture holder residing outside India for rectification of the register under Section 59 of the Act to take his name off the register, failing which the doctrine of holding out will apply.

### CASE LAW

In *Re. M.F.R.D. Cruz*, A.I.R. 1939 Madras 803, the plaintiff applied for 4,000 shares in a company but no allotment was made to him. Subsequently 4,000 shares were transferred to him without his request and his name was entered in the register of members. The plaintiff knew it but took no steps for rectification of the register of members. The company went into liquidation and he was held liable as a contributory. The Court held “when a person knows that his name is included in the register of shareholders and he stands by and allows his name to remain, he is holding out to the public that he is a shareholder and thereby he loses his right to have his name removed”.

### Rectification of a Register of Members

The register of members of a company contains names, addresses, occupations, if any etc. only of members of the company. Any person, whose name is entered in the register of members of a company, considered to be its member, although he may not own the shares which are shown in his name in the register of members. On the contrary, a person, whose name is not entered in the register of members is not considered as member of the company even though he may have done everything to entitle him to be put on the register of members. Injustice may, therefore, result from such omission or commission.

Section 59 of the Companies Act, 2013 confers powers on the Tribunal or a competent court outside India specified by the Central Government by notification in respect of foreign members or debenture-holders residing outside India to order rectification of register of members of a company if an appeal is made by the aggrieved person or by any member of the company or the company on any of the following grounds:

- (a) where the name of a person is without sufficient cause, entered in the register of members of a company;
- (b) where his name, after having been entered in the register, is omitted without sufficient cause; or
- (c) where default is made or unnecessary delay takes place in entering in the register of members the fact of any person having become, or ceased to be, a member of company.

This may happen where a person has transferred his shares according to law and the company either refuses or delays registration of transfer in the transferee’s name.

The Tribunal may, after hearing the parties to the appeal for rectification of register of members either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within ten days or direct for rectification of records of the depository or the register and in the latter case also direct the company to pay damages if any, sustained by the party aggrieved.

It is pertinent to note that though the time limit for filing an application for rectification of register of members has not been specified in the Act, the provisions of Article 137 of the Limitation Act would apply and in consequence, the application for rectification must be made within three years from the date on which the right occurs [Ref. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.*, (1983) 54 Com Cases 301 (Delhi)].

The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal. [Section 59(3)]

Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts

(Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned. [Section 59(4)]

If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both. [Section 59(5)]

### Foreign Register

Section 88(4) of the Companies Act, 2013 empowers companies to keep foreign registers of members or debenture-holders, other security holders or beneficial owners residing outside India. It states:

“A company may, if so authorised by its articles, keep in any country outside India, in such manner as may be prescribed, a part of the register referred to in sub-section (1), called “foreign register” containing the names and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India.”

If a company does not maintain foreign register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of section 88(1) or section 88(2), the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues. [Section 88(5)]

A foreign register is deemed to be a part of the company's principal register and it should be kept in the same manner as the principal register and be likewise open to inspection.

A duplicate of such register should be maintained at the registered office in India and all entries made in the foreign register should be made in the duplicate register at the registered office as soon as possible.

A company may discontinue a foreign register at any time but all the entries made in it must be transferred to the principal register.

The decision of a competent Court in the State or Country in which a foreign register is kept, with regard to its rectification, shall be as effective as if it were a decision of a competent Court in India, if the Central Government, by notification in the *Official Gazette*, so directs.

### Rule 7 of Companies (Management and Administration) Rules, 2014

(1) A company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country (hereafter in this rule referred to as the "foreign register").

(2) The company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office in Form No.MGT-3 along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice in Form No.MGT-3 with

## 310 EP-CL

the Registrar of such change or discontinuance.

(3) A foreign register shall be deemed to be part of the company's register (hereafter in this rule referred to as the "principal register") of members or of debenture holders or of any other security holders or beneficial owners, as the case may be.

(4) The foreign register shall be maintained in the same format as the principal register.

(5) A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, mutatis mutandis, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.

(6) If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.

(7) Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

(8) The company shall—

(a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and

(b) keep at such office a duplicate register of every foreign register duly entered up from time to time.

(9) Every such duplicate register shall, for all the purposes of this Act, be deemed to be part of the principal register.

(10) Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered in any other register.

(11) The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

### **Closing of Register of Members**

Section 91 of the Companies Act, 2013 contains guidelines for closing the register of members. It lays down:

“(1) A company may close the register of members or the register of debenture-holders or the register of other security holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time, subject to giving of previous notice of at least 7 days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in the prescribed manner.

(2) If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided above, or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company



and every officer of the company who is in default shall be liable to a penalty of 5000 rupees for every day subject to a maximum of one lakh rupees during which the register is kept closed..”

The provisions contained in Section 154 (Corresponds to section 91 of the Companies Act, 2013) are permissive and not mandatory. The section has application only when a company desires to close its register of members and in such a situation, the requirements of the section are to be complied with. *Talyar Tea Co. v. Union of India*, (1991) 71 Com Cases 95

The power in this section is intended for the convenience of the company in order to enable the register of members to be brought up to date for the purpose of calculating dividend and bonus, etc. However, even if the register of members is closed, the company is obliged to make certain entries during the period of closure, such as entries relating to registration and probates and letters of administration, notices of change of name and address and court orders, such as changing orders, etc. [*Killick Nixon Ltd. v. Dhanraj Mill Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

The closure of the register is cloaked with the right to refuse the transfer of shares/debentures. Record date is an alternate for closing the registers. The purpose of closing the registers is to get the registers updated and to fix a cut-off date for the purpose of payment of dividend or issue of rights and bonus shares. This purpose can also be achieved by fixing a record date for a day.

#### **Rule 10 of Companies (Management and Administration) Rules, 2014**

##### **Closure of register of members or debenture holders or other security holders.-**

(1) A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India, if such company is a listed company or intends to get its securities listed, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

(2) The provisions contained in sub-rule (1) shall not be applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders.

#### **Rule 15 of Companies (Management and Administration) Rules, 2014**

##### ***Preservation of Registers, etc.***

(1) The register of members along with the index shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose; and

(2) The register of debenture holders or any other security holders along with the index shall be preserved for a period of eight years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.

(3) Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of eight years from the date of filing with the Registrar.

(4) The foreign register of members shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of eight years from the date of redemption of such debentures or securities.

(5) The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.

### **Power of the Central Government to Investigate into the Ownership of Company**

Sometimes, the registered holder of shares in a company may be a nominee for some other person, who really owns the shares. This enables persons, who in fact control a company, to conceal their real status from the shareholders and from the public and practice fraud with regard to the management of the company. To check such a practice, Sections 216 empowers the Central Government to appoint an inspector to investigate into and report on the ownership of a company.

### **Declaration by Persons not holding Beneficial Interest in any Share**

The main purpose of Sections 216 which empowers the Central Government to investigate the ownership of the shares of the companies is to know the *benami* shareholding. However, this section may not be effective every time. Therefore, Section 89 of the Companies Act, 2013 makes it obligatory on the part of a person, whose name is entered in the register of members of a company as the holder of a shares in that company but who does not hold beneficial interest in such shares to make a declaration to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares [Sub-section (1)].

Sub-section (2) of the Section 89 makes it obligatory for any person who, holds or acquires beneficial interest in a share of a company to make a declaration to the company specifying the nature of his interest, the particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.

Where any change occurs in the beneficial interest in such shares, the person referred in sub-section (1), and the beneficial owner specified under sub-section (2) shall make a declaration within thirty days, from the date of such change to the company in the prescribed Form containing the prescribed particulars. [Sub-section (3)]

The Central Government may make rules to provide for the manner of holding and disclosing beneficial interest and beneficial ownership under this section. [Sub-section (4)]

Sub-section (5) provides that if any person fails, to make a declaration as required under sub-section (1) or sub-section (2) or sub-section (3), without any reasonable cause, he shall be punishable with fine which may extend to fifty thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

Sub-section (6) makes it obligatory on the part of the company to make a note of such a declaration in the register concerned and to file within thirty days with the Registrar of Companies a return in the prescribed form with regard to such a declaration.

If a company, required to file a return under sub-section (6), fails to do so before the expiry of the time specified under the first proviso to sub-section (1) of section 403, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than five hundred rupees but

which may extend to one thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues. [Sub-section (7)]

No right in relation to any share in respect of which a declaration is required to be made under this section but not made by the beneficial owner, shall be enforceable by him or by any person claiming through him. [Sub-section (8)]

Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged. [Sub-section (9)]

### **Rule 9 of Companies (Management and Administration) Rules, 2014**

#### ***Declaration in respect of beneficial interest in any shares.-***

(1) A person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the beneficial interest in such shares (hereinafter referred to as “the registered owner”), shall file with the company, a declaration to that effect in Form No.MGT-4, within a period of thirty days from the date on which his name is entered in the register of members of such company:

When any change occurs in the beneficial interest in such shares, the registered owner shall, within a period of thirty days from the date of such change, make a declaration of such change to the company in Form No.MGT-4.

(2) Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name (hereinafter referred to as “the beneficial owner”) shall file with the company, a declaration disclosing such interest in Form No. MGT-5, within thirty days after acquiring such beneficial interest in the shares of the company:

Provided that where any change occurs in the beneficial interest in such shares, the beneficial owner shall, within a period of thirty days from the date of such change, make a declaration of such change to the company in Form No.MGT-5.

(3) Where any declaration under section 89 is received by the company, the company shall make a note of such declaration in the register of members and shall file, within a period of thirty days from the date of receipt of declaration by it, a return in Form No.MGT-6 with the Registrar in respect of such declaration with fee.

## **8. RIGHTS OF MEMBERS**

When once a person becomes a member he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Act. The appointment of a receiver, the attachment of the shares, the pledge of the shares or taking over of the management of a company which is holding shares in another company under Section 18A of the Industries (Development & Regulation) Act, 1951 will not alter the position. So long a person’s name stands registered in the books as a member, even if he has sold the share and has given the share certificates and the blank transfer deed duly signed, he alone is entitled to exercise the rights of membership [*Balakrishna Gupta & Others v. Swadeshi Polytex Ltd. and Others* (1985) 58 Com Cases 563 (S.C.); and *Life Insurance Corporation of India v. Escorts Ltd. & Others* (1986) 59 Com Cases 548 (S.C.)]. These rights are derived by virtue of the membership contract between the company and the member and the general law. Some of these rights can be exercised by him individually and others alongwith other members unless member himself holds shares equivalent to the minimum holding prescribed under the various provisions of the Companies Act, 2013.

## Individual Rights

Members of a company enjoy certain rights in their individual capacity, which they can enforce individually. These rights are contractual rights and cannot be taken away except with the written consent of the member concerned. These rights can be categorised as under:

- (1) Right to receive copies of the following documents from the company:
  - (i) Abridged financial statement and auditor's report in the case of a listed company (Section 136).
  - (ii) Report of the Cost Auditor, if so directed by the Government.
  - (iii) Notices of the general meetings of the company (Sections 101-102).
- (2) Right to inspect statutory registers/returns and get copies thereof without payment on any fee or on payment of prescribed fee.

The members have been given right to inspect the following registers etc.:

- (i) Debenture trust deed (Section 71);
  - (ii) Register of Charges and instrument of charges (Section 85 & 87);
  - (iii) Copies of contract of employment with Managing or Whole-time directors);
  - (iv) Shareholders' Minutes Book (Section 119);
  - (v) Register of Contracts, Companies and Firms in which directors are interested (Section 189);
  - (vi) Register of directors and key managerial personnel and their shareholding (Section 170);
- (3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 96, 100, 105 and 107).
  - (4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

- (i) To transfer shares (Sections 44 and 56 and Articles of Association of the company).
- (iii) To resist and safeguard against increase in his liability without his written consent.
- (iv) To receive dividend when declared.
- (v) To have rights shares (Section 62).
- (vi) To appoint directors (Section 152).
- (vii) To share the surplus assets on winding up (Section 320).
- (viii) Right of dissentient shareholders to apply to Tribunal (Section 48).
- (ix) Right to be exercised collectively by passing a special resolution and intimating the same to the Central Government for investigation of the affairs of the company (Section 210).
- (x) Right to make application collectively to the Tribunal for relief in cases of oppression and mismanagement (Sections 241).
- (xi) Right to file class action suits before the Tribunal (Section 245)
- (xi) Right of Nomination. (Section 72)
- (xii) Right to file a suit or take any other action in case of any misleading statement or the inclusion or omission of any matter in the prospectus. (Section 37)

## Collective Membership Rights

Members of a company have certain rights which can be exercised by members collectively by means of

democratic process, i.e. by majority of members usually unless otherwise prescribed. This involves the principle of submission by all members to the will of the majority, provided that the will is exercised in accordance with the law and the Memorandum and Articles of Association of the company. Thus, the shareholders in majority determine the policy of the company and exercise control over the management of the company.

However, if and when the majority becomes oppressive or is accused of mismanagement of the affairs of the company, Section 241 read with section 244 confers right, to not less than one hundred members of a company or not less than one-tenth of the total number of its members whichever is less or any member or members holding not less than one-tenth of the issued share capital of the company (but they must have paid all calls and others sums due on their shares) and in the case of a company not having a share capital, not less than one-fifth of the total number of its members, to apply to Board under Section 241 for relief in cases of oppression or for relief in cases of mismanagement respectively.

Section 100 of the Companies Act, 2013 confers on members, holding not less than one-tenth of the paid-up share capital of a company, right to make a requisition to the Board of directors to call an extraordinary general meeting of the company. The section also confers on members having not less than one-tenth of the total voting power in a company not having a share capital, to make a requisition to the Board to call an extraordinary general meeting of the company. If the Board of directors of the company does not, within twenty-one days from the date of the deposit of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of those matters on a day not later than forty-five days from the date of deposit of the requisition, the meeting may be called and held by the requisitionists themselves within a period of 3 months from the date of the requisition.

### **Voting Rights of Members**

The right of attending shareholders' meetings and voting thereat is the most important right of a member of a company, as shareholders' meetings play a very important role in the company's life. Directors are appointed by the shareholders, who direct the affairs of the company, formulate short-term plans and long-term policies of the company, appoint management personnel to constitute organisation to implement their plans and policies in order to achieve the objects of the company.

In view of the importance of the general meetings of a company, the Companies Act has not left the members to the will of the directors to call general meetings. If the members feel that the affairs of the company are not being properly managed by the directors and the directors are avoiding to call a general meeting of the company, Section 100 of the Companies Act confers right on members specified therein to deposit a requisition setting out the matters for the consideration of which the meeting is to be called and if the Board of directors does not proceed within twenty-one days of the requisition to call a meeting within forty-five days of the requisition, the requisitionists may themselves call the meeting.

Section 47 provides that every member of a company limited by shares and holding equity share capital therein, shall have right to vote on every resolution placed before the company and his voting right on a poll shall be in proportion to his share in the paid up equity share capital of the company.

Section 43 of the Companies Act, 2013 provides that a company limited by shares shall be entitled to issue (i) equity share capital with voting rights or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed by the Central Government.

Preference shareholders ordinarily vote only on matters directly affecting the rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital. The voting right of a preference shareholder on poll shall be in proportion

to his share in the paid-up preference share capital of the company. In respect of a resolution on a matter affecting both equity shareholders and preference shareholders, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares. However, where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company (Section 47).

Section 50 of the Act lays down that a company may, if authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him although no part of that amount has been called up. Such advance payment, however, shall not confer on the member concerned any voting rights.

### **Shareholders' Pre-emptive Rights with regard to further issue of share capital (Right Shares)**

To preserve the shareholders' proportionate dividend, liquidation and voting rights, pre-emptive rights are often recognised, but their existence and scope can be effected by provisions in the articles. However, Section 62 of the Companies Act, 2013 secures shareholders' pre-emptive rights with regard to the further issue of share capital by the company. The Section lays down:

“(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the condition that unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person and the notice of offer shall contain a statement of this right [Sub-clause (a)].

### **Variation of Member's Rights**

Member's rights are determined by the Companies Act, Memorandum of association, Articles of association of the company and the terms of issue of shares. Rights attached to a class of shares are known as “class rights”.

Member's rights relate to dividend, voting at members' meetings and return of capital. Preference shareholders may have rights to a fixed amount or a fixed rate of dividend or to cumulative dividend. Where the ordinary shareholders are conferred the right to participate in the surplus assets on winding up of a company, it is not deemed to be a class right as it is implied even in the absence of any express provision in the articles.

Section 48 (1) of the Companies Act, 2013 lays down that the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class. Further, the variation of rights of shareholders can be effected only:

- (i) if provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or
- (ii) in the absence of any such provision in a Memorandum or Articles of association of the company, if such a variation is not prohibited by the terms of issue of the shares of that class.

However, if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

### **Rights of Dissenting Members**

Section 48(2) of the Companies Act, 2013 confers certain rights upon the dissenting shareholders. According to section 48(2), where the holders of not less than ten per cent of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation, they may apply to the Tribunal to have the variation cancelled; the variation shall not have effect unless and until it is confirmed by the Tribunal.

The above application shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

### **Nomination by Security holders (including members) (Section 72)**

Section 72(1) states that every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.

Section 72(2) states that when the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

Section 72(3) states that notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of the securities of a company, where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of the company, the nominee shall, on the death of the holder of securities or, as the case may be, on the death of the joint holders, become entitled to all the rights in the securities, of the holder or, as the case may be, of all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.

Section 72 (4) states that when the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

### **What is prescribed under Rule 19 of Companies (Share Capital and Debentures) Rules, 2014 with respect to nomination?**

Nomination by securities holders:-

- (1) Any holder of securities of a company may, at any time, nominate, in Form No. SH.13, any person as his nominee in whom the securities shall vest in the event of his death.
- (2) On the receipt of the nomination form, a corresponding entry shall forthwith be made in the relevant register of securities holders, maintained under section 88.
- (3) Where the nomination is made in respect of the securities held by more than one person jointly, all joint holders shall together nominate in Form No.SH.13 any person as nominee.
- (4) The request for nomination should be recorded by the Company within a period of two months from the date of receipt of the duly filled and signed nomination form.
- (5) In the event of death of the holder of securities or where the securities are held by more than one person jointly, in the event of death of all the joint holders, the person nominated as the nominee may upon the

production of such evidence as may be required by the Board, elect, either-

- (a) to register himself as holder of the securities ; or
- (b) to transfer the securities, as the deceased holder could have done.

(6) If the person being a nominee, so becoming entitled, elects to be registered as holder of the securities himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased share or debenture holder(s).

(7) All the limitations, restrictions and provisions of the Act relating to the right to transfer and the registration of transfers of securities shall be applicable to any such notice or transfer as aforesaid as if the death of the share or debenture holder had not occurred and the notice or transfer were a transfer signed by that shareholder or debenture holder, as the case may be.

(8) A person, being a nominee, becoming entitled to any securities by reason of the death of the holder shall be entitled to the same dividends or interests and other advantages to which he would have been entitled to if he were the registered holder of the securities except that he shall not, before being registered as a holder in respect of such securities, be entitled in respect of these securities to exercise any right conferred by the membership in relation to meetings of the company.

The Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the securities, and if the notice is not complied with within ninety days, the Board may thereafter withhold payment of all dividends or interests, bonuses or other moneys payable in respect of the securities, as the case may be, until the requirements of the notice have been complied with.

(9) A nomination may be cancelled, or varied by nominating any other person in place of the present nominee, by the holder of securities who has made the nomination, by giving a notice of such cancellation or variation, to the company in Form No. SH.14.

(10) The cancellation or variation shall take effect from the date on which the notice of such variation or cancellation is received by the company.

(11) When the nominee is a minor, the holder of the securities, making the nomination, may appoint a person in Form No. SH.13 specified under sub-rule (1), who shall become entitled to the securities of the company, in the event of death of the nominee during his minority.

### **Let us Remember!**

Any holder of securities of a company may at any time nominate in Form No. SH.13 any person as his nominee in whom the securities shall vest in the event of his death.

### **LIABILITY OF MEMBERS**

The liability of a member depends on the nature of the company. If the company is registered with unlimited liability, every member is liable in full for all the debts of the company contracted during the period of his membership. Where the company is limited by guarantee, each member will be bound to contribute in the event of winding up a sum specified in the liability clause of the memorandum of association. In case of company limited by shares, each member is bound to contribute the full nominal value of shares and his liability ends there. If before the full nominal value of the shares is paid, the company goes into liquidation, the member becomes liable as contributory to pay the balance when called upon to pay, by the liquidator of the company.



Where a company has been incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members shall be unlimited. [Section 7(7)]

If a member ceased to be member of a company within one year prior to the commencement of the winding up of the company he is liable to pay on the shares which he held to the extent of the amount unpaid thereon, if:

- (i) on the winding up, debts exist which were incurred while he was a member, and
- (ii) it appears to the Tribunal that the present members are not able to satisfy the contribution required from them in respect of their shares.

A person is liable as member in spite of a valid transfer of shares by him, if the name of the transferee is not placed on the register of members, in place of the transferors' name. If a person applies for shares in the name of a fictitious person or a person not in existence or uses another person's name for himself, or uses an alias, and shares are allotted in that name or alias, he will be liable as a member.

### LESSON ROUND-UP

- A Company is composed of members, though it has its own entity distinct from members.
- Every shareholder is a member and every member is a shareholder, however, there may be exceptions to this statement.
- Section 2(55) of the Companies Act, 2013, provides the modes by which a person may acquire membership of a Company.
  - by subscribing to the Memorandum,
  - by agreeing in writing to become a member,
  - by holding equity share capital of a Company as beneficial owner in the records of a depository.
- A non-profit making Company licensed under Section 8 of the Companies Act can become member of any other company.
- Foreigners, trade unions can hold shares in a company, and consequently become its members.
- Insolvent and bankrupt may be members of a company as long as they are on the register of members.
- Pawnee and Receiver cannot be treated as members.
- Persons taking shares in fictitious names become liable as a member besides incurring criminal liability.
- Person ceases to be a member when his name is removed from register of members of a company.
- In accordance with Section 88, every Company shall keep register of its members. This register shall be kept at the registered office of the Company subject to the provisions of Section 94 of the Companies Act, 2013.
- Every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company. On the other hand, preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital.
- Rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class.

### GLOSSARY

**Ipsa facto**

By that very fact or act.

<b>Minor</b>	Person below the age of majority.
<b>Estoppel</b>	The principle that precludes a person from asserting something contrary to what is implied by a previous action or statement of that.
<b>Cessation of membership</b>	A person ceases to be a member of a company when his name is removed from its register of members.
<b>Joint Members</b>	If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member.
<b>Insolvent</b>	Insolvency is the inability of a debtor to pay their debt. If a person is unable to pay his debt, he is said to be insolvent.

### SELF-TEST QUESTIONS

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

- Every shareholder of a company is known as a member while every member may not be known as a shareholder. Comment.
- Define a 'member'. Distinguish him from a shareholder. In what ways a person can become and cease to be a member of the company?
- Who can become a member of the company? Can the following persons or institutions become member of a company:  
(a) Minor; (b) Company; (c) Partnership firm; (d) Foreigner; (e) Insolvent.
- Describe the circumstances under which a register of members may be rectified? Illustrate your answer in the light of the relevant provisions of the Companies Act, 2013.
- What are the particulars to be recorded in a register of members of a company? Where is the register to be maintained and who has to maintain it? Can a member have access to the register?
- The name of X is found entered in the register of a company. But X contends that he is not a member of the company. The company maintains that X had orally agreed to become a member and hence his name was entered in the register and so he is a member. Is the contention of the company valid?
- What are the individual and group rights of a member?
- When does the liability of a member of a limited company become unlimited?
- Write short notes on:
  - Cessation of membership of a company;
  - Index of members;
  - Variation of members' rights;
  - Registration of shares in the name of public office.
  - Nomination by security holders.

# Lesson 13

## Transfer and Transmission of Securities

### LESSON OUTLINE

- Introduction
- Provision regulating transfer of Securities
- Stamp duty payable and Affixation/ Cancellation of shares
- Transfer of Debentures
- Power of Board of Directors to refuse registration
- Statutory Remedy against Refusal under Section 58
- Rectification of Register of Members under Section 59
- Transmission of securities
- Legal framework for Depository Systems
- Safeguards on transfer of Securities in Dematerialized mode
- Rectification of register of members

### LEARNING OBJECTIVES

Transferability feature of securities enables the company, to get permanent capital, the shareholder, to get liquid investments.

Securities of a Public Company are freely transferable. However, a Private Company is required to restrict the right to transfer its securities by its articles.

Earlier, the securities were transferred only through physical mode, but, now after the advent of depository system, the securities are transferred in dematerialized form, to a large extent.

Section 56-59 of Companies Act, 2013 deals with the transfer/transmission of shares. After reading this lesson you will be able to understand the concept of transfer of securities in a company, various provisions of company law regulating transfer of securities, powers of Board to refuse registration, transfer during winding up, transmission of securities, transfers under depository system, etc.

## TRANSFERABILITY- A BRIEF ON PROVISIONS OF COMPANIES ACT 2013

One of the most important characteristics of a company is that its shares are transferable. Section 44 of the Companies Act, 2013 states that the shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company.

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. Proviso to section 58(2) provides that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. In terms of Section 2(68), a private company is required to restrict the right to transfer its shares by its articles. Section 56 of the Companies Act deals with transfer and transmission of securities.

### TRANSFER OR TRANSMISSION OF SECURITIES

#### Free transferability of securities

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. The Board of directors of a Company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.

However, proviso to section 58(2) provides that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. It is now possible to contractually agree on terms such as right of first refusal, right of first offer, tag along, call option, put option, etc in the shareholder agreements/ investment agreements, in the case of a public company as well. These terms would now be binding on the investors. Therefore, private arrangements or contracts between two or more persons would be enforceable contracts.

#### Instruments of transfer to be presented to the company

A company, shall not register a transfer of securities of, the company, unless a proper instrument of transfer with the date of execution specified thereon duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company by the transferor or transferee within a period of **sixty days** (irrespective of the nature of the company, whether listed or unlisted) from the date of execution along with the certificate relating to the securities, or if no such certificate is in existence, then along with the related letter of allotment of securities. In case of loss of the instrument, the company may register the transfer in terms of indemnity.

Such instrument of transfer of securities held in physical form shall be in Form No. SH.4. Where a company not having share capital, as the instrument of transfer should also be in SH.4 and other conditions be complied where the references therein to securities were references instead to the interest of the member in the company.

However, nothing in section 56(1) shall prejudice any power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. [Section 56(2)].

#### **Test yourself !!**

Within what time a duly executed instrument of transfer(i.e. Form no SH. 4) is to be presented/delivered to the company by a transferor or transferee?

**Ans: within 60 days**

### Registration of partly paid up shares – Notice to the transferee

According to section 56(3), where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice in form SH. 5 to the transferee and the transferee gives 'no objection' to the transfer within two weeks from the receipt of the notice.

### Time Limit for Delivery of certificates

Section 56(4) states that every company, unless prohibited by any provision of law or any order of court, tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted

- (i) Within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
- (ii) Within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
- (iii) Within a period of one month in case of transfer or transmission of securities.
- (iv) Within a period of six months from the date of allotment in the case of any allotment of debentures.

### Intimation to depository

- Proviso to Section 56(4) states that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. No transfer deed is required for transfer of shares, where the shares are held in dematerialized form.

### Transfer of securities by legal representative

Section 56(5) of the Act provides that in case of death of holder of any security, the transfer of such security by the legal representative of the deceased shall be valid-

- Even though the legal representative is not the holder of such security;
- As if the legal representative were the holder of such security.

### Penalties

According to 56(6), when any default is made in complying with the provisions of sub-sections (1) to (5), the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

### Transfer of shares by depository with an intent to defraud, is liable under Section 447 for fraud

As per section 56(7), without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447 for fraud which is a severe punishment.

### Transmission of securities

Where any person acquires any right to securities by operation of any law, the company may register the transmission of shares in favor of such person if the company receives intimation of transmission from such person, and in such a case no transfer deed shall be necessary.

According to Section 56(2), a company shall have power to register on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

***Let us remember!***

A company shall not register a transfer of partly paid shares, unless the company has given a notice in Form No. SH.5 to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.

**Punishment for Personation of Shareholders [Section 57]**

Where any person deceitfully personates as an owner of any share or interest in a company, or of any share warrant or coupon issued in pursuance of this Act. and

- (i) thereby obtains or attempts to obtain any such share or interest or any such share warrant or coupon, or
- (ii) receives or attempt to receive any money due to any such owner.

He shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to 3 years and with fine which shall not be less than one lakh rupees but which may extend to 5 lakh rupees.

To 'personate' means to pretend to be someone else, especially for fraudulent purpose such as casting a vote in another person's name. Personation and impersonation imply the same thing.

**REFUSAL OF REGISTRATION OF TRANSFER AND TRANSMISSION AND APPEAL AGAINST REFUSAL (SECTION 58)**

Section 58 of the Companies Act, 2013, deals with process of the company to be followed by on refusal to register the transfer of securities.

(i) If a **private company** limited by shares refuses (whether in pursuance of any power of the company under its articles or otherwise), to register the transfer of, or the transmission of the right to any securities or interest of a member in the company, then the company shall send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transmission, within a period of **thirty days** from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company. Notice shall contain the reasons for refusal to register the transfer or transmission.

(ii) The transferee may **appeal to the Tribunal** against the refusal within a period of **thirty days** from the date of receipt of the notice or in case no notice has been sent by the company, within a period of **sixty days** from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

(iii) If a **public company** without sufficient cause refuses to register the transfer of securities within a period of **thirty days** from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, within a period of **sixty days** of such refusal or where no intimation has been received from the company, within **ninety days** of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

(iv) The **Tribunal**, while dealing with an appeal may, after hearing the parties, either dismiss the appeal, or by order—

- (a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of **ten days** of the receipt of the order; or
- (b) direct **rectification of the register** and also direct the company to pay damages, if any, sustained by any party aggrieved.

(v) If a person contravenes the order of the Tribunal he shall be punishable with imprisonment for a term not less than one year but may extend to three years and with fine not less than one lakh rupees which may extend to five lakh rupees.

The Ministry of Corporate Affairs has vide Companies (Removal of Difficulties) Order, 2013 dated 20th September, 2013 clarified that the constitution of the tribunal is likely to take some time, and therefore, and until a date is notified by the Central Government for transfer of all matters, proceedings or cases to the Tribunal, The Company Law Board (CLB) shall exercise the powers of the Tribunal under sections 24, 58 and section 59 of the Companies Act, 2013.

### Case Laws- Refusal to transfer

Refusal to register share transfer on suspicion that the employee if admitted as a member will attend general meetings of the company and may create nuisance by raising irrelevant issues and also obtain access to the records to the company as a shareholder is not a valid reason. (Appeal to the CLB No. 27, of 1975 dated 17th August, 1976, *Shri Nirmal Kumar v. Jaipur Metal and Electrical Limited*).

The mere attempts of a person to wind up a company more than once cannot be a ground for refusing to register transfer by the directors [*Rangpur Tea Association Ltd. v. Makkan Lal Samaddar* (1979), 43 Com Cases 58].

The power to refuse registration of shares which is conferred on the directors by the articles, is a discretionary power and must be exercised reasonably, and in good faith for the benefit of the company. Unless the contrary is proved, the power is deemed to have been exercised properly (*Berry & Stewart v. Tottenham Hostpur Football and Athletic Co. Ltd.*, 1936, 3 A11 E.R. 554).

Where the articles of association of a company confers a discretion on the directors with regard to acceptance of transfers, this discretion is a fiduciary one to be exercised bona fide in what the Board considers to be in the interest of the company. If on a true construction of the articles, the directors are only given the powers to reject on certain prescribed grounds and it is proved that on these grounds the request for transfer was rejected, the Court cannot substitute the opinion of the Board. If the articles of association give an unfettered discretion, the court would interfere with it only on proof of bad faith. [*M.J. Amrithalingam v. Gudiyatham Textiles Pvt. Ltd.*, (1972) 42 Com Cases 350].

The Supreme Court, in *Bajaj Auto Limited v. N.K. Firodia*, AIR 1971, S.C. 321, observed, “discretion implies just and proper consideration of the proposal under the facts and circumstances of the case. In the exercise of that discretion, the directors will act in the paramount interest of the company and in the general interest of the shareholders because the directors are in a fiduciary position both towards the company and towards every shareholder. The directors are, therefore, required to act *bona fide* and not arbitrarily and not for any collateral motive”. It was observed further that where the articles permitted the directors to decline to register transfer of shares without stating reasons, the Court would not draw unfavourable inferences against the directors because they did not give reasons. The Court would

assume that the directors acted reasonably and *bona fide* and those who allege to the contrary would have to prove and establish the same by evidence. However, if the directors gave reasons, the Court would consider whether they were legitimate and whether the directors proceeded on right or wrong principle. The Court has also laid down three tests to determine the proper exercise of power by the Board of directors. The tests are:

1. Whether the directors acted in the interest of the company;
2. Whether they acted on a wrong principle; and
3. Whether they acted on oblique motive or for a collateral purpose.

If the directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the Court would consider whether the reasons were legitimate or the directors acted on a wrong principle, or from corrupt motive. If the reasons for refusal given by the directors were legitimate, the Court would not over-rule that decision merely on the ground that the court would not have come to the same conclusion. The discretion of the directors was to be tested as the opinion of any fair and sensible man in the interest of the company.

Where the appellant transferee and respondent company were in the same line of business and were rivals, the refusal on the ground of rivalry will be justified in terms of the decision rendered by the Supreme Court in the Bajaj Auto Case. Under these circumstances, the investment cannot be considered to have been made *bona fide* with the intention of making profits. The respondent company is entitled to refuse the registration even in the absence of an enabling provision in articles in view of the provisions of Section 111(2) [Corresponds to section 58(3) and 58(4) of the Companies 2013] [*Modi Carpets Ltd. v. Trans-Asia Carpets Ltd.*, Appeal No. 2 of 1980 decided on 26.12.1981 (CLB)].

In *Shri T.N. Kuriakos v. Premier Tyres Ltd.*, decided on 13.6.1983 (CLB), the appeal against the refusal by the respondent company to register transfer of shares was allowed by the Company Law Board (Now Tribunal) on the ground that the refusal of the respondent to register transfer of shares in favour of the appellant was based on the decision of the Transfer Committee, a sub-committee of the Board of directors and not that of the Board of directors as such, and, therefore, the said decision was not a valid and legal decision.

## RECTIFICATION OF REGISTER OF MEMBERS (SECTION 59)

Section 59 of the Companies Act, 2013 provides the procedure for the rectification of register of members after the transfer of securities. The provision states that-

### (1) Remedy to the aggrieved for not carrying the changes in the register of members:

**Grounds of appeal:** If, without sufficient cause-

- (i) The name of any person is entered in the register of members; or
- (ii) The name of any person is omitted from the register of members; or
- (iii) Default or unnecessary delay is being made in entering in the register, the fact of any person having become a member
- (iv) Default or unnecessary delay is being made in entering in the register, the fact of any person having ceased to be a member

the person aggrieved, or any member of the company, or the company may appeal in such form as may be prescribed, to the Tribunal. In case of foreign members or debenture holders residing



outside India, the appeal shall be filed in a competent court outside India as may be specified by the Central Government by notification.

**(2) Order of the Tribunal:** The Tribunal may, after hearing the parties to the appeal by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order, or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

**(3) Right to transfer not restricted:** Section 58 of the Act shall not restrict the right of a holder of securities, to transfer such securities. Any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(4) Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned.

**(5) Default in complying with the order:** If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

**(6) Specific instances of rectification:**

Rectification has been held to be permissible in the following cases.

- (a) Applicant induced to take shares by misrepresentation.
- (b) Shareholders' name removed under unlawful surrender of his shares;
- (c) Irregular allotment;
- (d) Name of nominee entered in register without his knowledge or consent;
- (e) Allotment of shares to a non-resident without taking necessary permission for foreign exchange.
- (f) Allotment in violation of memorandum of association of the company.

**(7) Mutation of name in other Company's register of members:** The Company which has changed its name would be entitled to ask those companies in which it is holding shares to substitute a company's new name in their register of members in the place of old name. *Sulphur Dyes v. Hickson & Dadajee Ltd.* (1995) 83 Com Cases 533 (Bom).

## STAMP DUTY PAYABLE AND AFFIXATION/ CANCELLATION OF STAMPS

Before the transfer is lodged with the company, it should be duly stamped. The transfer of securities attracts stamp duty under the Indian Stamp Act, 1899 (Act 2 of 1899). Only the Central Government can levy stamp duty on share transfers. Stamps at the rate of twenty five paise for consideration of Rs. 100 or part thereof is payable. The duty chargeable shall, wherever necessary, be rounded off to the next five paise. [S.O. 130(E) dated 28.1.2004 issued by Department of Revenue].

The stamp duty payable on transfer of debentures is, however, governed by Article 62(b) of Schedule I to the Indian Stamp Act, 1899, and also varies from State to State. In this case, the duty would be:

- (i) The duty applicable where the deed is executed, or
- (ii) The duty applicable where the registered office of the company is situated, whichever is higher.

The amount of consideration is required to be mentioned in the share transfer deed as otherwise the companies cannot verify whether share transfer stamp duty has been correctly charged thereby attracting the penal provisions of the Stamp Act in case of a default. Thus, in case where question of consideration does not arise like in the case of a gift of shares, stamp duty will be paid on the basis of the market value of shares and in case of unquoted shares or where quotations are not available at the face value of the shares.

Under Section 56(1), a company cannot register the transfer of securities unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company along with the certificate relating to the securities in question. The expression 'duly stamped' has not been defined in the Companies Act. Under Section 2(11) of the Indian Stamp Act, 1899 'duly stamped' as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in India. Under Section 12(1) of the Stamp Act, whoever affixes an adhesive stamp to an instrument which has been executed by any person shall, when affixing such stamp, cancel the same so that it cannot be used again. Sub-section (2) thereof makes it clear that any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall, so far as such stamp is concerned, be deemed to be unstamped. Sub-section (3) thereof provides the manner in which the adhesive stamp can be cancelled and provides that the stamp be cancelled by writing on or across the stamp his name or initials or the name or initials of his firm. Section 17 of the Indian Stamp Act, 1899 makes it clear that all instruments chargeable with duty and executed shall be stamped before, or at the time of execution. Therefore, the legal requirement is that the stamp must be cancelled either before or at the time of execution [Babulal Choukhani v. Western Indian Theatres Ltd. (1958) 28 Com Cases 565; Canara Bank v. Ballarpur Paper and Strawboard Mills Ltd., CLB decision, p.137].

It is necessary that the value of the consideration paid for a transfer must be determined as a part of the agreement because in the absence of such valuation it would not be possible to know whether stamp duty has been paid according to the value or not. A transfer form which does not indicate the value of the shares for the purposes of transfer would be void and not capable of being accepted.

The "value of the shares" means the price which the shares would fetch at the time of the transfer and not the face value of the shares. The consideration actually paid or agreed to be paid is the value of the shares. So long as there is nothing to indicate that the consideration was not truly stated in the transfer, the one mentioned therein should be accepted as the consideration that was paid. Union of India v. Kulu Valley Transport Ltd. (1958) 28 Com Cases 29 at 36 (P&H)

### Case Laws

A company cannot register transfer of shares unless the instrument of transfer is duly stamped and is delivered to the company. The expression "duly stamped" has to be construed with reference to the provisions of Section 2(11) of the Indian Stamp Act, 1899 and the document in question would be an invalid one if the stamp affixed thereon has not been cancelled. Under Section 108(1) of the Companies Act, 1956 [Corresponds to section 56(1) of the Companies Act, 2013] it is mandatory that the company shall not register the transfer of shares unless a properly executed instrument of transfer duly stamped

has been delivered to the company [Shri Parveen Sharda v. Chopsani Ice Aerated Water and Oils Mills Ltd., Appeal No. 1 of 1982 decided on 10.1.1983 (CLB)].

In Vardhaman Publishers Ltd. v. Mathrubhumi Printing & Publishing Co. Ltd. (1990), the Kerala High Court held that affixing stamps on a separate sheet of paper and attaching it to the transfer application or cancellation of stamps by drawing a line across the stamp was not improper and would not invalidate the said application. On the question of whether a newly added Article empowering the Board to reject transfer of shares would affect transactions of sale of shares entered into before the insertion of the Article, the Court held that the property in the shares passes on the date of transfer and the right to have the shares registered in the transferee's name becomes crystallised on that day itself. Any alteration of articles will not affect concluded transactions and in respect of such transactions, the existing articles would prevail. So, if the original (unaltered) Articles as on the date of transfer permit free transfer of shares, the Board cannot refuse registration of the transfer.

### LOST TRANSFER DEEDS

It is sometimes found that the transfer documents sent to companies are lost, say, in transit. In such a case, the proviso to section 56(1) of the Act provides that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period (within 60 days from the date of execution of the instrument of transfer), the company may register the transfer on such terms as to indemnity as the Board may think fit.

The Board of directors of the company should be satisfied that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee has been lost. The proof may be in the form of an affidavit from the transferor or the transferee and supported by the purchase or sale note of the broker and the registration receipt issued by the postal authorities.

In addition, the Board can take an **indemnity** on such terms as it may think fit to safeguard its position and after that company may register the transfer.

### DELEGATION OF POWERS FOR TRANSFER

It is the articles of the company which authorise the Board of directors to accept or refuse transfer of securities, at their discretion. The Board further have the power to delegate all or any of their powers to any of the directors of the company or any person even not in the employment of the company. Therefore, the articles of association should authorise the Board of directors to delegate the powers suitably. Only in the case of refusal to register a transfer, the directors are required to exercise their discretion.

### TRANSFER OF DEBENTURES

In case of transfer of debentures, a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee should be delivered to the company by the transferor or transferee within a period of **sixty days** from the date of execution along with the certificate relating to the debentures or if no such certificate is in existence with the letter of allotment of debentures.

Stamp duty is payable for transfer of debentures and the duty varies from State to State, as explained above.

After registering the transfer, the particulars thereof have to be recorded in the Debenture Transfer Register and should be initialed by the appropriate authority. After making appropriate endorsements, the debenture certificate may be sent to the party concerned.

### TRANSFER OF SHARES TO A MINOR

In India, a minor is not competent to enter into any contract, as under Section 11 of the Indian Contract

Act, 1872, a person who has attained the age of majority is only competent to contract. Since a minor cannot enter into a contract or agreement except through a guardian, and since as per Section 153, no notice can be taken of the fact that the guardian holds a share in trust for a minor, it follows that his name cannot be entered in the Register of Members and therefore, he cannot become a member of a company. There is, however, no objection in law to the guardian of a minor entering into a contract on behalf of a minor, by virtue of the statutory right conferred on the guardian of a minor under Section 8 read with Section 4 to 6 of the Hindu Minority and Guardianship Act, 1956. Since Section 56 of the Companies Act, 2013 enables execution of transfer deed by or on behalf of the transferor or the transferee, the transfer deed can be executed by a minor through his natural guardian as transferee, and the contract so entered into by a minor through his natural guardian is a binding and valid contract under Section 8 of the Hindu Minority and Guardianship Act, 1956.

The articles of association of a company cannot impose a blanket ban prohibiting transfer of shares in favour of a minor, as such a restriction is unreasonable and not sustainable. Section 44 of the Companies Act, 2013 provides that shares in a company are movable property and are transferable in the manner provided by the Articles. The expression 'in the manner provided by the articles of association of the company' can only be interpreted to mean the procedure to be adopted for transfer and impose restrictions, which are meaningful and reasonable. In case, the restriction imposed on transfer to a minor is accepted, it would mean that the shares of a deceased member can never be inherited by the legal heir who might be a minor. This would lead to a highly unjust situation and cannot be accepted as tenable. Accordingly, if the shares can be transmitted in favour of a minor, there is no reason why the shares which are fully paid-up and in respect of which no financial liability devolves on the minor are to be held as not transferable merely because of the ban imposed in the articles of association [*Saroj v. Britannia Industries Ltd.*, Appeal No. 5/80 decided on 14.12.81 by CLB].

#### **TRANSFER OF SHARES TO PARTNERSHIP FIRM**

A firm is not a person and as such is not entitled to apply for membership. The Department of Company Affairs (Now, Ministry of Corporate Affairs) has in its Circular No. 4/72 dated 9.2.1972 stated that a firm not being a person cannot be registered as a member of a company except where the company is licensed under Section 25 (Corresponds to section 8 of the Companies Act, 2013).

#### **TRANSFER OF SECURITIES TO A BODY CORPORATE**

An incorporated body being a legal person can acquire securities in its own name. Where a company is a transferee, the following documents are required to be submitted to the company:

- (a) A certified true copy of the Board resolution and/or power of attorney authorizing the signatory of the instrument of transfer to execute the instruments;
- (b) A certified true copy of a Board resolution passed under Section 179(3)(e) of the Companies Act; and
- (c) A certified true copy of Memorandum and Articles of Association of a company.

#### **TRANSFER WITHOUT THE AUTHORITY OF THE OWNER**

Shares in a company can be transferred either by registered owner or by anyone else with his authority. A sale by any unauthorized person will be void. Accordingly, the Supreme Court held that, transfer of shares by the husband of a lady owner without her authority was void and the transferee obtained no rights. *John Tinson & Co. P. Ltd. v. Surjeet Malhan (Mrs.)* (1997) 88 Com Cases 750: AIR 1997 SC 1411.

## POSITION OF TRANSFEROR

When a transferor makes a transfer, he makes an implied representation that the transfer will be registered by the company in the name of the transferee in the place of transferor. If the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his direction and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on consideration which has failed.

However, after the transfer form has been executed the transferor cannot be compelled to undertake any financial burden in respect of the shares at the instance of transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor.

## TRANSFER IN VIOLATION OF ARTICLES

Where the article of a private company requires that transfers of the company shares should be made with the previous sanction of the company's Board of Directors, the Supreme Court held that any transfer without such approval would be invalid. *Jogn Tinson & co. P. Ltd. v. Surjeet Malhan (Mrs.)* (1997) 88 Com Cases 750: AIR 1997 SC 1411.

Where a transfer was made in violation of a private company's articles requiring that shares must be first offered to existing members, it was held that the transferor was not the proper person to object. *Prafull Kumar Rout v. Orient Engineering Works (P.) Ltd.*, (1986) 60 Com Cases 65 (Ori).

## TRANSMISSION OF SECURITIES

Transmission of securities has not been defined by the Companies Act. 'Transmission by operation of law' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the holder of securities or by purchase in a Court-sale.

Thus, transmission of securities takes place when the registered holder of securities dies or is adjudicated as an insolvent, or if the holder of securities is a company, it goes into liquidation. Because a deceased person cannot own anything, the ownership of all his property passes, after his death, to those who legally represent him. Similarly, when a person is declared insolvent, his entire property vests in the Official Assignee or Official Receiver. Upon the death of a sole registered holder of securities, so far as the company is concerned, the legal representatives of the deceased holder of securities are the only persons having title to the securities unless securities-holder had appointed a nominee, in which case he would be entitled to the exclusion of all others.

## TRANSMISSION IN CASE OF SOLE OWNER

On the death of a sole owner of shares, vesting of rights and liabilities goes in favor of the legal heirs. They are entitled to be registered as the holders of shares. *Scott v. Scott (London) Ltd.*, (1940) Ch. 794; *safeguard Industrial Investments Ltd. v. National Westminster Bank Ltd.*, (1980) 3 All ER 849. But the legal heirs do not by itself become members of the company. The company cannot register them as members without their consent. *Re, Cheshire Banking Co. Duff's Executor's case*, (1886) 32 Ch D 301. A company cannot compel them to become member nor it is a duty to do so. *State of Kerala v. West*

Coast Planters Agencies Ltd., (1958) 28 Com Cases 13 (Ker). The company can justifiably register them as members when they apply for it.

### **Transmission of shares to widow**

If a widow applies for transmission of the shares standing in the name of her deceased husband without producing a succession certificate and if the articles of association of the company so authorises, the directors may dispense with the production of succession certificate, probate or letter of administration upon such terms as to indemnity as the directors may consider necessary, and transmit the shares to the widow of the deceased by obtaining an indemnity bond.

### **Transmission of joint holdings**

In case some shares are registered in joint names and the articles of the company provide that the survivor shall be the only person to be recognised by the company as having any title to the shares, the company is justified in refusing to register the transmission of title by operation of law in favour of the son of the deceased holder even though he may obtain succession certificate from the Court.

Section 56(1) of the Companies Act, 2013 states that the transfer of securities must be effected by a proper instrument of transfer and that a provision in the articles of an automatic transfer of securities of a deceased securities-holder is illegal and void. Such transfer does not amount to transmission which takes place by operation of law. In case of Government company - In Sub-section (1) of Section 56, after the proviso, the following provisos shall be inserted, -

Provided further that the provisions of this sub-section, in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee, shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond:

Provided also that the provisions of this sub-section shall not apply to a Government Company in respect of securities held by nominees of the Government. - Inserted by notification dated 5th june, 2015.

Section 56(2) of the Act provides that nothing in the sub-section(1) shall prejudice the powers of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. It follows that, for such transmission, instrument of transfer is not required, and, merely an application addressed to the company by the legal representative is sufficient.

Articles of companies generally provide for formalities to be observed for transmission of shares. In the absence of such provision in the articles of the company, Regulations 23 to 27 of Table F of Schedule I to the Act will govern the procedure for transmission. According to these regulations, the legal representatives are entitled to the shares held by deceased member and the company must accept the evidence of succession e.g., a succession certificate or letter of administrations or probate or any other evidence properly required by the Board of directors. He is, however, not a member of the company by reason only of being the legal owner of the shares. But he may apply to be registered as a member. On the contrary, instead of being registered himself as a member, he may make such transfer of the shares as the deceased or insolvent member could have made. The Board of directors also have the same right to decline registration as they would have had in the case of transfer of shares before death. But if

the company unduly refuses to accept a transmission, the same remedies are available to the legal representative as in the case of a transfer namely, an appeal to the Tribunal under Section 58.

### DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

S.No.	Transfer of Securities	Transmission of securities
1.	Transfer takes place by a voluntary or deliberate act of the parties by way of a contract.	Transmission is the result of the operation of law e.g. due to death, insolvency or lunacy of a member.
2.	An instrument of transfer is required in case of transfer.	No instrument of transfer is required in case of transmission.
3.	Transfer is a normal course of transferring property.	Transmission takes place on death or insolvency of a holder of securities.
4.	Transfer of securities is generally made for some consideration.	Transmission of securities is generally made without any consideration.
5.	Stamp duty is payable on transfer of securities by a holder of securities.	No stamp duty is payable on transmission of securities.
6.	As soon as transfer is complete, the liability of the transferor ceases.	Shares continue to be subject to the original liabilities.

### REVIEW QUESTIONS



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

The Board of Directors of a company or the concerned depository has discretion to refuse or withhold transfer of any security.

- True
- False

**Correct answer: False**

The Board of Directors of a company or the concerned depository has no discretion to refuse or withhold transfer of any security.

### Rejected Documents

Documents which are not duly stamped or where stamps are not cancelled should be returned to the person lodging them pointing out the errors so as to enable them to rectify the error. In *Federal Bank Ltd. v. Smt. Sarla Devi Rathi* (1997) CLA 183 (Raj.), the company had not registered 100 shares that Smt. Sarla Devi Rathi, the respondent, had purchased and neither they returned the share certificates to her. The company urged that since the respondent had not become a shareholder of the company, no cognizance of the complaint could be taken. The High Court held that there was a *prima-facie* case against the company.

The CLB had pointed out that the company on not registering the transfer should have returned the documents to the party who lodged them (the transferee in this case) and not the transferor as the transferor loses his right in the shares as soon as he executes the transfer in blank.

### Time for pointing out insufficiency of stamps

Where a company by mistake or otherwise registers a transfer which should have been refused because of insufficient or uncanceled stamps, or because of the instrument being unstamped, it should point out the error to the transferee within such time (within one year from the date of execution) that the transferee can have the matters rectified through the orders of the Collector. Afterwards it would be too late. [*Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.* (1994) 1 Comp LJ 178 (CLB – Mad)].

### Impounding of Documents Relating to Share Transfer

The Board of directors are not persons to impound or regularise an instrument of transfer which is not duly stamped, *Mathrubhumi Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80 93 (Ker) as they have no authority under Sections 33 and 42 of the Stamp Act.

## JUDICIAL PRONOUNCEMENT ABOUT TRANSFER OF SHARES

**(A) *In Dove Investments P. Ltd. v. Gujarat Industrial Investment Corpn. Ltd.* [(2005) 60 SCL 604 (MAD)]**, the respondent company lodged with the appellant company shares pledged with it for effecting transfer of the same in its name. The appellant registered some of the shares and refused to register the balance on the ground that the respondent had failed to comply with the provisions of Section 108(1A) and 108(1C) [Corresponds to section 56 of the Companies Act, 2013]. The respondent was successful before the CLB which held that provisions of Section 108(1C) [Corresponds to section 56 of the Companies Act, 2013] are directory and directed the appellant to register the shares. The appellant challenged the order of the CLB (Now Tribunal) before the High Court. The Appeal was dismissed. According to the High Court, in so far as Sub-section (1C) is concerned, if the transfer of shares falls within any one of the exempted cases mentioned in that Sub-section, the requirements as to presentation of the instrument of transfer in favour of the prescribed authority and delivery thereof to the company within the prescribed time limit, as contemplated in Sub-section (1A) are not applicable, provided the conditions stipulated in Sub-section (1C) are satisfied. In view of the same, if any bank or financial institution or the Central Government or a State Government or any corporation owned or controlled by the Central Government or a State Government, or a corporation granting a loan against the security of shares, intends to get such shares registered in its own name, in the event of failure on the part of the borrower to repay the amount of loan, it shall complete the instrument of transfer and lodge it with the company for registration of the transfer in its own name. In such a circumstance, they will have to stamp or otherwise endorse on the instrument of transfer the date on which the bank or financial institution decides to get such share registered in its own name and the instrument so stamped or endorsed will have to be delivered to the company, together with the share certificate, for registration of the transfer within two months from the date so stamped or endorsed. It was not in dispute that the instruments of transfer were neither stamped nor endorsed by the petitioner, as required under Sub-section (1C) however, stamped by the prescribed authority contemplated under Sub-section (1A).

**(B) *Mukundlal Manchanda v. Prakash Raodlines Ltd.* (1971) Com Cases 575**, it was held that the requirement of Sub-section 1A(b)(ii) has to be read reasonably, so as to enable its smooth functioning; a delivery of instrument of transfer within a reasonable time should be held as a proper delivery. Further, where the company opines that the instrument of transfer has become stale and that it is improper to act upon it, the instrument of transfer has to be held as liable to be ignored. Further, even the belated delivery can be acted upon under certain circumstances while moving the Central Government under Sub-section (1) of Section 108(1A) [Corresponds to section 56 of the



Companies Act, 2013]. In the light of the said provision, even though the discretion lies in the company either to recognize the transfer or not to recognize it depending upon the staleness of the instrument, the affected person can very well move the Central Government under Sub-section (1D) by explaining the circumstances under which the delay occurred and the hardship that resulted by the non-recognition of the transfer. It was rightly concluded that in the light of the scheme of Section 108 [Corresponds to section 56 of the Companies Act, 2013], particularly after the insertion of Sub-section (1A), (1B), (1C) and (1D), the Court have to bear in mind that the trivialities would not render an act futile and technical formalities required to be complied with for a valid transaction cannot outweigh the importance to be given to the substance of the transaction. Though the matter was taken up by way of appeal before the Divisional Bench of the Karnataka High Court, the Division Bench had not gone into the said aspect, namely, whether mandatory or directory, however, confirmed the judgment of the Single Judge in Mukundlal Manchanda's case was to be upheld and accordingly it was held that except Section 108(1) [Corresponds to section 56 of the Companies Act, 2013] other provisions namely Sub-sections (1A) and (1C) are directory and not mandatory in nature.

- (C) ***Letheby & Christopher Ltd., Re* (1904) 1 Ch 815.** A transfer deed executed by the transferor alone does not pass the title in the shares to the transferee. Where the transferor's address and the distinctive numbers of the shares were not mentioned in the transfer form, the same was held to be not void because those particulars were verifiable from the accompanying share certificate.
- (D) ***CIT v. Ramaswamy* (1985) 57 Com Cases 7, 10 (Mad).** A transfer is complete as between the transferor and transferee when all the formalities such as execution of the transfer deed and handing over the share certificates are completed.
- (E) ***Life Insurance Corporation of India v. Escorts Ltd.,* (1986) 59 AIR 1986 SC 1370,** the Supreme Court held that "a transfer effective between transferor and the transferee is not effective as against the company and any person without notice of the transfer being registered in the company's register.
- (F) ***Vickers System International Ltd. v. Mahesh P. Keshwani* (1992) 73 Com Cases 317: (1991) 2 Comp LJ 444 (CLB).** Transfer of shares by HUF Section 108 [Corresponds to section 56 of the Companies Act, 2013] enables the execution of a transfer deed by or on behalf of the transferor or the transferee. In the case of a joint family, the transfer form would be executed by the holding member or, in his absence, by the manager (Karta) of the family who represents the family. The same would be true when the family is transferee. The CLB directed the company to register shares in the name of the Hindu undivided family showing Mahesh P. Keshwani as its Karta.
- (G) ***Mohideen Pichai Taraganar v. Tinnevilly Mills Co. Ltd.,* AIR 1928 Mad 571.** Section 108 [Corresponds to section 56 of the Companies Act, 2013] not to apply to Auction Sales/Sale of Forfeited Shares. A transfer by a registered holder of shares cannot have any application to a Court auction sale or sale of forfeited shares for non payment of calls etc.
- (H) ***Castrol India Ltd. v. S.S. Transfer of Mehta* (1993) 78 Com Cases 146 (1993) 2 Comp LJ 8 (CLB).** Where special permission is necessary, the transfer in question could be effected only with the permission of Special Court, (Trial of Offences Relating to Transactions in Securities Ordinance, 1992), it was held that the refusal by the company to accept the transfer without such permission was justified.
- (I) ***Choukhani v. Western India Theatres Ltd.,* A.I.R. 1957 Cal. 709.** If the director refuse the request

for transfer of shares with *mala fide* intent i.e. if they act oppressively, capriciously, or corruptly, the Company Law Board will interfere and order registration of the transfer of shares.

- (J) **Re. Wahib Bus and Mails Transport Co., (1947) 17 Com Cases 182** The onus of proving bad faith on the part of directors rests on the plaintiff. However, the directors cannot refuse to register transfer of shares effected by a Court sale, in spite of powers given by the articles.
- (K) **Vallur Mohammad Saheb v. Golden Agro-Tech Industries Ltd. (2008) 83 SCL 391 (CLB-CHENNAI)**, the transferee purchased 2700 shares of the company and lodged the transfer deed along with the original share certificates to the Registrar and Share Transfer Agent (RSTA) of the company. The company did not register the shares in the name of the transferee in spite of the transferor taking up the matter with the company. The transferee, therefore, filed petition under section 111/111A [Corresponds to section 58 & 59 of the Companies Act, 2013] to direct the company as well as its RSTA to pay damages with future interest from the date of filing the petition till the date of realization, or to issue duplicate share certificates to the petitioner. Allowing the petition, it was held that the bar embodied in section 22 of the SICA does not extend to any direction which may be issued by the CLB (Tribunal) under section 111/111A [Corresponds to section 58 & 59 of the Companies Act, 2013] for rectification of the register of members of the company. In view of this legal position, the resistance of the company for not registering the transfer of shares constituting miniscule 2700 shares only in favour of the transferee was not tenable.
- (L) **Hindustan Mercantile Bank Ltd. v. D.N.Choudhury Cotton Mills Ltd. (2008) 83 SCL 399 (CLB-KOL.)**, the legal opinion on which the transferor company had relied upon was on the basis that the transferee company along with a few other companies was acting in concert to acquire shares in violation of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 [Replaced by SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011]. To come to the conclusion that the transferee along with others was acting in concert, reliance had been placed on commonality of directors both in the transferee-company and other companies. Since the company was not a listed company, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, were not applicable. Further, it was found that neither the transferee company nor other companies had acquired shares of the transferor company. Accordingly, the company was to be directed to register the transfer of shares in favour of the transferee.
- (M) **Sham Sunder Kukreja v. Hindustan Lever Ltd. (2001) 44 CLA 38 (CLB)**. If, by virtue of Section 111A(3) of the Companies Act, 1956 [Corresponds to section 59(1) of the Companies Act, 2013], the petition should have been filed within 2 months of the registration of the securities submitted for transfer, and where on the basis of facts and circumstances of the case, the transfer was effected in a fraudulent manner, the period of limitation (2 months) shall not apply.
- (N) **Dr. Rajiv Das v. The United Press Ltd. (2001) (CLB)**. In the case, where the shares of a company were held in joint names and one of these joint holders requested the company to split the shares equally between the joint holders by issuing fresh certificates, the company shall not be legally bound to do so unless the share transfer deeds executed by both the joint holders duly completed and stamped were lodged with the company together with the relevant share certificates, in terms of the provisions of Section 108 of the Companies Act, 1956 [Corresponds to section 56 of the Companies Act, 2013].
- (O) **T.S. Premkumar v. Tamil Nadu Mercantile Bank Ltd. 2001 (CLB)**. There shall be no justification, if a company/bank asks for information on Income Tax Returns (including that of the nominees of

the transferee), the sources of the consideration paid for the purchase of shares, the details of the group to which the transferee is attached, for the purposes of registration of transfer of shares, if the number of the shares which are subject matter of transfer, is insignificant, and after the registration of which the controlling of interest in the company/bank is not changing.

**(P) Transferor Holds Bonus Shares Only as a Trustee for the Transferee.** *Charanjiv Lal v. ITC Ltd. and Another (2005) 5 COMP LJ 138 (CLB)*, the petitioner-transferee purchased 100 equity shares of ITC limited of bearing and lodged the same through post, which were received by the company on 10<sup>th</sup> December, 1991. However, the company did not take any action to register the shares in the name of the petitioner and informed him that it had not received the share certificates and the transfer instrument. To prevent any unauthorized transfer of the shares, he obtained a *status quo* order from Senior Civil Judge, Delhi. In the meanwhile, the company declared 60 bonus shares on two occasions against the impugned 100 shares of which the certificate relating to first 60 bonus shares had been sent to the transferor. The suit filed by the transferee-petitioner was dismissed for want of jurisdiction and hence the petitioner-transferee approached the Company Law Board. The Petition was allowed. The view expressed by the Judge was that the bonus shares always go with the original shares and the transferor holds bonus shares only as a trustee for the transferee. Considering that the original shares have been sold before the record date, in the absence of denial by the transferor nearly a month before the record date, it is the petitioner transferee who is entitled to the bonus shares and not the transferor.

## TRANSFER OF SECURITIES REGISTERED WITH A DEPOSITORY

As stated earlier, in terms of Section 56 of the Act, the transfer of securities of, a company (other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository), cannot be registered unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and transferee along with the certificate relating to the securities has been delivered to the company. Therefore, the requirements of section 56 are not applicable in respect of transfer of securities where both the transferor and transferee are entered as beneficial owners in the records of a depository. Besides, no stamp duty is payable for registration of transfer of shares in depository form. However, transaction charges are payable to depository participants.

## REVIEW QUESTIONS



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

A transfer is said to be completed only after all the formalities such as execution of the transfer deed and handing over the share certificates are completed.

- True
- False

**Correct answer: True**

## COMPLIANCE WITH SECTION 56 – A MANDATORY PROVISION

The Allahabad High Court had held that the provisions of Sub-section (1) are not mandatory but only directory and, therefore, the registration of a transfer of shares without an instrument of transfer is not void. *Maheshwari Khetan Sugar Mills v. Ishwari Khetan Sugar Mills*, (1963) 2 Comp LJ 74 : (1963) 33 Com Cases 1142 (DB) (All). But Section 108 [Corresponds to section 56 of the Companies Act, 2013]

mentions the words 'shall not register' which have the effect of forbidding the act of transfer except on the fulfilment of certain conditions precedent.

The above decision of the Allahabad High Court has since been reversed by the Supreme Court in *Mannalal Khetan v. Kedar Nath Khetan* (1977) 47 Com Cases 185: AIR 1977 SC 536 where the mandatory nature of the provisions of Sub-section (1) of Section 108 [Corresponds to section 56 of the Companies Act, 2013] has been elaborately discussed and emphasised. The result is that without production of the share certificate along with the application for transfer, the transfer cannot be registered and if registered, the registration will be void.

In *Vasant Investment Corporation Ltd. v. Company Law Board* (1999) 19 SLL 502 (Bom), it was held that it is for the party making an appeal to the CLB (Now Tribunal) to prove that the decision of the Board of directors is initiated by an ulterior motive in case of a refusal by the Board to register a transfer.

The Section 59 assimilates in its fold the provisions for rectification of register of members empowering the Tribunal to order rectification of register of members. Sub-section (1) of Section 59 provides that if the name of any person is without sufficient cause entered in the register of members of a company, or after having been entered in the register is without sufficient cause omitted therefrom, or if a default is made or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved or any member of the company, or the company may appeal to the Tribunal or to a competent court outside India specified by the Central Government by notification in respect of foreign members or debenture-holders residing outside India, for rectification of the register.

The Tribunal may, after hearing the parties to the appeal, by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within 10 days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved. [Sub-section (2) of section 59].

### CASE LAW

In *Ratnesh H. Bagga v. Central Circuit Cine Association* [(2005) 128 Com Cases 370 (CLB)], decided on 10.9.2004, respondent was a Section 25 company [Section 8 company under the new Companies Act, 2013]. The petitioner applied for membership of the respondent and his application was rejected. The petitioner filed a petition under Section 111 of the Companies Act, 1956 [Corresponds to section 59 of the Companies Act, 2013] seeking rectification of the register of members by putting his name in the register of members of the respondent company.

The petition was dismissed.

The reason stated was that Sub-sections (1), (2) and (3) of Section 111 [Corresponds to section 59 of the Companies Act, 2013] apply only to transfer or transmission of shares and has no application in the present case. Sub-section (4) [Corresponds to section 59(1) of the Companies Act, 2013] would apply only in a case of rectification of something in the register which should not be there or something omitted from the register which should rightly be there. The complaint of the petitioner is that the association had rejected his application for membership and thereby refused to put his name in the register of members. The two conditions prescribed in Section 41 of the Act [Corresponds to section 2(55) of the Companies Act, 2013] are cumulative in nature in the sense that there should not only be an agreement in writing but the name should also be entered in the register of members to become a

member of a company. Merely agreeing to become a member of a company and on that basis to claim that the refusal of the company to enter his name in the register would entitle a petitioner to file a petition under Section 111 [Corresponds to section 59 of the Companies Act, 2013] is not sustainable. Whether the refusal by the association was *mala fide* or whether the articles giving power to the association to reject an application of membership are valid etc. are beyond the scope of Section 111 [Corresponds to section 59 of the Companies Act, 2013].

It is, however, pertinent to note that though time limits for filing of an appeal in circumstances stated in sub-section (3) & (4) of section 58 the Companies Act, 2013 have been specified, however no limit has been laid down for preferring an appeal for rectification of the register of members in Sub-section (1) of section 59 of the Companies Act, 2013]. But in regard to rectification to register of members provisions of Article 137 of the Limitation Act would apply and in consequence the application for rectification of register of members must be preferred within three years from the date on which the right occurs. [*Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.* (1983) 54 Com Cases 301 (Delhi)].

The provisions stated above regarding rectification of the register of members shall apply in relation to the rectification of the register of debentureholder as they apply in relation to the rectification of the register of members.

If a person contravenes the order of the Tribunal under section 58, he shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees. In addition, where any default is made in complying with the order of the Tribunal under section 59, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

## BLANK TRANSFER

**Meaning:** When a shareholder signs the transfer form without filling in the name of the transferee and the date of execution and hands it over with the share certificate to the transferee thereby enabling the transferee to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'.

### Purpose of Blank transfer:

- (a) The 'blank transfer' enables a buyer to sell the shares contained in 'blank transfer deed' to some other person by delivering the share certificate and blank transfer deed without becoming an owner of such shares.
- (b) The process of buying and selling of shares through a blank transfer may continue any number of times.
- (c) Any buyer buying the shares by way of a 'blank transfer' may become the owner of such share, by filling his own name and other particulars in the blank transfer deed as a transferee and depositing with the company the transfer deed so filled up along with the share certificate. Such a buyer becomes the transferee of shares and no intervening buyer of shares shall be regarded as transferee.
- (d) Until some buyer is registered by the company as shareholder, the original shareholder (i.e. the transferor) shall continue to be the owner of the shares.
- (e) When the name of the buyer is registered as a shareholder by the company, he shall acquire good

title to the shares notwithstanding the fact that the shares were transferred to him under a 'blank transfer'

Although one buyer may sell the shares to another buyer by way of 'blank transfer, yet a **'blank transfer deed' is not a negotiable instrument.** Accordingly, the title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor. Thus, the *bona fide* transferee from a person who has acquired a blank transfer deed by fraud does not acquire good title to the shares included in the deed.

#### **Evils Connected with 'blank transfer':**

Following are the evil intentions behind 'blank transfer'

- (1) Avoidance of transfer stamps;
- (2) concealment of the identity of the real beneficial owners behind their nominees;
- (3) evasion of tax by suppression of 'secret' profit invested in holdings on blank transfers.

Shares are usually transferred in blank when a shareholder borrows money on its security, e.g., by pledging the shares; the pledger make default in payment of the amount due at the time appointed for repayment, the pledgee or the holder of the share certificate and the blank transfer instrument has implied power to fill up the blanks in the instrument by inserting the date and his own name as transferee and to get himself registered as a member of the company. The pledger is under an implied obligation not to prevent or delay such registration. This right to get himself registered as a member is available to the transferee even after the death of the transferor [In *Re. Bengal Silk Mills Co. Ltd.*, (1942) Com Cases 206].

A blank transfer accompanied by the delivery of the share certificates vests in the transferee both equitable as well as legal rights in the shares. But until the registration of his name in the register of members, the transferee does not acquire a title and thus he cannot exercise any right as shareholder in respect of those shares.

In all cases only a *bona fide* holder will have the right to fill in his name or the name of a person for whom he is acting under an authority and apply for registration of the transfer. [*Colonial Bank v. Hepworth*, (1887) 36 ChD 26]. Where share scrips accompanied by duly executed transfer forms came into the hands of a *bona fide* purchaser, it was held that the original owner who signed in blank was estopped from questioning the validity of the title of the *bona fide* purchaser. [*Sumitra Debi Jalan v. Satya Narayan Prahladka*, AIR 1965 Cal 355].

In *Howrah Trading Co. Ltd. v. C.I.T.* (1959) 29 Com Cases 282 : AIR 1959 SC 775, the Supreme Court recognised the validity of "blank transfers" viz., where the name of transferor is entered and the transferor signs the transfer with the share scrip annexed, and hands it over to the transferee who, if he chooses, may complete the transfer by entering his name and then apply to the company to register his name in the place of that of the transferor.

### **FORGED TRANSFER**

It may happen that a forged instrument of transfer is presented to the company for registration. In order to avoid the consequences which will follow a forged transfer, companies normally write to the transferor about the lodgement of the transfer instrument so that he can object if he wishes. The company informs him that if no objection is made by him before a day specified in the notice, it would register the transfer. The consequences of a forged transfer are detailed hereunder:

- (a) A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the

shareholder and the company is bound to restore his name on the register of members [*People's Ins. Co. v. Wood and Co.*, 1961 (31) Com Cases 61]. A forged document never has any legal effect. It can never move ownership from one person to another, however, genuine it may appear. Thus, a forged instrument of transfer leaves the ownership of the shares exactly where it always was in the so-called transferor. It follows that if a company registers a forged transfer, the true owner can apply so as to be replaced on the register and his name will be restored. But the company does not incur any liability in damages by putting the name on the register.

- (b) However, if the company issues a share certificate to the transferee and he sells the shares to an innocent purchaser, the company is liable to compensate such a purchaser, if it refuses to register him as a member, or if his name has to be removed on the application of the true owner.
- (c) If the company is put to loss by reason of the forged transfer, as it may have paid damages to an innocent purchaser, it may recover the same independently from the person who lodged the forged transfer.

### EXAMPLE

Let us take an example to illustrate the consequences of forged transfer. Suppose, 'A' is a registered shareholder and his name is entered on the register of members in respect of certain number of shares. By fraud or theft, B obtains possession of 'A' share certificate and having forged a document purporting to be a transfer of shares to himself from A, succeeds in getting himself registered as a member and obtains from the company a new shares certificate made out in his name. In spite of this, A does not cease to be the owner of the shares and a member of the company, as a forged document, being a nullity, does not move ownership from him to B or any other person. Producing the new certificate as evidence of his title, B purports to sell the shares to C, an innocent purchaser, who in reliance upon B's certificate, buys the shares in good faith and without notice of B's fraud. The company then registers C as a member and issues the share certificate to him in respect of the shares purchased by him. When A discovers the fraud, he being entitled for the rectification of register, has C's name struck off the register of members and has his own name restored as the registered holder of the shares. A never ceased to be the owner of the shares, although the company issued successive certificates to B and C. The company will be liable in damages to C and for other incidental loss. But it would be entitled to indemnity as against B, and if the forged transfer were lodged by a broker acting for B, against the broker also, even though the broker was innocent to the fraud for a person who brings a transfer to the registering authority and requests him to register it, impliedly warrants that it is a genuine document.

A forged transfer can pass no title and is a nullity. In *Simm v. Anglo-American Telegraph Co.*, (1879) 5 QBD 188, CA; *France v. Clark*, (1884) 26 ChD 257 CA; when shares transferred under a forged signature and the transferee received a share certificate, the title does not pass to him.

The fact that the transferee was a *bona fide* purchaser for value did not make any difference and the transferee was bound to return the scrips to the person to whom the same rightfully belong. [*Kaushalya Devi v. National Insulated Cable Company of India* 1977 Tax LR 1928 (Del)]

In case of joint shareholdings, a transfer to be effective must be executed by all and if the signature of any one be forged, the transfer will be void. *Nicol's case*, case (1885) 9 Ch D 421.

A person acting in good faith, sends in and procures registration of the transfer and the issue of a fresh certificate on the basis of a forged deed is bound to indemnify the company against the untoward consequences. [See *Welch v. Bank of England*, (1955) Ch 508 : (1955) 1 All ER 811]. This happens when a stock broker, trusting his clients innocently forwards forged document to the company. [*Yeung v. Hongkong and Shanghai Banking Corpn.*, (1980) 2 All ER 599].

Further Section 57 states that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

### REVIEW QUESTIONS



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

A forged transfer can pass title.

- True
- False

**Correct answer: False**

A forged transfer cannot pass any title and is a nullity.

### DEATH OF A JOINT SHAREHOLDER

Where shares are held in joint names, and one of the joint shareholder dies the survivor alone will be recognized as the holder of the said shares. It would be sufficient for the company to delete the name of the deceased shareholder after obtaining satisfactory evidence of his death. This of course does not prevent a third person from calling on the company to register his name as holder of the shares after obtaining evidence such as probate of a will for the purpose of proving his title to the shares as against the surviving joint holders.

### TRANSPOSITION OF NAME

In the case of joint-shareholders, one or more of them may require the company to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint-holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. Since no transfer of any interest in the shares take place on such transposition, the question of insisting on filling transfer deed with the company, may not arise. Transposition does not also require stamp duty.

The Stock Exchange Division of the Department of Economic Affairs has clarified that there is no need of execution of transfer deed for transposition of names if the request for change in the order of names was made in writing, by all the joint-holders. If transposition is required in respect of a part of the holding, execution of transfer deed will be required.

### DEATH OF TRANSFEROR OR TRANSFEREE BEFORE REGISTRATION OF TRANSFER

Where the transferor dies and the company has no notice of his death the company would obviously register the transfer. But if the company has notice of his death, the proper course is not to register until the legal representative of the transferor has been referred to.

Where the transferee dies and company has notice of his death, a transfer of shares cannot be registered in the name of the deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the names of the later. But if there is a dispute, an



order of Court will have to be insisted upon.

In *Killick Nixon Ltd. v. Dhanraj Mills Ltd.*, it was held that the company is not bound to enquire into the capability of the transferee to enter into a contract. The company has to act on the basis of what is presented in the transfer deed.

### **Proof in a transfer by representative**

Where a transfer is executed by a person in a representative capacity such as an officer of a body corporate or by an attorney, proof of the authority, must be produced, before the transfer can be registered.

### **Relationship between Transferor and Transferee**

Pending registration, the transferee has only an equitable right to the shares transferred to him. He does not become the legal owner until his name is entered on the Register of Members in respect of the shares. But as between the transferor and the transferee, immediately after the transfer is made, the contract of transfer will subsist and the transferee becomes the beneficial owner of the shares so transferred to him. A relation of trustee (transferor) and beneficiary (transferee) is thereby established between them. The transferor is under obligation to comply with all reasonable directions of the transferee. The transferee should, however, take prompt steps to get himself registered as a member.

Section 126 of the Companies Act, 2013 provides that where the transferor gives a mandate to pay the dividend to the transferee pending registration of transfer, the same should be paid to the transferee, otherwise the dividend in relation to such shares should be transferred to the Unpaid Dividend Account mentioned in Section 124. It is further provided that in the case of offer of rights shares or fully paid bonus shares, the same should be kept in abeyance till the title to the shares is decided.

### **RIGHTS OF TRANSFEROR**

In *JRRT (Investments) Ltd. v. Haycraft*, (1993) BCLC 401 (Ch.D) it was held that, the transferor is not deprived off his valuable rights, the right to dividend and the right to vote even where the purchaser has failed to make payment. An unpaid vendor has the right to exercise voting rights in respect of shares registered in his name. He is not obliged to comply with the directions of the purchaser in respect of the shares taken by him.

But on the other hand, the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his directions and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on a consideration which has failed. However, after the transfer form has been executed the transferor cannot be compelled to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members, the Supreme Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor. [*Mathalone (R) v. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385 : (1954) 24 Com Cases 1 See also *Life Insurance Corporation of India v. Escorts Ltd.* (1986) 59 Com Cases 548 : AIR 1986 SC 1370]. But where, due to the transferee's own default, the transfer of shares is not registered the transferor cannot be held to be a trustee for the defaulting transferee simply because the share continues to remain in the transferor's name in the books of the company.

The seller's duty is complete when he hands over to the transferee a duly executed transfer form. [*Skinner v. City of London Marine Insurance Corpn.*, (1885) 14 QBD 882].

Where a transferor transfers his share for consideration and delivers along with the share certificate the transfer form duly signed by him, but the transferee, instead of completing the transfer by signing his own name as transferee and presenting it for registration to the company, chooses to keep the transfer in blank and passes it on to others along with the share certificate, it cannot be said that the transferor, simply because the share continues to stand in his name, should be treated as a trustee for a series of unknown holders of the blank transfer.

When he sold his share to the original transferee he could not be deemed to have represented to the transferee anything more than that the share was transferable nor to have agreed to the transferee keeping or passing on the transfer in blank from hand to hand for an indefinite duration, without its being presented to the company for registration.

Where a shareholder executes a blank transfer to enable another to deal with the shares, he is bound not to do anything to obstruct registration of the transfer and if he improperly intervenes he is liable in damages, *Hooper v. Herts*, (1906) 1 Ch 549: (1904-7) ALL ER Rep 849 (CA).

**Transferor's right to indemnity for calls** - Where a transferor has paid for calls to the company after the shares are transferred, there arises an implied promise by the transferee to indemnify the transferor. Such a promise to indemnify can be implied even in the case of blank transfers [*Ashworth Partington & Co.*, (1925) 1 K].

**Transferee's right to Dividends, Bonus and Rights Shares** - Where the transferor, by reason of the shares standing in his name, has received after the transfer, any dividend on shares, bonus or other benefit accruing in respect thereof, the transferee being the person lawfully entitled thereto, can recover the same from the transferor, provided that he has not allowed his claim to become time barred under the provisions of the Limitation Act. [*Chunnihal Khushaldas Patel v. H.K. Adhyaru*, (1956) 26 Com Cases 168 : AIR 1956 SC 655].

**Dividend to transferee after transfer** - In one case the transfer was registered and dividends paid to the transferee. Later, the register was rectified by removing the transferee's name from the register on the ground of a technical nature, like inadequacy of stamps, it was held that the transferee was not bound to handover the dividend amount to the transferor. [*Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.*, (1994) 1 Comp LJ 178 (CLB-Mad)]. However the Madras High Court held that the company should not be allowed to rectify the register on a technical ground after transferring the shares.

**Position under the Securities Contracts (Regulation) Act, 1956** - As regards the position of a transferor after transfer, Section 27 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) may also be noted. It provides as follows:

**Title to dividends** - (1) It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee, who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

*Explanation:* The period specified in this section shall be extended -

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
- (ii) in case of loss of transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

(2) Nothing contained in Sub-section (1) shall affect -

- (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or
- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

## EFFECTS OF TRANSFER

Once a transfer form has been executed, the transfer is complete as between the transferor and the transferee and the transferee acquires the right to have his name entered in the register of members. No further application is necessary for having the name of the transferee entered in the register of members and the transferee perfects his title to the share after the entry in the Register of Members. Once the transferee becomes a member of the company, a contractual relationship arises with the company, [*Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

A company cannot refuse to register a transfer on the ground that the transfer was without consideration or that there was a collusion and connivance between the transferor and transferee. Any objection about inadequate consideration can be raised only by the transferor himself and not by the company particularly where the shares are fully paid. Where the transfer is in a spot delivery contract, Section 108 [Corresponds to section 56 of the Companies Act, 2013] is not applicable. [*Sanatan Investment Co. Pvt. Ltd. v. Prem Chand Jute Mills Ltd.* (1983) 54 Com Cases 186 (Cal)].

## Priority among Transferees

It was held in *Society General De Paris v. Jonet Walker and other* (1886) 11 Ac 20 that where a shareholder has fraudulently sold his shares to two different transferees, the first purchaser will, on the ground of time alone, be entitled to the shares in priority to the second.

For example, a person assigned his property, including some shares, for the benefit of his creditor. The assignee failed to get the share certificates registered in his name, but gave notice of assignment to the company. The assignor sold the shares to another who applied for registration. It was held that the assignee's claim was prior in time and therefore, entitled to registration. [*Peat v. Clayton*, (1906) 1 Ch. 659].

## Pledging of Shares

Shares of a company can be a subject matter of a valid pledge. Section 2(7) of the Sale of Goods Act, 1930, defines the term 'goods' as meaning every kind of moveable property other than actionable claim and money and includes stocks and shares. Shares are goods under the Sale of Goods Act, 1930 and

therefore can be a subject matter of pledge under the Indian Contract Act, 1872. In *Kanhaiyalal Jhanwar vs Pandit Shirali And Co. And Ors* [AIR 1953 Cal 526], the Calcutta High Court held that the deposit of share certificates themselves is sufficient to create a pledge thereon.

On the death of a sole owner of shares, the rights and liabilities goes in favour of the legal heirs. They are entitled to be registered as the holder of the shares. But the company can register them as members with only their consent and when they apply for it. *Re Cheshire Banking Co., Duff's Executor's case* (1886) 32 Ch D 301.

### COMPANY'S LIEN ON SHARES

Articles 9 to 12 of Table F of Schedule I to the Act carry the rules as to lien. These articles are not compulsory. A company may adopt its own articles regarding the subject matter of lien as also regarding any money due to it from the shareholder either originally or subsequently by a special resolution. The fact to be noted is that unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on the shares of members. [*Canara Bank Ltd. v. Tribhuvandas Jetha Bhai*, AIR 1957 Trav. C. 183 : (1957) 27 Com Cases 647]. But in the case of listed company, one of the requirements is that the articles of the company shall provide that the fully paid shares will be free from all lien, while in the case of partly paid shares, the company's lien, if any, will be restricted to monies called or payable at a fixed time in respect of such shares [Rule 19(2)(ii) of the Securities Contracts (Regulation) Rules, 1957]. In a lien the company shall have first and paramount lien on the shares of each member for his debts and liabilities to the company. Such a provision is fully effective for private as well as public companies. [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656: (1900-3) All ER 746 (CA)]

Where lien is acquired by a subsequent amendment of the articles, it will not allow the company to upset any rights which might have been acquired. But otherwise the right of a lien subsequently brought in, shall be binding on all the members even if they became shareholders before the alteration [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656 : (1900-3) All ER 746 (CA)].

### Extent and waiver of lien

The right of lien extends to any monies receivable by the shareholder in respect of the shares even in the winding up of the company. A lien on the proceeds of sale of shares is a lien on the shares.

Where the articles of association of a private limited company gave the company a first and paramount lien over the shares of any shareholder indebted to it, and the shareholder created an equitable charge on the shares in favour of a third party, the company's lien was held to have priority over the equitable charge. [*Champagne Perrier-Janet S.A. v. H.H. Finch Ltd.*, (1982) 3 All ER 713].

The company can waive the lien either expressly or by doing anything which has the effect of waiving the right.

Where a company registers a transfer of shares over which it has a lien, the registration will operate as a waiver of the lien. [See *Turner Morrison & Co. Ltd. v. Hungerford Investment Trust Ltd.*, (1972) 42 Com Cases 512 : AIR 1972 SC 1311].

### Enforcement and postponement of lien

The usual method of enforcing a lien is a refusal by the company to register a transfer of shares until the dues of the company in respect of those shares are first paid.

An article merely giving a right of lien is not enough to confer a right to bring the property to sale in exercise of such right. [See *Bank of India Ltd. v. Rustom Fakirji*, AIR 1955 Bom 419].

In the absence of a provision in the articles giving power to the company to enforce a lien by sale, the lien cannot be enforced except through Court. [*New London & Brazilian Bank v. Brockle Bank*, (1882) 21 Ch D 302].

A lien cannot be enforced by forfeiture, even if the articles provide that it may be so enforced. For, a lien is in the nature of an equitable mortgage and a clause for forfeiture in a mortgage is invalid as a clog on the equity of redemption.

In a case, certain shares which were subject to a first and paramount lien were given to bank as security for an overdraft and the bank gave notice to the company, the Court held that the bank's claim was prior to that of the company which arose subsequently. Notice to the company means notice to any director or officer who is authorised in the matter. [*United India Sugar Mills Ltd., Re* AIR 1933 ALL 607].

### TRANSFER OF SHARES IN DEPOSITORY MODE

Depository system maintains the ownership records of securities in the book entry form while in physical mode every share transfer is required to be accomplished by physical movement of share certificates to, and registration with the company concerned. The process of physical movement of share certificates often involves long delays and a significant portion of transactions end up as bad deliveries due to the faulty completion of paperwork, or signature differences with the specimens on record with the companies, or for other procedural lapses. Investors also face problems on account of loss of share certificates, forgery and mutilation. The significant time involved in effecting ownership changes also impounds a substantial volume of shares at any given time leading to lower trading volumes.

As part of capital market reform, the Government promulgated on September 20, 1995, the Depositories Ordinance, 1995 to provide for legal framework for setting up of depositories to record the ownership details in book entry form. Later, on November 28, 1995, the Government introduced in Parliament the Depositories Bill, 1995 to replace the said Ordinance. The Bill was enacted as the Depositories Act, 1996.

### Legal Framework for Depository Systems

The legal framework for depository system in the Depositories Act provides for the establishment of single or multiple depositories. Anybody to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 2013 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfilment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

In the depository system, share certificates belonging to the investors are dematerialised and their names are entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies register are replaced by the name of depository as the registered owner of the securities. The depository however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and be subject to all the liabilities in respect of the securities held by a depository.

Shares in the depository mode are fungible and do not have distinctive numbers. The ownership changes in the depository are done automatically on the basis of *delivery payment*.

The companies which enter into an agreement with the depository will give an option to the holders of eligible securities to avail the services of the depository through participants. The investors desiring to join the depository are required to surrender the certificates of securities to the issuer company in the specified manner and on receipt of information about dematerialisation of securities by the issuer company, the depository enters in its records the names of the investors as beneficial owners. Similarly, the beneficial owner has right to opt out of a depository in respect of any security and claim the share certificates and get his name substituted in the register of members as the registered owner in place of the depository.

There has to be regular, mandatory flow of information about the details of ownership in the depository record to the company concerned. In case of any reservation about the acquisition of securities on the ground that the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, SEBI Act, 1992 or Companies Act, 2013 or any other law for the time being in force, the depository, company, depository participants, the holder of securities or SEBI shall have a right to make an application to the Tribunal for rectification of register or records concerned. Pending decision of the Tribunal, the holder of securities can transfer such securities and the transferee concerned shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

The Act provides for detailed regulations to be framed by SEBI and detailed bye-laws to be framed by depositories with the approval of SEBI. The bye-laws provide for rights and obligations of participants, beneficial owners and procedure for ensuring adequate safeguards to protect the interests of investors. The Act requires the depository to indemnify for loss caused to beneficial owner due to negligence of depository or its participants.

### **How does an investor avail services of a depository?**

#### **(a) In the case of existing securities:**

An investor before availing the services of a depository, shall enter into an agreement with the depository through a participant and then shall surrender security certificates to the issuer. The issuer on receipt of security certificate shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall thereafter enter the name of the investor in its records as beneficial owner.

#### **(b) In the case of fresh issue:**

At the time of initial offer the investor would indicate his choice in the application form. If the investor opts to hold a security in the depository mode, the issuer shall intimate the concerned depository about the details of allotment of a security made in the favour of investors and records the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the names of allottees as the beneficial owners. In such case a prior agreement by the investor with the depository as well as an agreement between the issuer company and depository may be necessary.

#### **(c) In the case of exit from the depository:**

If a beneficial owner or a transferee of a security desires to take away a security from depository, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and inform the issuer. The issuer shall make arrangements for the issue of certificate of securities to the investor within 30 days of the receipt of intimation from the depository.

**(d) In the case of transfer within the depository:**

The depository shall record all transfers of securities made among the beneficial owners on receipt of suitable intimation to the effect that a genuine purchase transaction has been settled.

**(e) In the case of pledge:**

Before creation of any pledge or hypothecation in respect of a security, the beneficial owner is required to obtain prior approval of the depository and on creation of pledge or hypothecation, the beneficial owner shall give intimation of such pledge or hypothecation to the depository. The depository shall make appropriate entries in its records which will be admissible as evidence.

**What is free transferability of securities?**

It refers to a situation where on receipt of intimation regarding settlement of purchase transaction, the transfer of a security is effected immediately and the transferee enjoys all the rights and obligations associated with the securities. Once a genuine purchase transaction is settled, nobody including the issuer, depository, participant, any intermediary or regulatory authority can withhold the transfer of security.

**Types of securities freely transferable**

Only securities i.e. the shares, debentures, any other securities and any interest therein of a public limited company (listed as well as unlisted companies) have been made freely transferable. The Board of directors of such a company or the concerned depository shall not have any discretion to refuse or withhold a transfer of such security. Any other security, for example, shares or debentures of a private company or any unit of a mutual fund, or any security issued by any issuer other than a public limited company are not freely transferable and would be subject to the restrictions contained in the articles of association or the bye-laws of the concerned issuer and terms of issue.

**Safeguards to address the concerns of the Investors on Transfer of Securities in Dematerialized Mode**

The concerns arising out of transfer of securities from the Beneficial Owner (BO) Accounts without proper authorization by the concerned investor have been brought to the notice of SEBI by some Investors' Associations. Accordingly SEBI has decided to put in place the following safeguards to address the concerns of the Investors on electronic transfer.

- (a) The depositories shall give more emphasis on investor education particularly with regard to careful preservation of Delivery Instruction Slip (DIS) by the BOs. The Depositories may advise the BOs not to leave "blank or signed" DIS with the Depository Participants (DPs) or any other person/entity.
- (b) The DPs shall not accept pre-signed DIS with blank columns from the BO(s).
- (c) The DPs shall issue only one DIS booklet containing not more than 20 slips for individual account holders and not more than 100 slips for non-individual account holders, at a time.
- (d) If the DIS booklet is lost/stolen/not traceable by the BO, the same must be intimated to the DP immediately by the BO in writing. On receipt of such intimation, the DP shall cancel the unused DIS of the said booklet.
- (e) The DPs can issue subsequent DIS booklet to BO only after the BO has used not less than 75 per cent of the slips contained in the previous DIS booklet. The DP shall also ensure that a new DIS booklet is issued only on the strength of the DIS instruction request slip (contained in the previous

booklet) duly complete in all respects, unless the request for fresh booklet is due to loss, etc., as referred to in clause (d) above.

- (f) The DPs shall not issue more than 10 loose DIS to one account-holder in financial year (April to March). The loose DIS can be issued only if the BO(s) come in person and sign the loose DIS in the presence of an authorized DP official.
- (g) The DPs shall put in place appropriate checks and balances with regard to verification of signatures of the BOs while processing the DIS.
- (h) The DPs shall cross check with the BOs under exceptional circumstances before acting upon the DIS.
- (i) The DPs shall mandatorily verify with a BO before acting upon the DIS, in case of an account which remained inactive i.e., where no debit transaction had taken place for a continuous period of 6 months, whenever all the ISIN balances in that account (irrespective of the number of ISINs) are transferred at a time. However, in case of active accounts, such verification may be made mandatory only if the BO account has 5 or more ISINs and all such ISIN balances are transferred at a time. The authorized official of the DP verifying such transactions with the BO, shall record the details of the process, date, time, etc., of the verification on the instruction slip under his signature.

### LESSON ROUND-UP

- As per Section 56(1) of the Companies Act, 2013, a company, whether public or private shall not register transfer of securities of the company unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and transferee has been delivered to the company along with the certificate relating to the securities or if no such certificate is in existence, along with the related letter of allotment of securities.
- Provisions of Section 56 not to apply to transfer of securities registered with the Depository.
- The transfer of shares attracts stamp duty under the Indian Stamp Act, 1899.
- The power of refusal to register a transfer of securities must be exercised judicially and not arbitrarily.
- The right of the holder of securities to transfer his securities in a company is absolute and he may appeal to the National Company Law Tribunal if there is any refusal to register transfer or transmission. Power of NCCT are vested with CLB, till the NCCT becomes effective.
- When a shareholder sells only a part of the shares and not all of them, the procedure is different.
- In compulsory winding up, the transfer of shares made during winding up of a company is void unless it is made with the sanction of the Tribunal.
- Unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on shares of members.
- Every holder of securities of a company has right to nominate at any time in the prescribed manner a person to whom his securities shall vest in the event of his death.
- Depository system reduces the cost of issue and transfer of securities by eliminating stamp duty, it entitles the transferee to all the rights associated with the securities immediately on settlement of purchase transaction.



## GLOSSARY

<b>Fungibility</b>	A good or asset's interchangeability with other individual goods/assets of the same type. Assets possessing this property simplify the exchange/trade process, as interchangeability assumes that everyone values all goods of that class as the same.
<b>Dividend</b>	Part of profit divisible among shareholders.
<b>Stamp duty</b>	The tax placed on legal documents usually in the transfer of assets or property. The transfer of documents in locations where this law exists, is only legally enforceable once they are stamped, which shows the amount of tax paid.
<b>Transmission of Securities</b>	It refers to those cases where a person acquires an interest in securities by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the holder of securities or by purchase in a Court-sale.
<b>Lien on shares</b>	A lien is the right to retain possession of a thing until a claim is satisfied. In the case of a company lien on a share means that the member would not be permitted to transfer his shares unless he pays his debt to the company.

## SELF-TEST QUESTIONS

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

- 1.(a) Distinguish between transfer and transmission of securities.
- (b) "The directors have uncontrolled and unfettered powers to refuse registration of transfer of securities" — Comment.
2. What are the remedies available against refusal to register transfer of securities?
3. Explain the procedure for transfer of shares and debentures.
4. What are the consequences of a forged transfer?
5. Under what circumstances shares can be transferred during the winding up of a company?
6. A buys 200 shares in a company from B on the faith of a share certificate issued by the company. A tenders to company a transfer to himself from B duly executed together with B's share certificate. The company discovers that the certificate in the name of B has been fraudulently obtained and refuses to register the transfer. Is A entitled to get the registration of the transfer?
7. X and Y each held half the issued capital of the company. The Articles provided "the directors may, at any time, in their absolute and uncontrolled discretion refuse to register any transfer of shares".  
X died and his executor applied to have his shares registered in his name. Y, who is director, refuse under the above mentioned provision of Articles. Can the Court come to the rescue of X's executor?
8. An agreement for transfer of certain shares was entered into and the transferee was registered as a member without transfer deed being executed. Is the registration of the transfer valid?
9. State the powers of the Board of directors to refuse registration?
10. What are the benefits of depository system?



# Lesson 14

## Institution of Directors

### LESSON OUTLINE

- Concept of Director
- Definition of Director
- Types of Directors i.e. executive director, non-executive director, nominee director and independent director etc.
- Legal position of Directors
- Minimum and Maximum number of Directors
- Maximum number of Directorships
- Appointment of Directors
- Obtaining Director Identification Number (DIN)
- Cancellation and surrender of DIN
- Removal of Directors
- Retirement of Directors
- Resignation of Directors
- Vacation of office of Directors
- Register of Directors and KMP

### LEARNING OBJECTIVES

The company is an artificial person and is managed by the human beings. The human who runs it are known as Board of Directors. Directors acting collectively are known as Board. The directors play a very important role in the day to day functioning of the company. It is the board, who is responsible of the company's overall performance.

To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors (collectively) and directors (individually). Directors of a Company are its eyes, ears, brain, hands and other essential limbs.

Chapter XI of Companies Act, 2013 read with Companies (Appointment and Qualification of Directors) Rules, 2014 specifies regulatory prescriptions relating to appointment of directors, directors identification number, disqualification, vacation, removal etc., The Act has brought in many new provisions such as appointment of women director, resident director, independent director by certain class of companies. After reading this lesson, you will be able to understand the legal concept of director, their qualifications, appointment, vacation, removal, etc.

*"Effective leadership is putting first things first. Effective management is discipline, carrying it out." – Stephen Covey*

## INTRODUCTION

On incorporation, a company becomes an artificial person in the eyes of law, it has a perpetual succession, its members may come and may go but the company lives till its death as aforementioned. It is empowered to hold all properties in its own name and in its own right. It can sue others and can be sued by others in its own name.

In order to enable a company to achieve its objects as enshrined in the objects clause of its Memorandum of Association, it has necessarily to depend upon some agency, known as Board of directors.

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company.

The Companies Act 2013 does not contain an exhaustive definition of the term “director”. Section 2(34) of the Act prescribed that “director” means a director appointed to the Board of a company.

Section 2(10) of the Companies Act, 2013 defined that “Board of Directors” or “Board”, in relation to a company, means the collective body of the directors of the company.

The term ‘Board of Directors’ means a body duly constituted to direct, control and supervise the affairs of a company.

As per Section 149 of the Companies Act, 2013, the Board of Directors of every company shall consist of individual only. Thus, no body corporate, association or firm shall be appointed as director.

Again Section 166 of Companies Act, 2013, prohibits assignment of office of director to any other person. Any assignment of office made by a director shall be void.

### Minimum/Maximum Number of Directors in a Company [Section 149(1)]

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required.

The restriction of maximum number of directors shall not apply to section 8 companies.

#### LET US REMEMBER!!

Minimum number of directors

Public Company	-	3 Directors
Private Company	-	2 directors
One Person Company (OPC)	-	1 Director

Maximum Number of Director is 15, which can be increased by passing a special Resolution. Section 8 companies can have more than 15 directors.

### Number of directorships [Section 165]

Maximum number of directorships, including any alternate directorship, a person can hold is 20. It has come with a rider that number of directorships in public companies/ private companies that are either holding or subsidiary company of a public company shall be limited to 10 i.e., a person cannot be a director of more than 10 public companies. For the purpose of counting such directorship in public company, directorship in private companies that are either holding or subsidiary of a public company shall be included. Alternate directorship shall also be included while calculating the directorship of 20 companies. Section 8 company will not be counted for the purpose of maximum number of Directorship. Further the members of a company may restrict abovementioned limit by passing a special resolution.

If a person accepts an appointment as a director in contravention of above mentioned provisions, he shall be punishable with fine which shall not be less than five thousand rupees but which may extend to twenty five thousand rupees for every day after the first day during which the contravention continues.

#### REMEMEBER THAT!

- Maximum limit on total number of directorship has been fixed at 20 companies and the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.
- The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.

### Indian Resident Director

The provision relating to appointment of Indian resident director are contained in section 149 (3) of the Companies Act, 2013. i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. Companies incorporated after 30.9.2014 need to have the resident director from the date of incorporation itself.

### Woman Director

Second Proviso to section 149(1) read with

Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes the following class of companies shall appoint at least one woman director-

- (i) every listed company;
- (ii) every other public company having :-
  - (a) paid-up share capital of one hundred crore rupees or more; or
  - (b) turnover of three hundred crore rupees or more .

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date of its incorporation:

However any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board Meeting or three months from the date of such vacancy whichever is later.

For example: in case of ABC Ltd., the vacancy of the woman director arises on January 15, 2015 and the

next Board meeting is scheduled to take place on February 15, 2015, then the vacancy shall be filled up either by February 15, 2015 or by April 14, 2015, whichever is later i.e. April 14, 2015. If for any reason the meeting of Board of directors shifted to May 10, 2015, then the vacancy shall be filled up either by April 14, 2015 or May 10, 2015, whichever is later i.e. May 10, 2015.

The paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

### Independent Directors

The details of definition, declaration, qualification etc. are dealt in Lesson No. 15

### Director elected by Small Shareholders [Section 151]

According to section 151 of the Act every listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as may be prescribed.

“Small shareholder” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Here, the ‘nominal value’ of shares is relevant. It does not matter how much is the ‘paid up value’ or ‘market value’ of shares. However, a small shareholder may be a holder of equity shares or preference shares or both.

For example: Mr. A holds 5000 equity shares of Rs. 10 each (Rs. 5 paid up) in XYZ Ltd. However, Mr. A cannot be considered as small shareholder since the nominal value of shares held by him (i.e. Rs. 50,000) exceeds Rs. 20,000.

### Terms & Conditions for Small Shareholders’ Director

Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014 laid down the following terms and conditions for appointment of small shareholder’s director, which are as under:

(i) ***Election of small shareholders’ director:***

A listed company, may upon notice of not less than

- (a) One thousand small shareholders; or
- (b) one-tenth of the total number of such shareholders,

which ever is lower; have a small shareholder’s director elected by the small shareholder.

A ‘Small Shareholders’ Director’ may be elected voluntarily by any listed company. Thus, a listed company, may, on its own, act to appoint a Small Shareholders’ Director. In such a case, no notice from small shareholder(s) is required.

(ii) **Notice of intention to propose a candidate:**

The small shareholders intending to propose a person as a candidate for the post of small shareholder’s director shall leave a signed notice of their intention with the company at least 14 days before the meeting specifying the their details and proposed director’s details. The details include name, address, shares held and folio number etc. If the proposer does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

***Shareholders eligible to give notice:*** The notice shall be given by at least-

- (a) 1000 small shareholders; or

- (b) 1/10th of the total number of small shareholders, which ever is lower.
- (iii) **Statement by the proposed small shareholders' director:** The notice shall be accompanied by a statement signed by the proposed director for the post of small shareholders' director stating
  - (a) his Director Identification Number;
  - (b) that he is not disqualified to become a director under the Act; and
  - (c) his consent to act as a director of the company.
- (iv) **Small shareholders' director to be an independent director:**  
 Small shareholders' director shall be considered as an independent director, if-
  - (a) he is eligible for appointment as an independent director as per sub-section (6) of section 149; and
  - (b) he gives a declaration of his independence as per sub-section (7) of section 149.
- (v) **Tenure of office and no retirement by rotation:** The tenure of small shareholders' director shall not exceed a period of 3 consecutive years and he shall not be liable to retire by rotation. Further he shall not be eligible for re-appointment after the expiry of his tenure.
- (vi) **Grounds of disqualification:** Disqualifications of a small shareholders' director are the same as that of any other director specified under section 164 of the Act.
- (vii) **Grounds of vacation of office:** A Small shareholders' director shall vacate the office if -
  - (a) he ceases to be a small shareholder, on and from the date of cessation;
  - (b) he incurs any of the disqualifications specified in section 164;
  - (c) the office of the director becomes vacant in pursuance of section 167;
  - (d) he ceases to meet the criteria of independence as provided section 149 (6).
- (viii) **Number of small shareholders' Directorship:** A person shall not hold the office of small shareholders' director in more than two companies. If second company is in competitive business or is in conflict with business of the first company, he shall not be appointed in second company.
- (ix) **No association with the company for next 3 years:** He shall directly or indirectly not be appointed or associated in any other capacity with the company either directly or indirectly for a period of 3 years from the date of cessation as a small shareholder's director.

Important points to note:

- (i) A small shareholders' director may be removed by passing an ordinary resolution in the general meeting in accordance with the provisions of section 169 of the Act. At the time of voting on such resolution, every equity shareholders shall have a right to vote irrespective of the fact as to whether he is a small shareholder or not.
- (ii) A small shareholders' director shall be included in the 'total number of directors' as prescribed under section 152 (6) of the Act.

## APPOINTMENT OF DIRECTORS [ Section 152]

### *First Director*

The first directors of most of the companies are named in their articles. Regulation 60 of Table F provides

that the number of the directors and the names of the first directors shall be determined in writing by the subscribers of the memorandum or a majority of them. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152. Section 152(1) of the Act is applicable to all companies, whether public or private.

*General provisions relating to appointment of directors*

1. Except as provided in the Act, every director shall be appointed by the company in general meeting. Where any provision contained in the Act requires or specifies any other manner of appointment of directors, the appointment may be made in such manner.
2. Director Identification Number (DIN) is compulsory for appointment of director of a company.
3. Every person proposed to be appointed as a director shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under the Act.
4. A person appointed as a director shall on or before the appointment give his consent to hold the office of director in physical form DIR-2 i.e. Consent to act as a director of a company.
5. Company shall file Form DIR-12 (particulars of appointment of directors and KMP along with the form DIR-2 as an attachment within 30 days of the appointment of a director and necessary fee.
6. The consent to act as director and intimation to Registrar is not required in case of section 8 company and where appointment of such director is done by the Central or State Government, as the case may be.

**Retirement by Rotation [Section 152(6)]:**

Articles of the Company may provide the provisions relating to retirement of the all directors. If there is no provision in the article, then not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at annual general meeting. 'Total number of directors' shall not include independent directors appointed on the Board of a company. Nominee directors appointed by a financial institution or by Central Government under section 408 of the Companies Act, 2013 shall not be included in the 'total number of directors' for the purpose of section 152(6) of the Act. At the annual general meeting of a public company one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment. As between the persons who became directors on the same day, the directors who shall retire may be determined by agreement among themselves. In the absence of any such agreement the persons liable to retire shall be chosen by lot.

Government companies have been exempted vide notification dated June 5, 2015 from the applicability of this section. Accordingly, directors in Government Companies are not liable to retire by rotation.

**(a) Vacancy in case of retiring director [Section 152 (7)]** At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next



week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

(b) If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless—

- (i) a resolution for the re-appointment of such director has been put to the meeting and lost;
- (ii) the retiring director has expressed his unwillingness to be so re-appointed;
- (iii) he is not qualified or is disqualified for appointment;
- (iv) a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or
- (v) section 162 i.e. appointment of directors to be voted individually is applicable to the case.

**Let us remember:**

- (1) The provisions of section 152(6) and (7) are not applicable to a Government company in which the entire paid up share capital is held by the Government, Central or State, jointly or severally or the subsidiary of a Government company, in which the entire paid up share capital is held by that Government company.
- (2) For the purposes of section 152, the 'retiring director' means a director retiring by rotation.
- (3) An additional director appointed as per section 161(1) shall be included in the 'total number of directors' for the purpose of section 152(6).

**Punishment [Section 159]**

If any individual or director of a company, contravenes any of the provisions of section 152, such individual or director of the company shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to fifty thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first day during which the contravention continues.

**Appointment of Additional Director [Section 161(1)]**

The board of directors can appoint additional directors, if such power is conferred on them by the articles of association. Regulation 66 of Table F authorizes the Board to appoint the additional directors. The number of directors and additional directors together shall not at any time exceed maximum strength fixed for the Board by the articles. Such additional directors hold office only up to-

- (a) the date of next annual general meeting; or
- (b) the last date on which the annual general meeting should have been held,

whichever is earlier.

If default is made in holding annual general meeting, the additional director shall vacate his office on the last day on which the annual general meeting ought to be held. A person who fails to get appointed as a director in a general meeting cannot be appointed as Additional Director. Section 161(1) of the Act applies to all companies, whether public or private.

### Appointment of Alternate Director [Section 161(2)]

Section 161(2) of the Act empowers the Board, if so authorized by its articles or by a resolution passed by the company in general meeting, to appoint a director (termed as 'alternate director') to act in the absence of an original director during his absence for a period of not less than three months from India.

The provisions applicable to an alternate director are as follows.

**(i) Applicability:**

Section 161(2) of the Act applies to all companies, whether public or private.

**(ii) Conditions for appointment of an alternate director:**

- (a) The Board of Directors of a company must be authorised by its articles or by a resolution passed by the company in general meeting for appointment of the alternate director.
- (b) The person in whose place the Alternate Director is being appointed should be absent for a period of not less than 3 months from India.
- (c) The person to be appointed as the Alternate Director shall be the person other than the person holding any alternate directorship for any other Director in the company.
- (d) If it is proposed to appoint an Alternate Director to an Independent Director, it must be ensured that the proposed appointee also satisfies the criteria of Independence as per section 149(6) of the Act.

**(iii) Power to appoint:**

The Board may appoint an alternate director only if it is authorized by the articles or by an ordinary resolution passed at a general meeting. The right to appoint an alternate director vests in the Board. The original director has no right to appoint an alternate director. The members have no right to appoint an alternate director, The members can only empower to appoint alternate director as and when board thinks fit.

**(iv) Method of appointment:**

There is no condition that an alternate director shall be appointed only by passing a resolution at a Board meeting. Therefore, an alternate director can be appointed by passing a resolution by circulation.

**(v) Terms of office of an alternate director:**

- (a) Not exceeding the term permissible to original director: An alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed. If the original director ceases to be a director by reason of death or vacation of office under section 167, the alternate director shall immediately cease to hold his office.
  - (b) On the return of original director: The alternate director shall vacate his office when the original director in whose place he has been appointed returns to India.
- (vi) **Automatic reappointment applies to the original director:** If the term of office of an original director expires before he returns back to India, the provision for automatic reappointment of a director as envisaged under section 152(7)(b) shall be applicable to the original director, and not to the alternate director.

As per section 165, an alternate directorship in a company shall also be included while counting the number of directorship held by a director.

**Appointment of Directors by Nomination [Section 161(3)]**

Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government Company. The main objective of appointment of a nominee director is to ensure that borrower company complies with all legal requirements under various laws. In other words, nominee directors are watchdogs of the financial institutions to safeguard their investments.

**Appointment of Directors in casual vacancy [Section 161(4)]**

Meaning of 'casual vacancy'

A 'casual vacancy' means any vacancy occurring by reason of death, resignation, disqualification, removal or for any other reason other than retirement or expiry of tenure of office of a director. In simple words, if the office of a director comes to an end otherwise than in the normal course, such vacancy is called as a casual vacancy.

*Applicability:*

Section 161(4) does not apply to a private company. Therefore, a private company may fill a casual vacancy in the manner provided by its articles. Where the articles are silent, the casual vacancy may be filled by the members in general meeting.

*Terms of office of a director filling casual vacancy:*

The appointed director filling casual vacancy shall hold office only up to the term of the director in whose place he is appointed would have held office if it had not been vacated (i.e. up to the unexpired term of the director in whose place he is appointed). Therefore, he is not a 'retiring director' within the meaning of section 152 of the Act.

**Appointment of directors to be voted individually [Section 162(1)]**

A single resolution shall not be moved for the appointment of two or more persons as directors of the company unless a proposal to move such a motion has first been agreed to at the meeting without any vote being cast against it.

A resolution moved in contravention of aforesaid provision shall be void, whether or not any objection was taken when it was moved. A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

Provisions related to appointment of directors to be voted individually shall be applicable to public companies only. However, a Government company in which the entire paid up share capital is held by the Government, Central or State, jointly or severally or the subsidiary of a Government company, in which the entire paid up share capital is held by that Government company and private companies are exempted from compliance of aforesaid provisions i.e. such companies can pass a single resolution for appointment of 2 or more persons as directors. The Ministry of Corporate Affairs vide its notification dated June 05, 2015 exempted such class of companies from compliance of such provisions.

**Proportional representation for appointment of directors [Section 163]**

The articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation, whether by the

single transferable vote or by a system of cumulative voting or otherwise and such appointments may be made once in every three years and casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161. Single transferable vote means, a candidate gets elected if he gets the required number of votes fixed as quota. These systems of voting ensure that the Board will have fair representation of the minority interest.

The provisions of proportional representation of directors shall not apply in case of a Government company in which the entire paid up share capital is held by the Government, Central or State, jointly or severally or the subsidiary of a Government company, in which the entire paid up share capital is held by that Government company.

### **Right of persons other than retiring directors to stand for directorship [Section 160]**

1. A person who is not a retiring director shall be eligible for appointment to the office of a director at any general meeting, if he, or some member intending to propose him as a director, has, not less than fourteen days before the meeting, left at the registered office of the company, a notice in writing under his hand signifying his candidature as a director or, as the case may be, the intention of such member to propose him as a candidate for that office. Such a person may be a member or a non-member, an additional director or a director to fill a casual vacancy or an alternate director or a nominee director.
2. Such notice must come along with the deposit of one lakh rupees or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than twenty five of total valid votes cast either on show of hands or on poll on such resolution.

In case of Nidhi company, instead of Rupees One Lakh, the deposit of Rupees ten thousand is required with the notice.

3. Section 160 is not applicable to Government Company where the entire paid up share capital is held by Central Government jointly or severally or in case of subsidiary of Government Company in which the entire paid up capital is held by that Government Company.

Further, Section 160 is not applicable to Private Companies, Section 8 Companies whose article provide for election of directors by Ballot.

### **Refund of deposit in case of section 8 Companies**

The Ministry of Corporate Affairs has clarified that in case of a Section 8 Company, where the person proposed as a director fails to secure 25% of valid votes cast, the Board of directors of the company may decide whether to forfeit the deposit or to refund it [General Circular No. 38/2014 dated 14.10.2014]

### **Notice of candidature of a person for directorship [Section 160(2) and Rule 13]**

Notice of candidature of a person for directorship: The Companies (Appointment and Qualification of Directors) Rules, 2014 lays down the procedure for giving notice of candidature by a person for directorship as under:

- (a) **Time limit for informing the members:** The company shall, at least seven days before the general meeting, inform its members of the candidature of a person for the office of a director or the intention of a member to propose such person as a candidate for that office.-
- (b) **Manner of informing the members:**
  - In writing
    - (i) by serving individual notices, on the members-

- through electronic mode to such members who have provided their email addresses to the company for communication purposes, and
- (ii) by placing notice of such candidature or intention on the website of the company, if any.

**Exemption from serving individual notices:** The company shall not be required to serve individual notices upon the members as aforesaid, if the company advertises such candidature or intention, not less than seven days before the meeting.

- (i) at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and
- (ii) at least once in English language in an English newspaper circulating in the district in which registered office of the company is situated.

The provisions of section 160 are mandatory. Non-compliance of procedure prescribed under section 160 would render the appointment invalid. The provisions regarding right of persons other than retiring director to stand for directorship is no longer applicable to private companies i.e provisions of Section 160 like seeking deposit of rupees one Lakh, notice of candidature etc. shall not apply to a private company and a Government company in which the entire paid up share capital is held by the Government, Central or State, jointly or severally or the subsidiary of a Government company, in which the entire paid up share capital is held by that Government company in case of appointment of a director in a general meeting. The Ministry of Corporate Affairs vide its notification dated June 05, 2015 exempted such class of companies from compliance of such provisions.

### **DIRECTOR IDENTIFICATION NUMBER (DIN)**

The Companies (Appointment and Qualification of Directors) Rules, 2014, provides for the procedure for making application for allotment of DIN.

#### *Procedure for application for allotment of DIN - Section 153 & Rule 9*

- (1) Every individual, who is to be appointed as director of a company shall make an application electronically in Form DIR-3 (Application for allotment of Director Identification Number) to the Central Government for the allotment of a Director Identification Number (DIN) along with such fees as may be prescribed.
- (2) The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.
- (3) (a) The applicant shall download Form DIR-3 from the portal, fill in the required particulars and attaching photograph; proof of identity; proof of residence; and specimen signature duly verified and sign the form digitally.
- (b) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by -:
  - (i) a chartered accountant in practice or a company secretary in practice or a cost accountant in practice; or
  - (ii) a company secretary in full time employment of the company or by the managing director or by director of the company in which the applicant is to be appointed a director;
- (4) Rule 9(4) provides that in case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with declaration in Form-DIR-3A. This declaration will be submitted along with Form DIN-3.

The MCA vide Notification No. S.O. 1354(E) dated 21st May, 2014 delegates the powers and functions of the Central Government in respect of allotment of Director Identification Number under section 153 of the Companies Act, 2013 to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida.

*Procedure for Allotment of DIN- Section 154 and Rule 10*

The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as mentioned below:

- (1) On the submission of the Form DIR-3 on the portal and payment of the requisite amount of fees through online mode an application number shall be generated by the system automatically.
- (2) After generation of the application number, the Central Government shall process the application received for allotment of DIN under Sub-rule (2) of Rule 9 decide on the approval or rejection thereof and communicate the same to the applicant along with DIN allotted. In case of approval by way of a letter by post or electronically or in any other mode within a period of one month from the receipt of such application.
- (3) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of fifteen days of such placing on the website and email.

Provided that Central Government shall-

- (a) reject the application and direct the applicant to file fresh application with complete and correct information, where the defect has been rectified partially or the information given is still found to be defective;
  - (b) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and
  - (c) inform the applicant either by way of letter by post or electronically or in any other mode.
- (4) In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.
  - (5) All Director Identification Numbers allotted to individual(s) by the Central Government before the commencement of Companies (Appointment and Qualification of Directors) Rules, 2014 shall be deemed to have been allotted to them under these rules.
  - (6) The Director Identification Number so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.
  - (7) Every director, functioning as a director in one or more companies on or before the 30th June, 2007 and who has not yet intimated his DIN to such company or companies shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director as per Form DIR-3B (New Form). The intimation by the company of Director Identification Number of its directors under section 157 of the Act shall be furnished in Form DIR-3C (New Form) within fifteen days of receipt of intimation under section 156 (Sub rule 10A).

**Cancellation/Surrender/Deactivation of DIN [ Rule 11]**

The Competent Authority (Central Government/RD (North),Noida/ Authorised Officer by the RD) may, upon being satisfied on verification of particulars or documentary proof attached with the application along with specified fee received from any person, cancel or deactivate the DIN in case –

- (a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DIN shall be merged with the validly retained number;
- (b) the DIN was obtained in a wrongful manner or by fraudulent means;
- (c) of the death of the concerned individual;
- (d) the concerned individual has been declared as a lunatic or of unsound mind by a competent Court;
- (e) if the concerned individual has been adjudicated an insolvent.

Provided that before cancellation or deactivation of DIN pursuant to clause (b), an opportunity of being heard shall be given to the concerned individual;

- (f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN but after verification of e-records.

**Intimation of changes in particulars of Director [Rule 12]**

- (1) Every individual having DIN in the event of any change in his particulars as stated in Form DIR-3, intimate such change(s) to the Central Government within a period of 30 days of such change(s) in Form DIR-6 (Intimation of change in particulars of Director to be given to the Central Government). The applicant shall fill in the relevant changes in DIR-6, verify the form and attach duly scanned copy of the proof of the changed particulars and submit electronically. Form requires pre-certification by the professional CA/CS/CMA in practice.
- (2) The Central Government shall incorporate the said changes in the electronic database after due verification from the enclosed proofs and confirm the applicant by post/email/any other mode.
- (3) The DIN cell of the MCA shall also intimate the change(s) in the particulars of the director submitted to it in Form DIR-6 to the concerned Registrar(s) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated.
- (4) The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within fifteen days of such change.

**General Provisions regarding DIN****Prohibition to obtain more than one DIN:**

According to Section 155, No individual shall apply for/obtain/ possess another Director Identification Number who has already been allotted a Director Identification Number under section 154.

**Director to intimate DIN:**

Section 156 stipulated that Every existing director shall intimate his DIN to the company or all companies wherein he is a director within one month of the receipt of DIN from the Central Government.

### **Company to inform DIN to Registrar:**

Every company shall, within fifteen days of the receipt of intimation of DIN from director, furnish the DIN to the Registrar/authorised office by the Central Government in e-form DIR-3C. The e-form is to be digitally signed by Company Secretary of the company or Company Secretary in Practice.

If a company fails to furnish Director Identification Number under section 157 (1), before the expiry of the 270 days period from the date by which it should have been furnished with additional fee, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

### **Obligation to obtain DIN:**

Section 158 specified that every person or company shall mention the DIN in return, information or particulars as required to be furnished under this Act, in case such return etc. relate to the director or contain any reference of any director.

### **Intimation of reasons of resignation on behalf of foreign Director**

Rule 15 of Companies (Appointment and Qualification of Directors) Rules, 2014, requires that a company shall intimate resignation of a director to Registrar in Form DIR-12 within 30 days from the date of receipt of notice of resignation and to post such information on its website.

Further, Rule 16 of above rules requires that a resigning director shall forward a copy of his resignation along with reasons for such resignation to the Registrar within 30 days from the date of resignation in Form DIR-11 with the prescribed fees.

In case a company has already filed Form DIR-12 with the Registrar under rule 15, a foreign director of such company resigning from his office may authorise in writing a practicing chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.”

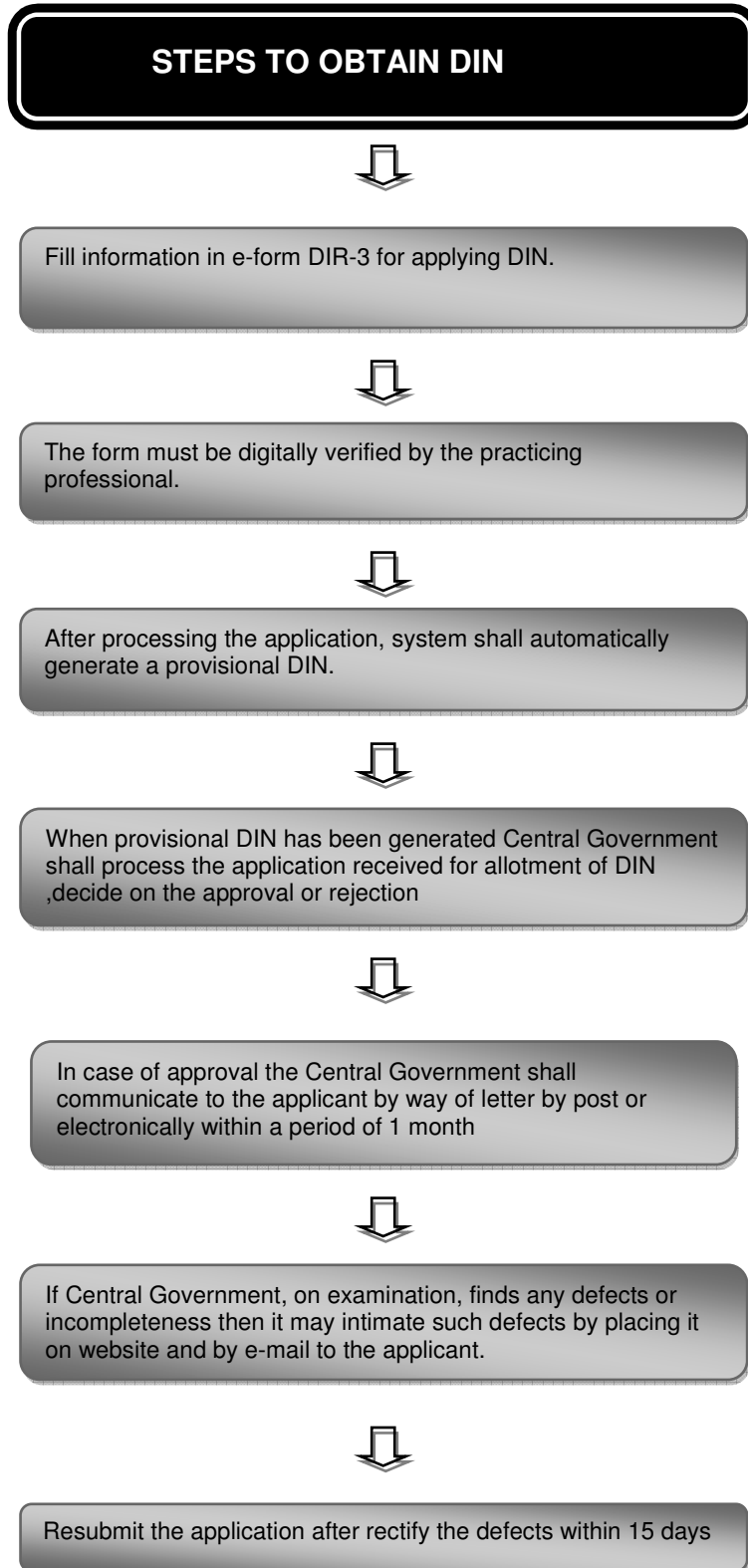
### **Punishment for Contravention**

Section 155 of the Act provides that no individual who has already been allotted a Director Identification Number under section 154, shall apply for, obtain or possess another Director Identification Number.

Section 159 of the Act, further provides that for contravention of the provisions relating to appointment, obtaining more than one DIN or non-intimation of DIN, the individual shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues.



## Steps to obtain DIN



## 11. Disqualifications for appointment of director [Section 164]

### (1) Grounds of disqualification:

A person shall not be eligible for appointment as a director of a company, if —

- (a) he is of unsound mind and stands so declared by a competent court;
- (b) he is an undischarged insolvent;
- (c) he has applied to be adjudicated as an insolvent and his application is pending;
- (d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence.

If a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

The expression 'or otherwise' means any offence in respect of which he has been convicted by a Court under the Companies Act, 2013 or under the Companies Act, 1956.[As per Rule 2(1)(k) of the Companies (Appointment and Qualification of Directors) Rules, 2014].

- (e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;
- (f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;
- (g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or
- (h) he has not been allotted DIN.

### (2) Disqualification by reason of default made by a company:

No person who is or has been a director of a company which—

- (a) has not filed financial statements or annual returns for any continuous period of three financial years; or
- (b) has failed to
  - repay the deposits accepted by it or pay interest thereon; or
  - redeem any debentures on the due date or pay interest due thereon; or
  - pay any dividend declared

and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

*If after the disqualification under section 164(2) is attracted, the default is made good by the company, the directors shall continue to remain disqualified. The provisions of section 164(2) shall not apply to Government company.*

**(3) Additional grounds of disqualification:**

A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2) of section 164 as stated above.

However, a public company is prohibited from providing any additional disqualifications.

**(4) Postponement of certain grounds of disqualification:**

The disqualifications referred to in clauses (d), (e) and (g) of section 164(1) shall not take effect—

- (a) for thirty days from the date of conviction or order of disqualification;
- (b) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed off; or
- (c) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed off.

***Provisions contained in Rule 14 of the Companies (Appointment and Qualification of Directors) Rules, 2014.***

- (a) Every director who disqualified u/s 164 (2), shall inform to the company concerned in Form DIR-8 (Intimation by Director) before he is appointed or re-appointed.
- (b) Whenever a company fails to file the financial statements/annual returns/fails to repay any deposit, interest, dividend/fails to redeem its debentures as specified u/s 164 (2), the company shall immediately file Form DIR-9 (Report by the company to Registrar), to the Registrar furnishing therein the names and addresses of all the directors of the company during the relevant financial years. But when a company fails to file the Form DIR-9 within a period of 30 days of the failure it would attract the disqualification u/s 164(2), officers of the company as specified u/s 2(60) shall be the officers in default.
- (c) Upon receipt of the Form DIR-9, the Registrar shall immediately register the document and place it in the document file for public inspection.
- (d) Any application for removal of disqualification of directors shall be made in Form DIR-10.

**Duties of directors [Section 166]**

The duties of directors as contained in section 166 of the Companies Act, 2013 are described as follows.

**1. Duty to act as per the articles of the company**

The director of a company shall act in accordance with the articles of the company.

**2. Duty to act in good faith**

A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

**3. Duty to exercise due care**

A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

#### **4. Duty to avoid conflict of interest**

A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

#### **5. Duty not to make any undue gain**

A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

#### **6. Duty not to assign his office**

A director of a company shall not assign his office and any assignment so made shall be void.

#### **Punishment for contravention:**

If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

### **Vacation of office of director [Section 167]**

#### **1. Grounds of vacation of office of a director [Section 167(1)]**

The office of a director shall become vacant in case—

- (a) He incurs any of the disqualifications specified in section 164;
- (b) He absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;
- (c) He acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;
- (d) He fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested
- (e) He becomes disqualified by an order of a court or the Tribunal;
- (f) He is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than 6 months;

Provided that the office shall be vacated by the director even if he has filed an appeal against the order of such court;

- (g) He is removed in pursuance of the provisions of this Act;
- (h) He, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

#### **2. Punishment for contravention [Section 167(2)]**

If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified above, he shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees or with both.

### 3. Consequences of vacation of office of all the directors [Section 167(3)]

Where all the directors of a company vacate their offices under any of the disqualifications specified above the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

### 4. Additional grounds of vacation of offices [Section 167(4)]

A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified above.

## Resignation of director [Section 168 & Rule 15 and 16]

The provisions relating to resignation of directors, as contained in section 168 of the Companies Act, 2013 and Rule 15 and 16 of the Companies (Appointment and Qualification of Directors) Rules, 2014 are described below.

### 1. Intimation of resignation to Registrar by director as well as by the company

A director may resign from his office by giving notice in writing. The Board shall, on receipt of such notice within 30 days intimate the Registrar in Form DIR-12 and also place the fact of such resignation in the Directors' Report of subsequent general meeting of the company and post the information on its website. The director shall also forward a copy of resignation alongwith detailed reasons for the resignation to the Registrar in Form DIR-11 within 30 days from the date of resignation.

### 2. Effect of resignation made under section 168 (1) [Section 168(2)]

The notice shall become effective from

- (i) the date on which the notice is received by the company; or
- (ii) the date, if any, specified by the director in the notice,

which ever is later.

### 3. No extinguishment of liability even after resignation

The director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

### 4. Consequences of resignation of all the directors [Section 168(3)]

If all the directors of a company resign from their office or vacate their office under section 167, the promoter or in his absence the Central Government shall appoint the required number of directors to hold office till the directors are appointed by the company in General Meeting.

Where all the directors of a company resign and as a consequences the digital signature certificates (DSC) of all the directors are deactivated, DIR-12 cannot be filed by the company due to lack of an authorized signatory director.

In order to enable the filing of DIR-12 in such a case, the Registrar are authorized, on request from the stakeholder, and after due examination, to allow any one of the resigned director who was an authorized signatory director for the purpose of filing DIR-12 only. (General circular No. 03/2015 dated 03.03.2015).

### Removal of directors [Section 169]

Under section 169 of the Act, a company may, by ordinary resolution remove a director before the expiry of the period of his office. The provisions of section 169 shall apply regardless of the way in which the director concerned was appointed and notwithstanding anything contained in the articles of the company or any agreement with the director concerned.

- (i) A company may, remove a director other than a director appointed by the National Company Law Tribunal u/s 242 of the Act, after giving him a reasonable opportunity of being heard.
- (ii) The directors appointed on the principle of proportional representation under section 163 cannot be removed by an ordinary resolution
- (iii) A special notice shall be required of any resolution, to remove a director under section 169 or to appoint somebody in place of a director so removed, at the meeting at which he is removed. Legal requirement of special notice

The intention to move the resolution for removal of a director must be-

- (a) Given to the company not earlier than 3 months before the date of general meeting **but at least 14 days before the general meeting** (excluding the day on which such notice is given and the day of the general meeting)
- (b) Signed by member(s) holding not less than 1% of total voting power or member(s) holding paid up share capital of rupees five lakhs.
- (iv) On receipt of the notice of this resolution, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting. [Section 169(3)]
- (v) Where notice has been given of a resolution to remove a director under this section and the director concerned makes with respect thereto representation in writing to the company and requests its notification to members of the company, the company shall, if the time permits it to do so,—
  - (a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
  - (b) send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company), and if a copy of the representation is not sent as aforesaid due to insufficient time or for the company's default, the director may without prejudice to his right to be heard orally require that the representation shall be read out at the meeting.

Provided that copy of the representation need not be sent out and the representation need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the Tribunal is satisfied that the rights conferred by this sub-section are being abused to secure needless publicity for defamatory matter; and the Tribunal may order the company's costs on the application to be paid in whole or in part by the director notwithstanding that he is not a party to it.

- (vi) The vacancy resulting from the aforesaid removal if he had been appointed by the company in general meeting or by the Board, may be filled in by the appointment of another director at the same meeting at which the director is removed, provided special notice of the proposed appointment has been given under sub section (2). [Section 169(5)]

- (vii) A director so appointed shall hold office for the remaining period for which the director who has been removed would have held office if he had not been removed. [Section 169(6)]
- (viii) If the vacancy is not filled in the same meeting as above, then it may be filled as a casual vacancy in accordance with the provisions of this Act provided that the director who was so removed from office shall not be reappointed as a director. [Section 169(7)]
- (ix) Nothing in this section shall be taken to deprive a person removed under this section of his rights to compensation or damages payable to him in respect of the premature termination of the directorship, or terms of his appointment as director or of any appointment terminating with that as a director. [Section 169(8)(a)]
- (x) Nothing in this section shall be derogating from any power to remove a director under any other provisions of this Act. [Section 169(8)(b)]

**Directors can not be removed under section 169**

- (a) Directors appointed by the Central Government under section 161(3) of the Act.
- (b) Directors appointed by the Tribunal under section 242 of the Act.
- (c) Directors appointed by way of proportional representation under section 163 of the Act.  
 Example: Where a company has appointed 4 directors out of total 6 directors, by way of proportional representation, only these 4 directors cannot be removed; the remaining 2 directors may be removed under section 169 of the Act.
- (d) Nominee directors appointed by any financial institution constituted under a special Act of Parliament, if the provisions contained in the special Act restrain removal of such nominee directors by the members.

**Register of Directors and Key Managerial Personnel and their shareholding**

Section 170 makes it obligatory for every company to maintain a register containing the prescribed particulars of all its directors and Key Managerial Personnel and their shareholding.

The provisions of section 170 read with Rule 17 and Rule 18 of the Companies (Appointment and Qualification of Directors) Rules, 2014 are as follows:

- (i) Every company shall keep at its registered office a register containing such particulars of its directors and key managerial personnel as may be prescribed and which shall include details of securities held by each of them in the company or its holding, subsidiary, subsidiary of its holding companies or associate companies. [Section 170(1)]
- (ii) A return containing such particulars and documents as may be prescribed, of the directors and the key managerial personnel shall be filed with the Registrar in e-form DIR-12 within 30 days from the appointment of every director and key managerial personnel, as the case may be, and within 30 days of any change taking place.

**Members right to inspect (Section 171)**

- (i) The register of directors and Key Managerial Personnel kept under section 170(1) shall be open for inspection during business hours and the members shall have the right to take extracts therefrom and copies thereof, on request and will be provided within 30 days free of cost. [Section 171(1)(a)]
- (ii) Such register shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting. [Section 171(1)(b)]
- (iii) If any inspection during business hours is refused, or if any copy required as above is not sent within thirty days from the date of receipt of such request, the Registrar shall on an application

made to him order immediate inspection and supply of copies required there under. [Section 171(2)]

### LESSON ROUND-UP

- To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors. Directors of a company are its eyes, ears, brain, hands and other essential limbs.
- Every public company shall have at least 3 directors and every private company shall have at least 2 directors and every one person company shall have atleast 1 director as per section 149.
- Directors are trustees for the company i.e. the directors are persons selected to manage the affairs of the company for the benefit of the shareholders.
- Section 164 lays down disqualifications of directors. Also individually only can be a director under section 152 of the Act.
- Maximum Number of Director is 15, which can be increased by passing a special Resolution.
- Certain prescribed class or classes of companies is required to have at least one woman director. This is a mandatory provision.
- Every company including one person company shall have at least on director who stays in India for a period of not less than 180 days in the previous calendar year.
- Maximum limit on total number of directorship has been fixed at 20 companies including sub limit of 10 for public companies.
- The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.
- A director may be removed from the office by giving a special notice.
- A director may resign his office in the manner provided by the articles.
- Any officer or employee of a company shall be punishable with the fine on the complaint of the company or any creditor or contributory thereof, if he wrongfully obtains, possess or withholds any property of the company.

### SELF-TEST QUESTIONS

1. Explain the concept and the evolution of the institution of directors.
2. What are the qualifications of a director? When is a person disqualified for appointment as a director of the company? What are the rules as regards disqualification of Directors?
3. Explain the law relating to number of directors.
4. Who may be appointed as director of a company?
5. How can the directors be removed from the office before the expiry of their term?
6. Under what circumstances is a director deemed to have vacated the office of directorship?
7. How can the small shareholder's director be appointed?



# Lesson 15

## Independent Directors

### LESSON OUTLINE

- Introduction
- Who can be an Independent Director
- Number of Independent Directors
- Manner of selection of Independent director
- Code for Independent Director
- Tenure of Independent Director
- Liability of Independent director
- Retirement of Independent directors
- Remuneration of Independent Directors
- Roles and functions of Independent Directors
- Duties of Independent Directors

### LEARNING OBJECTIVES

Independent Directors are required because they perform the following important functions i.e

- (i) They balance the conflicting interest of stakeholders.
- (ii) They fulfill a useful role in succession planning
- (iii) They act as a coach, mentor and sounding Board for their full time colleagues.
- (iv) They provide independent judgment and wider perspective.

Independent directors are meant to serve the company's shareholders. They should not be representative of any regulator or financial institution. The Companies Act 2013, has introduced new provisions relating to independent directors, eligibility criteria, tenure, appointment, qualification, code etc., Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) contains provisions relating to Independent Director in tune with Companies Act, 2013.

After reading this lesson you will be able to understand the legal provisions relating to appointment, remuneration, code, tenure and other prescriptions pertaining to independent directors.

## 1. INTRODUCTION

The Cadbury Committee in 1992, which itself was set up following the corporate scandals involving BCCI, Poly Peck and Maxwell, provided respectability to the concept of independent directors, by focusing on independent directors as a part of the new practices for better governance. Independent directors function as an oversight body in monitoring the performance and should raise red flags whenever suspicion occurs. They are expected to be more aware and question the company on relevant issues in their position as trustees of stakeholders.

The institution of independent directors is a critical instrument for ensuring good corporate governance and it is necessary that the functioning of the institution is critically analysed and proper safeguards are made to ensure efficacy.

Companies Act 2013 mandates appointment of independent directors by listed companies and other class of companies. It also prescribes other aspects such as maximum tenure of independent directors, separate meeting of independent directors, tenure, their qualifications, liability, appointment, remuneration etc. The Central Government has exempted section 8 companies from the requirement of appointment of Independent Director.

### Who can be an Independent Director

Section 149(6) of the Companies Act, 2013, provides that:

Independent Director, in relation to a company, means a director other than a managing director or a whole time director or a nominee director -

- (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

In case of Government company, instead of Board, the Ministry or Department of the Central Government which is administrative incharge of the company.

- (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
- (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
- (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. In Government companies, the criteria is not required to be followed.

#### Clarification of MCA on 'Pecuniary Interest'

(i) Section 149(6)(c): "pecuniary interest in certain transactions" :-

(a) This provision *inter alia* requires that an 'ID' should have no 'pecuniary relationship' with the company concerned or its holding/ subsidiary/ associate company and certain other categories specified therein during the current and last two preceding financial years. Clarifications have been sought whether a transaction entered into by an 'ID' with the company concerned at par with any member of the general public and at the same price as is payable/paid by such member of public would attract the bar of 'pecuniary relationship' under section 149(6)(c). The matter was examined and it was hereby clarified that in view of the provisions of section 188 which take away transactions in the ordinary course of business at

arm's length price from the purview of related party transactions, an 'ID' will not be said to have 'pecuniary relationship', under section 149(6)(c) in such cases.

(b) Stakeholders also sought clarification whether receipt of remuneration, (in accordance with the provisions of the Act) by an 'ID' from a company would be considered as having pecuniary interest while considering his appointment in the holding, subsidiary or associate company of such company.

The matter was examined in consultation with SEBI and it was clarified that 'pecuniary relationship' provided in section 149(6)(c) of the Act does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act.

- (d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) who, neither himself nor any of his relatives—
  - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
  - (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
    - (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
    - (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;
  - (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
  - (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or
- (f) who possesses such other qualifications as may be prescribed.

An independent director is required to possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business. Explanation.—For the purposes of this section, "nominee director" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

## 2. Number of Independent Directors

Every listed public company shall have at least one-third of the total number of directors as independent directors. Any fraction contained in such one third numbers shall be rounded off as one.

According to Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 the following class or classes of companies are required to have at least two directors as independent directors -

- (i) the Public Companies having paid up share capital of ten crore rupees or more; or
- (ii) the Public Companies having turnover of one hundred crore rupees or more; or
- (iii) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

A small shareholder's director may also be considered as an independent, if he fulfills the eligibility criteria and if he gives the declaration of his independence under section 149(6).

**Relevant date:** The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

**Higher number of independent directors due to composition of audit committee:**

If the company is required to constitute an audit committee, is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent directors shall be applicable to it.

Let us understand the concept through an example.

ABC Ltd. is having 6 directors in its Audit Committee, then 4 directors out of 6 must be Independent Directors (4 is forming majority). As per section 177(2) of the Companies Act, 2013, the Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. Although in terms of the Companies (Appointment & Qualification) Rules, 2014 the company is required to have at least 2 Independent directors, but in this case the limit of 2 will increase to 4 as the company is required to appoint a higher number of independent directors due to composition of its audit committee.

**Filling of intermittent vacancies:**

Any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

Let us understand the concept through an example.

In ABC Ltd., the vacancy of the independent director arises on January 15, 2015. As per the provisions of the Act, the vacancy shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

**CASE-A:** If the Board meeting is scheduled to be held on February 15, 2015, then the vacancy shall be filled-up by February 15, 2015 or by April 14, 2015 whichever is later. In this case it shall be filled up by April 14, 2015.

**CASE-B:** If, for any reason, the meeting of Board of Directors shifted to May 10, 2015, then the vacancy shall be filled-up by May 10, 2015 or by April 14, 2015 whichever is later. In this case it shall be filled up by May 10, 2015.

Where a company ceases to fulfil the prescribed criteria:

Where a company ceases to fulfill any of three conditions laid down above for three consecutive years, it shall not be required to comply with these provisions until such time as it meets any of such conditions.

**LET US REMEMBER!**

**Nominee Directors are not Independent Directors**

#### 4. Manner of selection of an Independent Director-

##### 1. Maintenance of data bank:

According to section 150(1) of the Act,

- (a) An independent director may be selected from a data bank containing names, addresses and qualifications of persons eligible and willing to act as independent directors.
- (b) The data bank shall be created and maintained in accordance with such rules as may be prescribed.
- (c) The data bank may be maintained by the agency (Any body, institute or association as may be authorised by Central Government) having expertise in creation and maintenance of such data bank.
- (d) Such agency shall put data bank of independent directors on the website of Ministry of Corporate Affairs or any other notified website.

One such databank as a joint initiative of The Institute of Chartered Accountants of India, The Institute of Company Secretaries of India and The Institute of Cost Accountants of India" under the active encouragement of the Ministry of Corporate Affairs, Government of India has been developed. **This Independent Directors Repository** facilitates the individuals who are eligible and willing to act as Independent Directors and also facilitates Companies to select the persons who are eligible and willing to act as Independent Directors.

##### 2. Responsibility of the company to exercise due diligence:

A Company must exercise due diligence before selecting a person from any data bank.

##### 3. Approval of appointment of independent director by the members:

Appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

**4. Changes in particulars:** An existing or applicant of such data bank of independent directors shall intimate any changes in his particulars within fifteen days of such change to the agency i.e. Independent Directors Repository [Rule 6(6)].

**5. Requirements for data bank displayed on the website:** Rule 6(7) prescribed that the databank posted on the website shall:

- a. be accessible at the specified website;
- b. be substantially identical to the physical version of the data bank;
- c. be searchable on the parameters specified in rule 6(2);
- d. be presented in a format or formats convenient for both printing and viewing online; and
- e. contain a link to obtain the software required to view print the particulars free of charge.

However, Rule 6(2) has been amended to rationalize the required information from the applicant registering on the databank of Independent Directors by removing the required details of Income Tax PAN, Mother's and Spouse Name from the databank of Independent Directors.

##### ➤ Declaration by independent director [Section 149(7)]

Every independent director shall at the first meeting of the Board in which he participates as a director

and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence as provided in sub-section (6) of section 149.

## 5. Code for Independent Directors (Schedule IV of the Companies Act 2013)

Section 149 (8) of the Act prescribes that the company and independent directors shall abide by the provisions specified in Schedule IV regarding code for independent directors. It is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

Code of Conduct includes

- guidelines of professional conduct,
- role, functions and duties,
- manner of appointment and re-appointment,
- resignation or removal,
- separate meetings,
- evaluation mechanism.

### *I. Guidelines of professional conduct:*

An independent director shall:

- (1) uphold ethical standards of integrity and probity;
- (2) act objectively and constructively while exercising his duties;
- (3) exercise his responsibilities in a *bona fide* manner in the interest of the company;
- (4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;
- (5) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;
- (6) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- (7) refrain from any action that would lead to loss of his independence;
- (8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- (9) assist the company in implementing the best corporate governance practices.

### *II. Role and functions:*

The independent directors shall:

- (1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- (2) bring an objective view in the evaluation of the performance of board and management;

- (3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
- (4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- (5) safeguard the interests of all stakeholders, particularly the minority shareholders;
- (6) balance the conflicting interest of the stakeholders;
- (7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
- (8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

*III. Duties:*

The independent directors shall—

- (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- (2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
- (3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;
- (4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;
- (5) strive to attend the general meetings of the company;
- (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;
- (7) keep themselves well informed about the company and the external environment in which it operates;
- (8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;
- (9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;
- (10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
- (11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
- (12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;
- (13) not disclose confidential information, including commercial secrets, technologies, advertising and

sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

*IV. Manner of appointment:*

- (1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.
- (2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.
- (3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.
- (4) The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :
  - (a) the term of appointment;
  - (b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;
  - (c) the fiduciary duties that come with such an appointment along with accompanying liabilities;
  - (d) provision for Directors and Officers (D and O) insurance, if any;
  - (e) the Code of Business Ethics that the company expects its directors and employees to follow;
  - (f) the list of actions that a director should not do while functioning as such in the company; and
  - (g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.
- (5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.
- (6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

*V. Re-appointment:*

The re-appointment of independent director shall be on the basis of report of performance evaluation.

*VI. Resignation or removal:*

- (1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.
- (2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.
- (3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of



replacement by a new independent director shall not apply.

*VII. Separate meetings:*

- (1) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;
- (2) All the independent directors of the company shall strive to be present at such meeting;
- (3) The meeting shall:
  - (a) review the performance of non-independent directors and the Board as a whole;
  - (b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
  - (c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

*VIII. Evaluation mechanism:*

- (1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
- (2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

**NOTED THAT:-**

**Section 149(8) provides that the company and independent directors shall abide by the provisions specified in Schedule IV (Code of Conduct for Independent Director).**

## **6. Tenure of Independent Director**

Section 149(10) provides that subject to the provisions of section 152 (Appointment of Directors),

- (a) an independent director shall hold office for a term up to five consecutive years on the Board of a company.
- (b) He shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.
- (c) No independent director shall hold office for more than two consecutive terms.
- (d) An independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director. During the said period of three years, an independent director shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.

*Explanation* to section 149(10) & (11) prescribes that, any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under those sub-sections.

## **Clarifications on Rules prescribed under the Companies Act 2013 - Matters relating to appointment and qualifications of directors and Independent Directors**

### ➤ **Section 149: Appointment of 'IDs'**

Clarification has been sought if 'IDs' appointed prior to April 1, 2014, may continue and complete their

remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company so decide) in accordance with the provisions of the new Act.

The matter was examined in the light of the relevant provisions of the Act, particularly section 149(5) and 149(10) & (11). Explanation to section 149(11) clearly provides that any tenure of an 'ID' on the date of commencement of the Act shall not be counted for his appointment/ holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), it is hereby clarified that it would be necessary that if it is intended to appoint existing 'IDs' under the new Act, such appointment shall be made expressly under section 149(10)/(11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

➤ **Section 149(10)/(11) - Appointment of 'IDs' for less than 5 years**

Clarification has been sought as to whether it would be possible to appoint an individual as an ID for a period less than five years.

It has been clarified that section 149(10) of the Act provides a term of "upto five consecutive years" for an 'ID'. As such while appointment of an 'ID' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of 'ID' for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.

➤ **Appointment of 'IDs' through letter of appointment:-**

With reference to Para IV (4) of Schedule IV of the Act (Code for IDs) which requires appointment of 'IDs' to be formalized through a letter of appointment, clarification has been sought if such requirement would also be applicable for appointment of existing 'IDs'? The matter has been examined. In view of the specific provisions of Schedule IV, appointment of 'IDs' under the new Act would need to be formalized through a letter of appointment.

**LET US REMEMBER:-**

Independent Director shall hold office for a term upto 5 consecutive years, but shall be eligible for re-appointment on passing of a special resolution.

He shall not hold office for more than 2 consecutive terms, but such independent director shall be eligible for appointment after the expiration of 3 years of ceasing to become an independent director.

## **7. Liability of Independent Director**

Section 149(12) provides that, notwithstanding anything contained in this Act, an independent director; a non-executive director not being promoter or key managerial personnel, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

## **8. Retirement by rotation not applicable to independent directors**

Section 149(13) states that the provisions of sections 152(6) & (7) in respect of retirement of directors by rotation shall not be applicable to independent directors.

## 9. Remuneration of Independent Director

Section 149(9) provides that notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members .

## 10. Requirement of explanatory statement [Section 152(6)]

In the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice of the general meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment.

### LESSON ROUND-UP

- An independent director in relation to a company means a director other than a managing director or a whole-time director or a nominee director.
- An independent director can be selected from a data bank (Independent Directors Repository) containing names, addresses and qualifications of persons who are eligible and willing to act as independent director.
- Every listed company shall have one-third independent directors.
- Section 149(8) provides that the company and independent directors shall abide by the provisions specified in Schedule IV.
- An independent director shall hold office for a term up to 5 consecutive years on the Board of a company.
- The re-appointment of an independent director shall be on the basis of report of performance evaluation. [Clause VIII of Schedule IV]
- The resignation or removal of an independent director will be in the manner as is provided in sections 168 & 169 of the Act.
- In case of listed company, 50% of the Board is to be independent if the Chairman is a, executive director, otherwise 1/3rd of the board is to be independent.
- The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.
- The company shall provide suitable training to independent directors to familiarize them with the company.

### SELF-TEST QUESTIONS

1. Write short notes on the followings:-
  - Independent director under Clause 49
  - Code for Independent Directors
  - Tenure of Independent Director
  - Maximum and Minimum Number of Independent Directors
2. Explain the manner of appointment of Independent directors.



# Lesson 16

## Board and its Powers

### **LESSON OUTLINE**

- Distribution of powers of a Company
- Exercise of Powers
- Board Committees
- Restriction on powers of Board
- Board's sanction for contracts in which Directors are interested.
- Related Party Transaction
- Register of Contracts or Arrangements in which Directors are interested
- Contract of Employment with Managing Director or Whole-Time Directors

### **LEARNING OBJECTIVES**

In the previous chapter, we had learnt about the concept of directors, their appointment, removal, remuneration etc. Now let us learn about the powers and duties of directors. Directors acting collectively i.e. Board of Directors are authorized to do what the company is authorized to do unless barred by restrictions on their powers by the provisions of the Companies Act, 2013, the Memorandum or Articles of the company. Except where express provisions are made that the powers of a company in respect of any matter are to be exercised by the company in general meeting, in all other cases the Board is entitled to exercise all its powers. The directors acting together are the authority for conducting the affairs of the company. They are authorised to do what the company is authorised to do, unless barred by restrictions on their powers by the provisions of the Companies Act, 2013 (the Act), the Memorandum or Articles of the company.

## DISTRIBUTION OF POWERS OF A COMPANY

The directors shall exercise their powers bona fide and in interest of the company. The directors while exercising their powers do not act as agents for the majority or even all the members and so the members cannot by resolution passed by a majority or even unanimously supercede the director's powers, or instruct them how they shall exercise their powers. This sovereignty of the directors within the limits of the powers conferred on them by the articles, and within limit laid down by the Act was clearly expressed by *Greer L.J. in John Shaw & Sons (Salford) Ltd. v. Shaw* (1935) 2 K.B. 113 in the following words:

“A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. The powers of management are vested in the directors. They and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in the directors, is by altering the articles, or if opportunity arises under the articles, by refusing to re-elect the directors whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders”.

In *Milan Senv. Guardian Plastics Ltd.* (1998) 2 Comp L J 320, the directors passed a resolution for rights issue which was questioned by certain shareholders. The Calcutta High Court held that the question whether the company needed additional capital was a question which should primarily be decided by the directors of the company and if they were of the view that further capital in the form of rights issue was required the Court would be slow to disturb the same unless there were extreme circumstances of malafides or breach of trust.

Thus, from the provisions of Section 179 and the exposition of the law stated above, it is clear that subject to the restrictions contained in the Act, Memorandum and articles, the powers of directors are co-extensive with those of the company itself.

The relationship of the Board of directors with the shareholders is more of federation than one of subordinates and superior. Some powers are specially reserved for the Board e.g. appointing directors in casual vacancies, the power to issue debentures, etc. On the other hand, some powers are exclusively reserved for the members in general meeting e.g. borrowing in excess of the paid-up capital and free reserves, selling or disposing off the whole or substantially the whole of the undertaking etc.

However, in the following exceptional cases, the general body of shareholders is competent to act even in matters delegated to the Board:

- (a) Directors Acting Mala Fide: The general body of shareholders can intervene when it is proved that the directors have acted for improper motive or arbitrarily or capriciously. In *Satya Charan Lal v. Romeshwar Prasad Bajoria* (1950) SCR 394, it was stated that ordinarily the directors of a company are the only persons who can conduct litigation in the name of company, but when they are themselves the wrong doers, and have acted malafide and their personal interest is in conflict with their duty in such a way that they cannot or will not take steps to seek redress for the wrong done to the company, the majority of the shareholders may take steps for redressal of the wrong.

In *Marshall's Valve Gear Co. Ltd. v. Manning Wardle & Co. Ltd.* (1909) 1 Ch. 267, A and three other persons were four directors of M. Co. and they held almost the whole of the subscribed capital of the company. A was the majority shareholder, but held less than three-fourth of the share capital. Another company, known as N. Co. was committing infringement of M. Co.'s trademark and other

three directors were interested in that company. The result was that at a meeting of the Board they declined to sanction any proceeding against N. Co. A, at a general meeting of the shareholders, resolved and commenced an action to restrain the alleged infringement.

- (b) Incompetent Board: The general body of shareholders may exercise the powers vested in the Board when the Board is incompetent to act, for instance, where all the directors are interested in the transaction or the Board is unwilling to act, or when there are no validly appointed directors functioning.

In *Vishwanathan v. Tiffins B.A. and P. Ltd.*, AIR 1953 Mad. 520, a clause in the articles of the company authorised the directors to fill casual vacancies and also to increase the number of directors within the maximum number fixed in the articles. Some casual vacancies occurred, and they were promptly filled at a general meeting of the shareholders. This was challenged on the ground that once the power to appoint was delegated to the Board, it could not have been exercised at a general meeting. The Court upheld the appointments by the company in the general meeting, as it found that at the time of the general meeting there was no director in office and, therefore, the members had the right to elect. Venkatarma Iyer, J. observed: "A company has inherent power to take all steps to ensure its proper working and that, of course, included the power to appoint directors. It can delegate these powers to the Board and such delegation will be binding upon it, but if there is no legally constituted Board which could function or if there is a Board that is unable or unwilling to function then the authority delegated to the Board lapses and the members can exercise the right inherent in them of appointing directors."

- (c) Deadlock in the Board: If the directors are unable or unwilling to act, on account of deadlock, the shareholders have the inherent power to act.

For instance, in the *Barron v. Potter* (1914) 1 Ch. 895, there were only two directors on the Board of the Company and one refused to act with the other. There was no provision in the articles enabling the general meeting of the shareholders to increase or reduce the number of directors. Held, that as there was a deadlock in the administration resulting from the fact that the power to take necessary steps to ensure the working of the company and to appoint additional director for the purpose.

From the above, it is clear that the residuary powers can be pressed into service by the shareholders in general meeting.

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

**The powers of directors are co-extensive with those of the company itself.**

### True

### False

**Correct answer: True**

The board of directors of a company is primarily an oversight board. It oversees the management of the company to ensure that the interest of non-controlling shareholders is protected. It also functions as advisory board. Independent directors bring diverse knowledge and expertise in the board room and the CEO uses the knowledge pool in addressing issues being faced by the company. The most important function of a monitoring board is to provide direction to the company.

Another very important function of a monitoring board is to set the 'tone at the top'. It is expected to create the right culture within the company.

### Meetings of the Board [Section 173]

Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum.

1. The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.
2. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings

Further Secretarial Standard 1 (SS-1) issued by ICSI clarifies that the Board shall meet at least once in every calendar quarter, with a maximum interval of one hundred and twenty days between any two consecutive Meetings of the Board

SS also states that it shall be sufficient that in the year of incorporation if a company, in addition to the first meeting to be held within thirty days of the date of incorporation, holds one meeting in every remaining calendar quarter in the year of incorporation

3. In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.
4. In case of Section 8 Company, after MCA exemptions Notification Dated 05.06.2015, the provision of Section 173(1) shall apply only to the extent that the Board of Directors, of such Companies shall hold at least one meeting within every six calendar months.

**Note:** With regard to Section 8 companies this section shall apply only to the extent that the Board of Directors, of such Companies shall hold at least one meeting within every six calendar months

**How many meetings a company will be required to hold in the year of incorporation, if a company is incorporated in the month of December?**

### One

### Two

**Correct answer: One**

### Notice of Board Meetings

1. The Act requires that not less than seven days' notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

The SS-1 states that in case the company sends the Notice by speed post or by registered post or by courier, an additional two days shall be added for the service of Notice.

2. In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all



directors and it shall be final only after ratification of decision by at least one Independent Director.

As per SS-1, In case the company does not have an Independent Director, the decisions shall be final only on ratification thereof by a majority of the Directors of the company, unless such decisions were approved at the Meeting itself by a majority of Directors of the company.

### **Agenda of Board Meetings**

The Act does not prescribe such requirement to circulate Agenda etc. However Good governance envisage such requirement.

1. The SS-1 issued by ICSI requires a Company to circulate Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.
2. Notes on items of business which are in the nature of Unpublished Price Sensitive Information may be given at a shorter period of time than stated above, with the consent of a majority of the Directors, which shall include at least one Independent Director, if any

### **Requirements and Procedures for Convening and Conducting Board's Meetings**

Directors may participate in the meeting either in person or through video conferencing or other audio visual means.

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedures, in addition to the procedures required for Board meetings in person, for convening and conducting Board meetings through video conferencing or other audio visual means:

- (1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.
- (2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
  - (a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
  - (b) to ensure the availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;
  - (c) to record the proceedings and prepare the minutes of the meeting;
  - (d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year;
  - (e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
  - (f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting, but the differently abled persons, may make request to the Board to allow a person to accompany him.
- (3) (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.

- (b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.
  - (c) A director intending to participate through video conferencing mode or audio visual means shall communicate his intention to the Chairman or the company secretary of the company.
  - (d) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangement in this behalf.
  - (e) The director, who desire, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year.
  - (f) In the absence of any such intimation from the director, it shall be assumed that the director will attend the meeting in person.
- (4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely :
- (a) name;
  - (b) the location from where he is participating;
  - (c) that he can completely and clearly see, hear and communicate with the other participants;
  - (d) that he has received the agenda and all the relevant material for the meeting; and
  - (e) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.
- (5) (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairman and confirm that the required quorum is complete.
- Explanation:* It is clarified that a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the Rules.
- (b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement of the meeting after every break to confirm the presence of a quorum throughout the meeting.
- (6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.
- (7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

- (8) (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.
- (b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or company secretary shall request for a repeat or reiteration by the director.
- (9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.
- (10) From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, directors, Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.
- (11) (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority.
- (b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.
- (12) (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.
- (b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
- (c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

*Explanation* - For the purposes of this rule, 'video conferencing or other audio visual means' means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

**Summarised procedure of Video conferencing:**

- Roll call by chairperson
- Directors to introduce themselves at each and every time they speak on matters
- Presence will be counted for QUORUM
- No unauthorized access.
- Differently abled Director may have person accompanying them
- Directors to repeat if there is any disturbances
- Chairperson to announce summary at the end of the Meeting
- Minutes of the meeting to contain the names of Directors who participated through Video conference.

### **Matters not to be dealt with in a Meeting through Video Conferencing or other Audio Visual Means**

Rule 4 prescribe restriction on the following matters, which shall not be dealt with in any meeting held through video conferencing or other audio visual means:

- (i) the approval of the annual financial statements;
- (ii) the approval of the Board's report;
- (iii) the approval of the prospectus;
- (iv) the Audit Committee Meetings for consideration of financial statement including consolidated financial statement, if any, to be approved by the Board under sub-section (1) of Section 134 of the Act; and
- (v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

The above restricted items can not be dealt through video-conference meeting. SS however clarifies that any Director participating through Electronic Mode in respect of restricted items with the express permission of Chairman shall however, neither be entitled to vote nor be counted for the purpose of Quorum in respect of such restricted items.

### **Penalty**

Every officer of the company who is duty bound to give notice under this section if fails to do so shall be liable to a penalty of twenty five thousand rupees.

### **Compliance with Secretarial Standards relating to Board Meetings**

For the first time in the history of Company Law in India, the Companies Act, 2013 has given statutory recognition to the Secretarial Standards issued by the Institute of Company Secretaries of India.

Section 118(10) of the Act reads as under:

Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In the context of this provision, observance of Secretarial Standards issued by the Institute of Company Secretaries of India on 23<sup>rd</sup> April, 2015 assumes special relevance and companies will have to ensure that there is compliance with these standards on their part. The ICSI has already issued the Secretarial Standard related to Board and General Meeting, which are effective from 1<sup>st</sup> July, 2015

### **Quorum for Board Meetings : Section 174**

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted - **Section 174(1)**

If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company. It shall not act for any other purpose.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the

Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

It can thus be observed that the provisions of the Companies Act, 2013, relating to board meetings have been made more realistic and in line with the current expectations of the corporate sector.

Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

#### **After exemption notification dated 05.06.2015, In case of Section 8 Company**

In sub-section (1) of Section 174,

(a) for the words "one-third of its total strength or two directors, whichever is higher", the words "either eight members or twenty five per cent. of its total strength whichever is less" has been substituted;

(b) the following proviso has been inserted, namely:-

"Provided that the quorum shall not be less than two members"

**Note:** In case of Section 8 companies the quorum for the board meetings shall be either eight members or twenty five per cent of its total strength whichever is less. However, the quorum shall not be less than two members.

#### **Passing of Resolution by Circulation: Section 175**

A company may pass the resolutions through circulation. The resolution in draft form together with the necessary papers may be circulated to all the directors or members of committee at their address registered with the company in India by hand or by speed post or through electronic means which may include e-mail or fax.

The said resolution must be passed by majority of directors or members entitled to vote.

If more than one third of directors require that the resolution must be decided at the meeting, the chairperson shall put the resolution to be decided at the meeting.

The resolution passed through circulation be noted at a subsequent meeting and made part of the minutes of such meeting.

#### **Defects in Appointment of Directors not to Invalidate Actions Taken [Section 176]**

All acts done by directors shall be valid notwithstanding that it is subsequently noticed that his appointment was invalid by reason of any defect or disqualifications or had terminated by virtue of the provisions of Companies Act or the articles of the company.

But this section doesn't give validity to any act done by directors whose appointment has been notices to be invalid or to have terminated.

#### **BOARD COMMITTEES**

A board committee is a small working group identified by the board, consisting of board members, for the

purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field.

Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allow in-depth scrutiny and focused attention.

However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure.

Mandatory Committees of the Board are prescribed under Companies Act, 2013 (for certain class of companies) and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for listed companies.

Mandatory Committees under the Companies Act 2013 are:

- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- Corporate Social Responsibility Committee

## **AUDIT COMMITTEE**

Audit Committee is one of the main pillars of the corporate governance mechanism in any company. The Committee is charged with the principal oversight of financial reporting and disclosure and aims to enhance the confidence in the integrity of the company's financial reporting, the internal control processes and procedures and the risk management systems.

The constitution of Audit Committee is mandated under the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Under the Companies Act, 2013, the Audit Committee's mandate is significantly different from what was laid down under Section 292A of the Companies Act 1956, and its scope and constitution have also been broadened.

## **Constitution of Audit Committee**

Section 177(1) of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014, provides that the Board of directors of following companies are required to constitute a Audit Committee of the Board-

- (i) All listed companies
- (ii) All public companies with a paid up capital of 10 crore rupees or more;
- (iii) All public companies having turnover of 100 crore rupees or more;
- (iv) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 crore rupees or more.

The paid up share capital or turnover or outstanding loans or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

**Composition of the Audit Committee Section [177(2)]**

- Audit Committee shall consist of a minimum of three directors.
- Independent directors should form a majority. (Not applicable for Section 8 companies *vide* notification no. GSR 466(E), dated 5-6-2015)
- Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statements.

**Note:** “Financially literate” shall mean the ability to read and understand basic financial statements i.e., balance sheet, profit and loss account, and statement of cash flows. A member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities.

**Functions/Role of the Audit Committee [Section 177(4)]**

Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board. Terms of reference as prescribed by the board shall *inter alia*, include, –

- (a) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

*In case of Government Companies, in Clause (1) of sub-section (4) of section 177, for the words “recommendation for appointment, remuneration and terms of appointment” the words “recommendation for remuneration” shall be substituted - Notification No. GSR 463(E) dated 05-06-2015*

- (b) review and monitor the auditor’s independence and performance, and effectiveness of audit process;
- (c) examination of the financial statements and the auditors’ report thereon;
- (d) approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014;

- (e) scrutiny of inter-corporate loans and investments;
- (f) valuation of undertakings or assets of the company, wherever it is necessary;
- (g) evaluation of internal financial controls and risk management systems;
- (h) monitoring the end use of funds raised through public offers and related matters.

**Powers of the Audit Committee [Section 177(5) and (6)]**

- The Audit Committee has the power to call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statements before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
- The Audit Committee has authority to investigate into any matter in relation to the items specified in terms of reference or referred to it by the Board and for this purpose the Committee has power

to obtain professional advice from external sources. The Committee for this purpose shall have full access to information contained in the records of the company.

- The auditors of a company and the key managerial personnel have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

### **Disclosure in Board's Report**

Section 177(8) of the Act provides that the board's report shall disclose the following –

- Composition of an Audit Committee
- Where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in the report along with the reasons therefor.

### **Number of Meetings and Quorum:**

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides for the minimum number of meetings and quorum of the audit committee.

- (i) The Audit Committee of a listed entity shall meet at least four (4) times in a year and not more than 120 days shall elapse between two meetings. [Regulation 18(2)(a)]
- (ii) The quorum for audit committee meeting shall either be
  - 2 members, or
  - 1/3rd of the members of the audit committee, whichever is greater;
  - with at least 2 independent directors. [Regulation 18(2)(b)]

The requirement of minimum 2 independent directors in the meeting of Audit Committee is new provision which must be complied by all the listed entities.

### **Audit Committee and Vigil Mechanism [Section 177(9) to (14)]**

1. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflicted of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.
2. In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.
3. This vigil mechanism shall provide for adequate safeguards against victimization of employees and directors who avail of the vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases.
4. In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.
5. The Vigil Mechanism shall operate for directors and employees to enable them to bring to report genuine concerns. Further the said mechanism shall provide safeguards against victimization and



provide for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

6. The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any and in the Board's report.

**As per the Companies Act 2013, in case a Company wants to constitute an Audit Committee with 4 Members. How many Independent Directors will be required in such Committee.**

### Two

### Three

**Correct Answer : Three**

**Additional role of the Audit Committee under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**

**A. The role of the audit committee shall include the following:**

- (1) oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
- (2) recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;
- (3) approval of payment to statutory auditors for any other services rendered by the statutory auditors;
- (4) reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
  - (a) matters required to be included in the director's responsibility statement to be included in the board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
  - (b) changes, if any, in accounting policies and practices and reasons for the same;
  - (c) major accounting entries involving estimates based on the exercise of judgment by management;
  - (d) significant adjustments made in the financial statements arising out of audit findings;
  - (e) compliance with listing and other legal requirements relating to financial statements;
  - (f) disclosure of any related party transactions;
  - (g) modified opinion(s) in the draft audit report;
- (5) reviewing, with the management, the quarterly financial statements before submission to the board for approval;
- (6) reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;
- (7) reviewing and monitoring the auditor's independence and performance, and effectiveness of audit

process;

- (8) approval or any subsequent modification of transactions of the listed entity with related parties;
- (9) scrutiny of inter-corporate loans and investments;
- (10) valuation of undertakings or assets of the listed entity, wherever it is necessary;
- (11) evaluation of internal financial controls and risk management systems;
- (12) reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
- (13) reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
- (14) discussion with internal auditors of any significant findings and follow up there on;
- (15) reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;
- (16) discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
- (17) to look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
- (18) to review the functioning of the whistle blower mechanism;
- (19) approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;
- (20) Carrying out any other function as is mentioned in the terms of reference of the audit committee.

**B. The audit committee shall mandatorily review the following information:**

- (1) management discussion and analysis of financial condition and results of operations;
- (2) statement of significant related party transactions (as defined by the audit committee), submitted by management;
- (3) management letters / letters of internal control weaknesses issued by the statutory auditors;
- (4) internal audit reports relating to internal control weaknesses; and
- (5) the appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.
- (6) statement of deviations:
  - (a) quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1).
  - (b) annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice in terms of Regulation 32(7).

## **SECTION 178: Nomination and Remuneration Committee and Stakeholders Relationship Committee**

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management's and personnel's remuneration and incentive schemes. The responsibilities of the Nomination and Remuneration Committee are defined in its policy document.

Except for certain large listed companies, the importance of constitution of the Nomination and Remuneration Committee has not been realised fully in India.

The Board of directors of following companies shall constitute Nomination and Remuneration Committee of the Board:

- (a) Every listed Companies; or
- (b) The following class of companies –
  - (i) all public companies with a paid up capital of ten crore rupees or more;
  - (ii) all public companies having turnover of one hundred crore rupees or more;
  - (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

***After exemption notification dated 05.06.2015 the provisions of Section 178 of the Act are not applicable to the Section 8 Companies.***

The committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors.

The chairperson of the company may be appointed as member, but shall not chair such committee.

As per section 178(2) of the Act, The Committee shall identify the person qualified to become directors and may be appointed in senior management and recommend their appointment and removal and also carry out evaluation of every director.

As per section 178(3) of the Act, The Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a director and recommend to the Board the policy relating to remuneration for directors, KMPs and other employees.

As per section 178(4) of the Act, while formulating its policy, the Nomination and Remuneration Committee shall ensure that

- (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors
- (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks and
- (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

Provided that such policy shall be disclosed in the Board's report.

Be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

***After exemption notification dated 05.06.2015, in case of the Government Company provisions of Section 178(2),(3)and(4) shall apply for the appointment of Senior management and other employees only.***

**As per the Companies Act 2013, in case a Company wants to constitute a Nomination and Remuneration Committee with 4 Members. How many Independent Directors will be required in such Committee.**

### Two

### Three

**Correct Answer : Two**

### **Duties of the Nomination and Remuneration Committee**

The duties of the Nomination and Remuneration Committee have now been specified. They include

- (a) identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down;
- (b) recommend to the Board their appointment and removal;
- (c) carry out evaluation of every Director's performance;
- (d) formulate the criteria for determining qualifications, positive attributes and independence of a Director and
- (e) recommend to the Board a policy, relating to the remuneration for the Directors, KMP and other employees.

### **The Stakeholders Relationship Committee**

Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee.

The Board of a company that has more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.

The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

The chairperson of each of the committees constituted under this section or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

### **Penalty for Contravention of Section 177 and 178**

Section 178(8) provides that the company shall be punishable with fine which shall not be less than one lakh

rupees but which may extend to five lakh rupees for contravention of provisions of Section 177 and 178. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine not less than rupees twenty five thousand but which may extend to one lakh rupees or with both.

However, the non-consideration of resolution of any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

Schedule IV under Section 149(7) of the Act contains the Code for Independent Directors. Under Sl. No. II (5) of the Code, Independent Directors are mandated to safeguard the interest of all stakeholders, especially the Minority Shareholders and balance the conflicting interests of the stakeholders.

**As per the Companies Act 2013, Stakeholders Relationship Committee is to be chaired by -**

### Independent Director

### Non-Executive Director

- Executive Director

**Correct Answer : Non-Executive Director**

The requirement for a Stakeholders Relationship Committee is an interesting one. Relationships with stakeholders can be critical, and balancing the contending interests of different stakeholder groups and building mutually beneficial relationships with stakeholders are hallmarks of the effective board.

Again minimum compliance would be to establish a committee and hope it does not get in the way or prove a distraction. More benefit might be derived from using such a provision as a catalyst to identify and/or reassess the nature, interests and priorities of different stakeholder groups, the current state of relationships with them and how these might be improved.

Direction should be seen as a separate but complementary activity to management, rather than as a route to elevated status and higher earnings. Directors need to look beyond functional considerations and work for the best interests of the company and its stakeholders. Their perspective should be strategic rather than departmental.

Directors must reconcile the concerns of various stakeholder groups, and respect views of colleagues who may have a different perspective. Non-financial considerations need to be taken into account.

### **Risk Management Committee under SEBI (Listing Obligations and Disclosure Requirement) Additional Regulations, 2015**

As per regulations 21 of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015, the board of directors of the top 100 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year shall constitute a Risk Management Committee.

The majority of members of Risk Management Committee shall consist of members of the board of directors.

The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

**ROUND UP:**

	Listed Company	Public Company			Company
		Paid up capital	Turnover	Loans or borrowings	No. of Shareholders or debenture holders
		10 Crore or more	100 crore or more	Exceeding 50 crore	1000 or more
Nomination and Remuneration Committee (3 or more Non-Executive Directors with majority Independent)	Yes	Yes	Yes	Yes	No
Audit Committee (Minimum of 3 directors with majority Independent)	Yes	Yes	Yes	Yes	No
Stakeholders Relationship Committee (Chairman shall be Non-executive Director)	Yes	No	No	No	Yes

**Corporate Social Responsibility Committee**

India has one of the richest traditions of CSR. Much has been done in recent years to make Indian entrepreneurs aware of social responsibility as an important segment of their business activity but CSR in India has yet to receive widespread recognition. If this goal has to be realised then the CSR approach of corporates has to be in line with their attitudes towards mainstream business- companies setting clear objectives, undertaking potential investments, measuring and reporting performance publicly.

One of the key changes in the Companies Act, 2013 is the introduction of a Corporate Social Responsibility section making India the first country to mandate CSR through a statutory provision. While CSR is not mandatory for companies, the rules are in line with the 'Comply or Explain' principle with penalties applicable only if an explanation is not offered. The provisions of the Section 135 of the Act may be summarized as under:

1. The Section applies to the following classes of companies during any financial year:
  - (i) Companies having Net Worth of rupees five hundred crore or more;
  - (ii) Companies having turnover of rupees one thousand crore or more;
  - (iii) Companies having Net Profit of rupees five crore or more
2. The companies specified above shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board.

A Company which ceases to be a company covered under the above three threshold requirement to constitute CSR Committee for three consecutive financial years shall not be required to constitute CSR Committee till such time it meets the threshold as specified above. [Rule 3(2)]

3. The CSR Committee shall consist of three or more Directors, out of which at least one Director shall be an Independent Director.
4. After taking into account the recommendations of the CSR Committee, the Board shall approve the CSR Policy for the company.
5. The contents of the Policy shall be disclosed in the Board's report.
6. It shall also be placed on the Company's website, if any, in a manner to be prescribed by the Central Government.
7. The Board shall ensure that the activities as are included in the CSR Policy (from the activities as specified in Schedule VII) are undertaken by the Company.

The following additional features of the Section are relevant:

1. While spending the amount earmarked for CSR activities, the company shall give preference to the local area and areas around it where it operates;
2. If the Company fails to spend the amount, the Board shall specify the reasons for not spending the amount in the Board's Report.
3. The eligible companies are required to spend in every financial year, at least two per cent of the Average Net Profits of the Company made during the three immediately preceding financial years in pursuance of its CSR Policy. For this purpose, "Average Net Profit" shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

### Other Board Committees

In addition to the Committees of the Board mandated by the Companies Act, 2013 viz, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company.

A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

1. Corporate Governance Committee
2. Science, Technology & Sustainability Committee
3. Regulatory, Compliance & Government Affairs Committee

### Power of Board [Section 179]

Section 179 of the Act deals with the powers of the board; all powers to do such acts and things for which the company is authorised is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting.

The following [Section 179(3) read with Rule 8 of Companies (Management & Administration) Rules, 2014] powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

- (1) to make calls on shareholders in respect of money unpaid on their shares;
- (2) to authorise buy-back of securities under section 68;
- (3) to issue securities, including debentures, whether in or outside India;
- (4) to borrow monies;
- (5) to invest the funds of the company;
- (6) to grant loans or give guarantee or provide security in respect of loans;

- (7) to approve financial statement and the Board's report;
- (8) to diversify the business of the company;
- (9) to approve amalgamation, merger or reconstruction;
- (10) to take over a company or acquire a controlling or substantial stake in another company;
- (11) to make political contributions;
- (12) to appoint or remove key managerial personnel (KMP);
- (13) to appoint internal auditors and secretarial auditor;

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.

The banking company is not covered under the purview of this section. The company may impose restriction and conditions on the powers of the Board.

After exemption notification dated 05.06.2015, in case of Section 8 Companies Matters referred to in clauses (d), (e) and (f) of sub-section (3) of Section 179 of the Act may be decided by the Board by circulation instead of at a Meeting.

*Note: in case of Section 8 companies resolutions related to borrow monies, to invest funds of the company and to grant loans or give guarantee or provide security in respect of loans by section 8 companies may be decided by the Board by circulation.*

### **SECTION 180 : Restriction on Powers of Board**

The board can exercise the following powers only with the consent of the company by special resolution, namely –

- (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.
- (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
- (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business;
- (d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital and free reserves specify the total amount up to which the money may be borrowed by Board.

The title of buyer or the person who takes on lease any property, investment or undertaking on good faith cannot be affected and also in case if such sale or lease covered in the ordinary business of such company.

The resolution may also stipulate the conditions of such sale and lease, but this doesn't authorise the company to reduce its capital except the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital and free reserves is not valid and effectual, unless the lender proves that the loan was advanced on good faith and also having no knowledge of limit imposed had been exceeded.



***After exemption notification dated 05.06.2015, in case of Private Companies provisions of Section 180 shall not apply.***

### **Section 181 : Contributions to Charitable Funds and Political Parties**

The power of making contribution to 'bona fide' charitable and other funds is available to the board subject to certain limits.

Further, the permission of company in general meeting is required if such contribution exceeds five percent of its average net profits for the three immediately preceding previous years.

### **Section 182 : Prohibitions and Restrictions Regarding Political Contributions**

According to Section 182 of the Act, a company, other than a government company which has been in existence for less than three financial years, may contribute any amount directly to any political party.

Further, the limit of contribution to political parties is 7.5% of the average net profits during the three immediately preceding financial years.

The contribution must be authorised by board in its meeting by resolution and such resolution deemed to be the justification in law for such contribution.

The donation may be directly or indirectly. The contribution so made if or likely to affect the public support for a political party deemed to be the contribution for political purpose.

If the expenditure incurred on advertisement in any publication souvenir, brochure, tract, pamphlet or the like is deemed as political contribution if such publication is by or on behalf of political party or if not, then for the advantage to such political party for a political purpose.

The company is required to disclose in its profit and loss account any amount or amounts contributed by it to any political party during the financial year and the particular of total amount contributed and the name of political party to whom the contribution so made.

### **Penalty for Contravention**

The contribution in contravention of the provisions of section 182, the company shall be punishable for an amount of which may extend to five times of the amount so contributed and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times of the amount so contributed.

### **Section 183: Power of Board and other Persons to make Contributions to National Defence Fund, etc.**

The Board is authorised to contribute such amount as it thinks fit to the National Defence Fund or any other fund approved by the Government for the purpose of national defence.

The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year.

### **Section 184 : Disclosure of Interest by Director**

The Act provides for the disclosure by directors relating his concern or interest in any company or companies or body corporate (including shareholding interest), firms or other association of individuals by giving a notice in writing in form MBP 1 (Rule 9(1)) at the first meeting of board after being appointed as director and at first meeting of board of every financial year, in addition to this, any change required to be disclosed in next board meeting.

As per section 184 (2) of the Act, every director is required to disclose the nature of his concern or interest at the meeting of board in which the contract or arrangement is discussed and he has not to participate in such meeting.

The abovementioned interest may be direct or indirect and relating to some contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director or such director in association with other director holds more than two percent shareholding or is a promoter, manager, Chief Executive Officer of that body corporate or with a firm or other entity in which such director is a partner, owner or member as the case maybe.

It shall be the duty of the director giving notice of interest to cause it to be disclosed at the meeting held immediately after the date of the notice. (Rule 9(2))

If a director is not concerned or interested at the time of contract but subsequently becomes concerned or interested is required to disclose his interest or concern at the meeting of the board held immediately after arose of such interest or concern.

In case of private companies the interested directors may participate in the Board Meetings after disclosure of interest. [Vide exemption notification dated 5th June, 2015.]

#### **After exemption notification dated 05.06.2015, In case of section 8 companies:**

Provisions of Section 184 (2) shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

All notices shall be kept at the registered office and such notices shall be preserved for a period of eight years from the end of the financial year to which it relates and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 9(3))

If a contract or arrangement entered into by the company without disclosure of interest by director or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

The contravention of the provisions leads to punishment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees or both.

Any contract or arrangement entered into or to be entered into between two companies, where any director of any company holds more than two percent of the paid up capital in other company, the provisions of this section shall not apply.

The details of Section 185 to 187 are dealt in Chapter 19 in detail.

### **RELATED PARTY TRANSACTIONS**

**Meaning of related party:** Regulation 2(1)(zb) of SEBI (Listing Obligations And Disclosure Requirements) Regulations, 2015 defines that “related party” means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards.

According to Section 2(76) of Companies Act 2013, “**related party**”, with reference to a company, means—

- (i) a director or his relative;
- (ii) a key managerial personnel or his relative;

- (iii) a firm, in which a director, manager or his relative is a partner;
- (iv) a private company in which a director or manager or his relative is a member or director;
- (v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent (2%) of its paid-up share capital;
- (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

- (viii) any company which is—

- a holding, subsidiary or an associate company of such company; or
- a subsidiary of a holding company to which it is also a subsidiary;

According to Notification no. GSR 464(E), dated 05/06/2015 in case of Private Companies this sub-clause shall not apply with respect to section 188.

- (ix) such other person as may be prescribed;

**Related Party:** Companies (Specification of definitions details) Amendment Rules, 2014 provides for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

### Definition of Relative

Similarly, according to Regulation 2(1) (zd) of SEBI (Listing Obligations And Disclosure Requirements) Regulations, 2015 “relative” means relative as defined under Section 2(77) of the Companies Act, 2013 and rules prescribed there under.

Provided this definition shall not be applicable for the units issued by mutual fund which are listed on recognised stock exchange(s).

### List of relatives in terms of Section 2(77)

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely-

- Father:  
Provided that the term “Father” includes step-father.
- Mother:  
Provided that the term “Mother” includes the step-mother.
- Son:  
Provided that the term “Son” includes the step-son.
- Son’s wife
- Daughter
- Daughter’s husband

➤ Brother:

Provided that the term "Brother" includes the step-brother;

➤ Sister

Provided that the term "Sister" includes the step-sister.

### **Definition of Related Party Transaction**

According to SEBI (Listing Obligations And Disclosure Requirements) Regulations, 2015 Regulation 2(1) (zc) defines that "related party transaction" means a transfer of resources, services or obligations between a listed entity and a related party, regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract.

Provided that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s).

### **Nature of Related Party Transactions**

The scope of dealing with Related Party Transactions has been widened in Companies Act, 2013. Section 188 (1) of the Act provides that except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as prescribed under Rule 15 of the Companies (Meetings of board and its Powers) Rules, 2014, no company shall enter into any contract or arrangement with a related party with respect to—

- (i) sale, purchase or supply of any goods or materials;
- (ii) selling or otherwise disposing of, or buying, property of any kind;
- (iii) leasing of property of any kind;
- (iv) availing or rendering of any services;
- (v) appointment of any agent for purchase or sale of goods, materials, services or property;
- (vi) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (vii) underwriting the subscription of any securities or derivatives thereof, of the company:

### **Conditions to be fulfilled before entering into Related Party Transactions**

Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that a company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:-

- (1) The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-
  - (a) the name of the related party and nature of relationship;
  - (b) the nature, duration of the contract and particulars of the contract or arrangement;
  - (c) the material terms of the contract or arrangement including the value, if any;
  - (d) any advance paid or received for the contract or arrangement, if any;
  - (e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
  - (f) whether all factors relevant to the contract have been considered, if not, the details of factors

not considered with the rationale for not considering those factors; and

- (g) any other information relevant or important for the Board to take a decision on the proposed transaction.
- (2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

### **PRIOR APPROVAL OF THE COMPANY BY A RESOLUTION**

*First Proviso to the Section 188 (1) of the Act* provides that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as prescribed, shall be entered into except with the prior approval of the company by a resolution.

Rule 15 of the Companies (Meetings of board and its Powers) Rules, 2014 provides that except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into,-

- (a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below-
  - (i) sale, purchase or supply of any goods or materials, directly or through appointment of agent, amounting to ten percent or more of the turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;
  - (ii) selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, amounting to ten percent or more of net worth of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;
  - (iii) leasing of property of any kind amounting to ten percent or more of the net worth of the company or ten percent or more of the turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188;
  - (iv) availing or rendering of any services, directly or through appointment of agent, amounting to ten percent more of the turnover of the company or rupees fifty crore, whichever is lower as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188:
 

The limits specified in sub-clause (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
- (b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and a half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188.
- (c) is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one percent of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statements of the preceding financial year.

**Exceptions:** The requirement of passing the resolution under first proviso shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are

consolidated with such holding company and placed before the shareholders at the general meeting for approval.

In case of wholly owned subsidiary, if the resolution is passed by the holding company, it shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

In case of Government companies above mentioned *First Proviso to Section 188 (1) of the Act* shall not apply to -

- (a) a Government company in respect of contracts or arrangements entered into by it with any other Government company;
- (b) a Government company other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be the State Government before entering into such contract or arrangement.  
*[Notification No. GSR 463(E) dated 5-6-2015]*

**Information to be provided:** The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars, namely:-

- (a) name of the related party;
- (b) name of the director or key managerial personnel who is related, if any;
- (c) nature of relationship;
- (d) nature, material terms, monetary value and particulars of the contract or arrangements;
- (e) any other information relevant or important for the members to take a decision on the proposed resolution.

#### **RELATED PARTY NOT TO VOTE ON RESOLUTION**

*Second Proviso to Section 188 (1) of the Act* provides that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.

- **Exemption to Private Companies:** In case of private companies second proviso shall not apply (Notification No. GSR 464(E) dated 5-6-2015).
- **Exemption to Government Companies:** In case of Government companies above mentioned *Second Proviso to the Section 188 (1) of the Act* shall not apply to -
  - (a) a Government company in respect of contracts or arrangements entered into by it with any other Government company;
  - (b) a Government company other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be the State Government before entering into such contract or arrangement. *(Notification No. GSR 463(E) dated 5-6-2015).*

#### **NON APPLICABILITY OF SECTION 188(1)**

Section 188(1) shall not apply to any transactions entered into by the company in its ordinary course of

business other than transactions which are not on an arm's length basis. The expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

### **DISCLOSURE IN BOARD'S REPORT**

Section 188(2) provides that every related party contracts or arrangements shall have to be disclosed in the Board's report and referred to shareholders along with the justification for entering into such type of transactions.

### **CONSEQUENCES OF ENTERING RELATED PARTY CONTRACTS OR ARRANGEMENTS BY THE DIRECTOR OR THE EMPLOYEE WITHOUT THE CONSENT OF THE BOARD OR APPROVAL BY RESOLUTION**

- Section 188(3) provides that where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under sub-section (1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.
- Section 188(4) states that it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

### **PENALTIES FOR NON COMPLIANCE**

Section 188(5) provides that any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall,—

- (i) in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and
- (ii) In case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

### **ROLE OF AUDIT COMMITTEE IN RELATED PARTY TRANSACTIONS**

Section 177(4)(iv) of the Companies Act, 2013 provides that the terms of reference of Audit Committee shall include approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed;

Thus, it is the responsibility of audit committee to approve the transactions of the company with related parties.

As per Rule 6A of Companies (Meeting of Board and its Powers) Second Amendment Rules, 2015, the audit committee may make omnibus approval for all related party transactions proposed to be entered into by the company subject to the following conditions, namely -

- (i) The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following, namely:-
  - (a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;
  - (b) the maximum value per transaction which can be allowed;
  - (c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;
  - (d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;
  - (e) transactions which cannot be subject to the omnibus approval by the Audit Committee.
- (2) The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval, namely: -
  - (a) repetitiveness of the transactions (in past or in future);
  - (b) justification for the need of omnibus approval.
- (3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.
- (4) The omnibus approval shall contain or indicate the following: -
  - (a) name of the related parties;
  - (b) nature and duration of the transaction;
  - (c) maximum amount of transaction that can be entered into;
  - (d) the indicative base price or current contracted price and the formula for variation in the price, if any; and
  - (e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.
- (5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.
- (6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.
- (7) Any other conditions as the Audit Committee may deem fit.

**Provisions under SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015**

Regulation 23 of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 provides following for Related Party Transactions:

- (1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions which shall also placed on the website of the company. A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the



annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

- (2) All related party transactions shall require prior approval of the audit committee.
- (3) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions, namely-
  - (a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;
  - (b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;
  - (c) the omnibus approval shall specify:
    - (i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,
    - (ii) the indicative base price / current contracted price and the formula for variation in the price if any; and
    - (iii) such other conditions as the audit committee may deem fit:
 

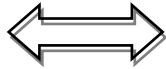
Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.
  - (d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.
  - (e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year:
- (4) All material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.
- (5) The provisions of sub-regulations (2), (3) and (4) shall not be applicable in the following cases:
  - (a) transactions entered into between two government companies;
  - (b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.
- (6) The provisions of this regulation shall be applicable to all prospective transactions.
- (7) For the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.

All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations.

Let us Recapitulate

RELATED PARTY IN RELATION TO COMPANY INCLUDES

OUTSIDERS



INSIDERS

SUBSIDIARIES

FELLOW  
SUBSIDIARIES

DIRECTORS  
OR HIS  
RELATIVES

CEO/ MD

COMPANIES  
UNDER  
COMMON  
CONTROL

ASSOCIATE

CFO

COMPANY  
SECRETARY

INVESTING  
PARTIES

JOINT  
VENTURES

WHOLE TIME  
DIRECTOR

## RELATED PARTY TRANSACTIONS



Sale, purchase or supply of any goods or materials directly or through appointment of agents ten percent. of the turnover of the Company or Rs. 100 crore, whichever is lower

Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding ten percent. of net worth of the Company or Rs. 100 crore, whichever is lower

Leasing of property of any kind exceeding ten percent of the net worth of the Company or ten per cent of turnover of the Company or Rs, 100 crore, whichever is lower

Availing or rendering of any services directly or through appointment of agents exceeding ten percent. of the turnover of the Company or Rs. 50 crore, whichever is lower

Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding 2,50,000 rupees

Remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth

### **Section 189: Register of Contracts or Arrangements in which Directors are interested**

Every company is required to keep one or more registers in Form MBP 4 giving separately the particulars of all contracts or arrangements and shall enter therein the particulars of (Rule 16(1))-

- (a) company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest as mentioned in sub-section (1) of section 184. But the particulars of the company or companies or bodies corporate in which a director himself together with any other director holds two percent or less of the paid-up share capital would not be required to be entered in the register.
- (b) contracts or arrangements with a body corporate or firm or other entity as mentioned under sub-section (2) of section 184, in which any director is, directly or indirectly, concerned or interested; and
- (c) contracts or arrangements with a related party with respect to transactions to which section 188 applies;

The entries in the register shall be made at once, whenever there is a cause to make entry, in chronological order and shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose. (Rule 16(2))

Such register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 16(3))

Such register or registers are required to be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Every director within thirty days of his appointment or relinquishment is required to disclose his concern or interest in other associations, which are required to be included in the register.

The register be kept at the registered office of the company and also open for inspection during business hours. The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding ten rupees per page. (Rule 16(4))

The register shall also be produced at the commencement of every annual general meeting of the company and shall remain open and accessible during continuance of the meeting to any person having the right to attend the meeting. [Section 189(4)]

### **Exceptions**

The provisions of section 189 of the act shall not apply to any contract or arrangement--

- (a) for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed five lakh rupees in the aggregate in any year; or
- (b) by a banking company for the collection of bills in the ordinary course of its business.

After exemption notification dated 05.06.2015, in case of section 8 Companies provisions of Section 189 shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

**Penalty**

Every director who fails to comply is liable to a penalty of twenty- five thousand rupees.

**Section 190: Contract of Employment with Managing Director or Whole-time Directors**

Every company which is not a private company is required to keep the copy of contract if in writing with a managing director or whole-time director for contract of service or a written memorandum setting its terms if not in writing.

The abovementioned copies required to be kept open to inspection for any member of the company free of cost.

**Penalty**

The default in complying with the provisions of this section, the company is liable to a penalty of twenty five thousand rupees and every officer of the company who is in default liable to a penalty of five thousand rupees for each default.

**Section 191: Payment to Director for Loss of Office, etc., in Connection with Transfer of Undertaking, Property or Shares**

No director of a company shall receive any payment by way of compensation in case of transfer of the whole or any part of any under taking or property of the company or the transfer to any person of all or any of the shares in a company; the following particulars mentioned in Rules 17 are required to be disclosed to the members of the company and they pass a resolution at a general meeting approving the payment of such amount:-

- (a) name of the director
- (b) amount proposed to be paid;
- (c) event due to which compensation become payable;
- (d) date of Board meeting recommending such payment;
- (e) basis for the amount determined;
- (f) reason/justification for the payment;
- (g) manner of payment - whether payable in cash or otherwise and how;
- (h) sources of payment; and
- (i) any other relevant particulars as the Board may think fit.

Any payment made by the company to a managing director or whole-time director or manager of the company by way of compensation for loss of office or as a consideration for retirement from office or in connection with such loss or retirement subject to the limit as set out under section 202. (Rule 17(2))

No payment shall be made to the managing director or whole time director or manager of the company by way of compensation for the loss of office or as consideration for retirement from office (Rule 17(3)) (other than notice pay and statutory payments in accordance with the terms of appointment of such director or manager, as applicable) or in connection with such loss or retirement if:

- (a) the company is in default in repayment of public deposits or payment of interest thereon;
- (b) the company is in default in redemption of debentures or payment of interest thereon;

- (c) the company is in default in repayment of any liability, secured or unsecured, payable to any bank, public financial institution or any other financial institution;
- (d) the company is in default in payment of any dues towards income tax, VAT, excise duty, service tax or any other tax or duty, by whatever name called, payable to the Central Government or any State Government, statutory authority or local authority (other than in cases where the company has disputed the liability to pay such dues);
- (e) there are outstanding statutory dues to the employees or workmen of the company which have not been paid by the company (other than in cases where the company has disputed the liability to pay such dues); and
- (f) the company has not paid dividend on preference shares or not redeemed preference shares on due date.

If the payment is not approved for want of quorum either in a meeting or an adjourned meeting, the proposal shall not be deemed to have been approved.

If a director of a company receives payment of any amount in contravention of sub-section (1) or the proposed payment is made before it is approved in the meeting, the amount so received by the director shall be deemed to have been received by him in trust for the company.

#### **Penalty upon Contravention**

The director who contravenes shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

#### **Section 192: Restriction on Non- Cash Transactions Involving Directors**

Where a Company enters into an agreement by which-

- (a) a director of the company or its holding, subsidiary or associate company or a person connected with him acquires or is to acquire assets for consideration other than cash, from the company; or
- (b) the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

The company then need the prior approval for such arrangement accorded by a resolution of the company in general meeting and if the director or connected person is a director of its holding company, approval shall also be required to be obtained by passing a resolution in general meeting of the holding company.

The notice for approval of the resolution by the company or holding company in general meeting shall include the particulars of the arrangement along with the value of the assets involved in such arrangement duly calculated by a registered valuer.

Any arrangement entered into by a company or its holding company in contravention of the provisions of this section shall be voidable at the instance of the company.

The arrangement will be valid if the restitution of any money or other consideration which is the subject matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or any rights are acquired bona fide for value and without notice of the contravention of the provisions of this section by any other person.

#### **Section 193: Contract by One Person Company**

Where One Person Company limited by shares or by guarantee enters into a contract except in its ordinary course of business with the sole member of the company who is also the director of the company, the company shall ensure that the contract is in writing.

If the contract is not in writing, it ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract.

The company is required to inform the Registrar about every contract entered into by the company and recorded in the minutes of the meeting of its Board within a period of fifteen days of the date of approval by the Board.

### **Section 194: Prohibition on Forward Dealings in Securities of Company by Director or Key Managerial Personnel**

Directors and key managerial personnel are prohibited from buying in the company, or in its holding, subsidiary or associate company –

- (a) a right to call for delivery or a right to make delivery at a specified price and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures; or
- (b) a right, as he may elect, to call for delivery or to make delivery at a specified price and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures.

### **Contravention and Penalty**

In case of contravention to this section Such director or key managerial personnel shall be punishable with imprisonment for a term which may extend to two years or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

Such director or key managerial personnel is liable to surrender the same to the company and the company shall not register the securities so acquired in his name in the register, and if they are in dematerialised form, it shall inform the depository not to record such acquisition and such securities, in both the cases, shall continue to remain in the names of the transferors.

### **SECTION 195: Prohibition on Insider Trading of Securities**

Insider trading of securities by director or key managerial personnel, including any trading is totally prohibited in the Act. Any communication required in the ordinary course of business or profession or employment or under any law is not amounting to insider trading.

### **Meaning of Insider Trading**

An act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

An act of counseling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

### **Contravention and Penalty**

If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

## LESSON ROUND-UP

- Director can participate in the Board meeting through video conferencing or other audio visual mode as may be prescribed
- Notice of not less than seven days in writing is required to call a board meeting and notice of meeting to all directors shall be given, whether he is in India or outside India by hand delivery or by post or by electronic means.
- The participation of director at Board meeting through video conferencing or by other electronic means shall be counted for the purpose of Quorum
- Every Listed Company and such other company as may be prescribed shall form Audit Committee comprised of minimum 3 directors with majority of the Independent Directors and majority of members of committee shall be person with ability to read and understand financial statement
- Vigil mechanism to be established in the prescribed manner by every listed company or such class or classes of companies, as may be prescribed.
- Every listed company and prescribed class or classes of companies, shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors
- Inter corporate investments not to be made through more than 2 layers of investment companies.
- Forward dealing in securities of company by director and key managerial personnel is prohibited.
- Insider trading of the securities in the company is prohibited.

## SELF-TEST QUESTIONS

1. Which Companies are required to Constitute Audit Committee, Nomination Remuneration Committee and Stakeholder Relationship Committee?
2. Explain the provisions relating to constitution of Corporate Social Responsibility Committee?
3. Explain the provisions relating to passing of resolution by circulation?
4. Analyse the powers of the Board and the restrictions on Board Powers under the Act?
5. Explain the term insider trading? Explain the provisions on Insider trading of Securities under the Act?
6. Explain the provisions relating to maintenance of Register of Contracts and Arrangements and the exceptions thereunder?

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# Lesson 17

## Appointment and Remuneration of Key Managerial Personnel

### LESSON OUTLINE

- Key managerial personnel (KMP) - introduction
- Compulsory Appointment of KMP
- Appointment of KMP by Board
- Vacancy of KMP office
- Penal provisions
- Period of appointment of KMP
- Disqualification of appointment
- Conditions for appointment
- Company secretary defined as KMP
- Powers & duties of CS
- Role of company secretary
- Functions of a company secretary

### LEARNING OBJECTIVES

The Companies Act 2013 has introduced a new concept for appointment of the Key Managerial Personnel at top level of the organizational structure. In the new Act the position of company secretary has been enhanced manifold, from record keeper to key managerial personnel. A present day company secretary is expected to do statutory, administrative, managerial and strategic functions.

After reading this lesson, you will be able to understand the legal and procedural aspects as regards appointment, conditions for appointment, how to fill the vacancies in office of KMP, CS as a Key Managerial personnel, powers and duties of KMP, Penal Provisions for the Contravention of provisions applicable, etc. from the Act.

## INTRODUCTION

The executive management of a company is responsible for the day to day management of a company. The Companies Act, 2013, has used the term key management personnel to define the executive management. The key management personnel are the point of first contact between the company and its stakeholders. While the Board of Directors are responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation.

Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of Key Managerial Personnel including Managing Director, Whole-time Director or Manager, managerial remuneration, secretarial audit etc.

Let us understand certain definitions.

### Key Managerial Personnel

The Companies Act, 2013 has for the first time recognized the concept of Key Managerial Personnel. As per section 2(51) “key managerial personnel”, in relation to a company, means—

- (i) the Chief Executive Officer or the managing director or the manager;
- (ii) the company secretary;
- (iii) the whole-time director;
- (iv) the Chief Financial Officer; and
- (v) such other officer as may be prescribed.

### Managing Director

Section 2(54) of the Companies Act, 2013, defines ‘managing director’. It stipulates that a “managing director” means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

### Whole Time Director

Section 2(94) of the Companies Act, 2013 defines “whole-time director” as a director in the whole-time employment of the company.

### Manager

Section 2(53) of the Companies Act, 2013 defines “manager” as an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

**Chief Executive Officer**

Section 2(18) of the Companies Act, 2013 means an officer of a company, who has been designated as such by it.

**Chief Financial Officer**

Section 2(19) of the Companies Act, 2013 defined “Chief Financial Officer” means a person appointed as the Chief Financial officer of a company.

**Company Secretary**

Section 2(24) of the Companies Act, 2013 defines “company secretary” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act.

**Appointment of Managing Director, Whole-Time Director or Manager**

Section 196 of the Companies Act, 2013 provides that no company shall appoint or employ at the same time a Managing Director and a Manager. Further, a company shall not appoint or reappoint any person as its Managing Director, Whole Time Director or manager for a term exceeding five years at a time and no reappointment shall be made earlier than one year before the expiry of his term.

No company shall appoint or employ at the same time a Managing Director and a Manager.

Section 196(4) of the Companies Act, 2013 provides that subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in Schedule V. Approval of the Central Government is not necessary if the appointment is made in accordance with the conditions specified in Schedule V to the Act.

The appointment of a managing director or whole-time director or manager and the terms and conditions of such appointment and remuneration payable thereon must be first approved by the Board of directors at a meeting and then by an ordinary resolution passed at a general meeting of the company.

**Exemption to private company for section 196(4) & (5) vide notification dated 05.06.2015**

*Section 196(4) and Section 196(5) is not applicable to Private Company*

**Note:** Exemption is given to the private companies for Section 196(4) which deals with appointment of Managing/Whole time director /manager /approval of Central Government as the case may be and Section 196(5) deals with validating actions of Managing/Whole time Director/manager, if the appointment is not approved by a company in general meeting.

**Exemption to Government company for section 196 (2), (4) & (5) vide notification dated 05.06.2015****Section 196 (2), (4) & (5) shall not apply to Government Company**

**Note:** Section 196(2) relates to term of managing director not to exceed five years. Section 196(4) relates to approval of the members/central government as the case may be for appointment of managing director and section 196(5) relates to validity of actions of Managing Director if his appointment is not approved at the General Meeting. These provisions are not applicable to a government company.

**Approval by Central Government is required in which of the following cases for appointment of managing director, whole-time director or manager**

- (a) If appointment is made in accordance with Schedule V
- (b) If appointment is made in accordance with Section 196 but at variance with conditions of schedule V

**Correct answer: b**

*Notice convening Board and General Meeting to contain particulars of appointment*

A notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

**Rule 3 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014**

A company shall file a return of appointment of a Managing Director, Whole Time Director or Manager within sixty days of the appointment, with the Registrar in Form No. MR.1 along with such fee as may be specified for this purpose.

Section 196(5) provides that subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid.

**Appointment not to invalidate act done by managing director/ whole-time director or manager**

**Appointment with the Approval of Central Government**

In case the provisions of Schedule V of the Companies Act, 2013 are not fulfilled by company, an application seeking approval to the appointment of a managing director (Whole-time director or manager) shall be made to the Central Government, in e-Form No. MR.2.

**Issue of General Notice before making Application to Central Government**

As per Section 201, before such application is made, there shall be issued by a company a general notice to the Members atleast once in a newspaper in the principal language of the district in which registered office is situated and atleast once in English in an English newspaper circulating in that district indicating the nature of application proposed to be made to the Central Government.

The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

**Central Government or Company to Fix Remuneration Limit with respect to appointment or remuneration (Section 200)**

In respect of cases where the company has inadequate or no profits, the Central Government or a company may fix the remuneration within the limits specified in the Act. While doing so, the Central Government or the company shall have regard to —

- (a) the financial position of the company;
- (b) the remuneration or commission drawn by the individual concerned in any other capacity;
- (c) the remuneration or commission drawn by him from any other company;
- (d) professional qualifications and experience of the individual concerned;

- (d) such other matters as may be prescribed.

As per Rule 6 for the purpose of item (e) of section 200, the Central Government or the company shall have regard to the following matters while granting approval:

- (1) Financial and operating performance of the company during the three preceding financial years.
- (2) Relationship between remuneration and performance.
- (3) The principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other executive directors on the board and employees or executives of the company.
- (4) Whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.
- (5) The securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

### Disqualifications

Section 196(3) of the Act makes a specific prohibitory provision with regard to the appointment of managing director, whole time director or manager. The section lays down that no company shall appoint or continue the employment of any person as its managing director, whole time director or manager who—

- (a) is below the age of twenty-one years or has attained the age of seventy years:
 

Provided that appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person;
- (b) is an undischarged insolvent or has at anytime been adjudged as an insolvent;
- (c) has at any time suspended payment to his creditors, or makes, or has at any time made, a composition with them; or
- (d) has at any time been, convicted by a court of an offence and sentenced for a period of more than six months.

Apart from this, Part I of Schedule V contains five other conditions which must be satisfied by a person to be eligible for appointment as managing director, whole-time director or manager without the approval of the Central Government. These conditions are as below:

- (a) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the following Acts, namely:-
  - (i) the Indian Stamp Act, 1899,
  - (ii) the Central Excise Act, 1944,
  - (iii) the Industries (Development and Regulation) Act, 1951,
  - (iv) the Prevention of Food Adulteration Act, 1954,
  - (v) the Essential Commodities Act, 1955,
  - (vi) the Companies Act, 2013 (18 of 2013) or any previous company law,
  - (vii) the Securities Contracts (Regulation) Act, 1956,
  - (viii) the Wealth-tax Act, 1957,

- (ix) the Income-tax Act, 1961,
  - (x) the Customs Act, 1962,
  - (xi) the Competition Act, 2002,
  - (xii) the Foreign Exchange Management Act, 1999,
  - (xiii) the Sick Industrial Companies (Special Provisions) Act, 1985,
  - (xiv) the Securities and Exchange Board of India Act, 1992,
  - (xv) the Foreign Trade (Development and Regulation) Act, 1992,
  - (xvi) the Prevention of Money Laundering Act, 2002.
- (b) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

Provided that where the Central Government has given its approval to the appointment of a person convicted or detained under sub-paragraph (a) or sub-paragraph (b), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

- (c) he has completed the age of 21 years and has not attained the age of 70 years.

Provided that where he has attained the age of 70 years; and where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the Central Government shall be necessary for such appointment;

- (d) where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling provided in section V of Part II.
- (e) he is resident in India.

*Explanation* : For the purpose of above, resident in India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India:

- (i) for taking up employment in India, or
- (ii) for carrying on a business or vocation in India.

But this condition shall not be applicable to the companies in Special Economic Zones, as may be notified by Department of Commerce from time to time.

However, a person, being a non-resident in India, shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, along with the visa application form, profile of the company, the principal employer and the terms and conditions of such person's appointment.

### **Reappointment of Managing Director**

Under sections 196 and 203 of the Companies Act, 2013, appointment includes reappointment. Reappointment of a managing director of a company must be taken for consideration before the expiry of his term of office. If the reappointment of the managing director is approved and if it is not in accordance with the conditions specified in Schedule V then the approval of the Central Government must be obtained for such reappointment. Rest of the provisions for reappointment of a managing director are same as in the case of appointment of a managing director.

### CASE LAW

The managing director of a company filed a suit on behalf of the company against the tenants and the trial court granted decree directing the tenants to vacate and deliver possession of the tenanted premises. The court also directed payment of damages and, in default, to pay interest. The tenants filed an application and contended that in the instant case, the managing director, who had filed suit, had no proper authorization from the board of directors. The Court dismissed the application of the tenants and held that the words 'substantial powers of management' specifically excludes certain acts from its purview. Therefore, except the excluded acts, the managing director has power and privilege of conducting the business of the company in accordance with the memorandum and articles of association of the company. The institution of the suit on behalf of the company by the managing director is deemed to be within the meaning of 'substantial powers of management', since such a power is necessary and incidental to manage the day-to day affairs and business of the company. Therefore, by virtue of provisions of section 2(26) [Corresponds to section 2(54) of the Companies Act, 2013], the suit instituted by the managing director is deemed to be within his power and authority. The suit was obviously filed for the benefit of the company. In that view of the matter, the contention that the managing director had no authority to file a suit is untenable and the same is rejected. [*Wasava Tyres v. Printers (Mysore) Ltd.* (2008) 86 SCL 171 (Kar)].

In *G. Subba Rao v. Rasmi Die-Casting Ltd.* [1998] 93 Com. Cases. 797, the Andhra Pradesh High Court held that from the definition of 'managing director' as per Section 2(26) [Corresponds to section 2(54) of the Companies Act, 2013], it is clear that the managing director has to act under the superintendence, control and direction of the Board of directors. Moreover, powers of routine administrative nature like the power to affix the common seal, to draw and endorse any negotiable instrument do not fall within the substantial powers conferred upon the managing director. What is to be seen is whether the managing director making any representation for and on behalf of a company had in fact, 'actual authority' either in terms of the provisions of the constitution of that company or by virtue of the delegation by the Board of directors.

A managing director must hold and continue to hold the office of director. A managing director is first a director and then a managing director with certain additional powers [*Shanta Shamsheer Jung Bahadur v. Kamani Brothers P. Ltd.* (1959) 29 Com Cases 501 (Bom.)]. A managing director is an ordinary director entrusted with special powers. If a company wants to appoint a person as managing director, who is not a director of the company, he has first to be appointed as an additional director in accordance with the provisions of Section 260 [Corresponds to section 161 of the Companies Act, 2013] of the Act.

### Appointment of Key Managerial Personnel

Section 203 of the Companies Act, 2013 read with Rule 8 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid-up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

- (i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
- (ii) company secretary; **and**
- (iii) chief financial officer:

**Rule 8 and 8A of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014***Rule 8. Appointment of Key Managerial Personnel-*

Every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial personnel.

Rule 8A Appointment of Company Secretaries in companies not covered under rule 8. A company other than a company covered under rule 8 which has a paid up share capital of five crore rupees or more shall have a whole-time company secretary.

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, requires such appointment by the Board of Directors only by means of Resolution passed at meeting of the Board.

An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless the articles of such a company provide otherwise; or the company does not carry multiple businesses. However, such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government are exempted from the above.

**MCA vide its notification S.O. 1913(E) dated 25-7-2014 notified that public companies having paid up Share capital of Rs. 100 Cr or more and annual turnover of Rs. 1000 Cr or more which are engaged in multiple businesses and have appointed Chief Executive Officer for each such business can appoint an individual as Chairperson and Managing Director.**

A Whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. However, he can hold such other directorship with the permission of the Board.

A whole-time key managerial personnel holding office in more than one company at the same time, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

**Vide Exemption notification dated 05.06.2015 for Government Company**

A new sub-section 4A has been inserted thereby providing that sub-sections (1), (2), (3) and (4) of section 203 shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole-time director of the Government Company.

**Note:** The Provisions of section 203 relating to appointment of KMP shall not apply to MD/CEO/Manager or



in their absence a whole time director of the Government Company.

### Functions of Company Secretary

According to Section 205 the functions of the company secretary shall include,—

- (a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
- (b) to ensure that the company complies with the applicable secretarial standards;
- (c) to discharge such other duties as may be prescribed.

*Explanation.*—For the purpose of this section, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government.

For the purposes of clause (c) of sub-section (1) of section 205, the Central Government has prescribed that the duties of Company Secretary shall also include-

- (1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
- (2) to facilitate the convening of meetings and attend Board, committee and general meetings, and maintain the minutes of these meetings;
- (3) to obtain approvals from the Board, general meetings, the Government and such other authorities as required under the provisions of the Act;
- (4) to represent before various regulators, Tribunal and other authorities under the Act in connection with discharge of various functions under the Act;
- (5) to assist the Board in the conduct of the affairs of the company;
- (6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
- (7) to discharge such other duties as may be assigned by the Board from time to time;
- (8) such other duties as have been prescribed under the Act and Rules.

Section 205(2) provides that provisions contained in section 204 and section 205 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or whole-time director under this Act, or any other law for the time being in force

### MANAGERIAL REMUNERATION

Just as profits drive business, incentives drive the managers of business. Not surprisingly then, in a fiercely competitive corporate environment, managerial remuneration is an important piece in the management puzzle. While it is important to incentivize the workforce performing the challenging role of managing companies, it is equally important not to go overboard with the perks and the pay. In India, to keep a check on unnecessary profit squandering by companies and, at the same time, to ensure adequate and reasonable compensation to managerial personnel, the law intervenes to do the balancing act.

**OVERALL MAXIMUM MANAGERIAL REMUNERATION**

Section 197 of the Companies Act, 2013, lays down the provisions for overall maximum managerial remuneration and managerial remuneration. The overall managerial remuneration to the Directors including managing director, whole time director and manager is summarized as under:

S. No.	Persons entitled for remuneration	Maximum remuneration in any financial year	If remuneration exceeds maximum remuneration in any financial year as provided under column (b)
	(a)	(b)	(c)
(i)	Directors including managing director, whole time director and manager of public companies	11% of the net profits of the company for that financial year	Company in general meeting with approval of Central Government subject to provisions of Schedule V may pay remuneration in excess of 11% of the net profits of the company.
(ii)	One Managing director/ Whole time director/ manager	5% of the net profits of the company for that year	With the approval of the company in general meeting this limit may be exceeded.
(iii)	More than one Managing director/ Whole time director/ manager	10% of the net profits	With the approval of the company in general meeting this limit may be exceeded.
(iv)	Directors who are neither Managing director nor whole time directors	1% of the net profits of the company if there is a managing director or a whole time director	Approval of the company in general meeting is required.
(v)	Directors who are neither Managing director nor whole time directors	3% of the net profits of the company if there is no managing director or whole time director	Approval of the company in general meeting is required.

After the exemption notification dated 05.06.2015, In case of Nidhi company, Section 197 (1) shall apply with modification which is as under-

Remuneration of a director who is neither managing director nor whole time director or manager for performing special services to the Nidhis specified in the articles of association may be paid by way of monthly payment subject to the approval of the company in general meeting and also to the provisions of section 197:

Provided that no approval of the company in general meeting shall be required where,-

(a) a Nidhi does not have a managing director or a whole-time director or a manager;

(b) the remuneration payable during a financial year to all the directors of the Nidhi does not exceed ten per cent of the net profits of such Nidhi or fifteen lakh rupees, whichever is less; and

(c) a remuneration payable under clause (b) is approved by a special resolution passed in this behalf by the Nidhi.

Second proviso to Section 197(1) limits the remuneration payable to directors who are neither managing directors nor whole-time directors to one percent of the net profits of the company, if there is a managing or whole-time director or manager; three percent of the net profits in any other case. However, Nidhi companies are allowed to pay remuneration to directors who are neither managing directors nor whole-time directors, for performing special services subject to conditions as laid down.

**In case of Government Company**

After the exemption notification dated 05.06.2015 provisions of Section 197 shall not apply to Government Company.

Section 197(1) also states that the net profits shall be computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

**Managerial Remuneration when there are no profits or profits are inadequate [Section 197(3) & (11)]**

- (a) If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay by way of remuneration any sum exclusive of sitting fees to its directors, including any managing or whole-time director or manager except in accordance with the provisions of Schedule V.
- (b) If the company is not able to comply with such provisions of Schedule V in the above case, then previous approval of the Central Government shall be taken.
- (c) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

**Remuneration payable by companies having no profit or inadequate profit without Central Government approval (Schedule V- Part II -Section II)**

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding, the limits under (A) and (B) given below:-

(A):

(1)	(2)
<i>Where the effective capital is</i>	<i>Limit of yearly remuneration payable shall not exceed</i>
(i) Negative or less than ₹5 crore	₹60 Lakhs
(ii) ₹5 crore and above but less than ₹100 crore	₹84 Lakhs
(iii) 100 crore and above but less than ₹500 crore	₹120 Lakhs
(iv) ₹500 crore and above	₹120 lakhs plus 0.01% of the effective capital in excess of ₹500 crore

Provided that the above limits shall be doubled if the resolution passed by the shareholders is a special resolution.

*Explanation.*- It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

**(B)** In case of a managerial person who is functioning in a professional capacity, no approval of Central Government is required, if such managerial person is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures and not having any, direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment and possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates:

Provided that any employee of a company holding shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company;

Provided further that the limits specified under items (A) and (B) of this section shall apply, if-

(i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee;

(ii) the company has not committed any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person and in case of a default, the company obtains prior approval from secured creditors for the proposed remuneration and the fact of such prior approval having been obtained is mentioned in the explanatory statement to the notice convening the general meeting;

(iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per the limits laid down in item (A) or a special resolution has been passed for payment of remuneration as per item (13), at the general meeting of the company for a period not exceeding three years.

(iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:-

*I. General information:*

- (1) Nature of industry
- (2) Date or expected date of commencement of commercial production
- (3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus
- (4) Financial performance based on given indicators
- (5) Foreign investments or collaborations, if any.

*II. Information about the appointee:*

- (1) Background details
- (2) Past remuneration

- (3) Recognition or awards
- (4) Job profile and his suitability
- (5) Remuneration proposed
- (6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)
- (7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

*III. Other information:*

- (1) Reasons of loss or inadequate profits
- (2) Steps taken or proposed to be taken for improvement
- (3) Expected increase in productivity and profits in measurable terms.

*IV. Disclosures*

The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statements:

- (i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
- (ii) details of fixed component and performance linked incentives along with the performance criteria;
- (iii) service contracts, notice period, severance fees; and
- (iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

**Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances: (Schedule V- Part II -Section III)**

In the following circumstances, a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above:—

- (a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.
- (b) where the company—
  - (i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or
  - (ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction for a period of five years from the date of sanction of scheme of revival, or
  - (iii) is a company in relation to which a resolution plan has been approved by the National Company

Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of five years from the date of such approval, it may pay remuneration up to two times the amount permissible under section II."

- (c) where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:—

- (i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;
  - (ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.
  - (iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.
- (d) a company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to ₹ 2,40,00,000 per annum.

#### **Remuneration to Directors in other Capacity [Section 197(4)]**

The remuneration payable to the directors including managing or whole-time director or manager shall be inclusive of the remuneration payable for the services rendered by him in any other capacity except the following:

- (a) the services rendered are of a professional nature; and
- (b) in the opinion of the Nomination and Remuneration Committee (if applicable) or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

#### **Sitting Fees to Directors for Attending the Meetings [Section 197(5)]**

A director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board. Provided that the amount of such fees shall not exceed the amount as may be prescribed.

The Central Government through rules prescribed that the amount of sitting fees payable to a director for attending meetings of the Board or committees thereof may be such as may be decided by the Board of directors or the Remuneration Committee thereof which shall not exceed the sum of rupees 1 lakh per meeting of the Board or committee thereof.

The Board may decide different sitting fee payable to independent and non-independent directors other than whole-time directors.

Rule 4 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 requires that sitting fees of Independent and Women Directors shall not be less than the sitting fees payable to other Directors.

### **Monthly Remuneration to Director or Manager**

#### *Permissible forms of Remuneration*

A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. [Section 197 (6)]

#### *Independent directors are not entitled to stock options*

An independent director shall not be entitled to any stock option and may receive remuneration by way of fees, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. [Section 197 (7)]

#### *Commission or remuneration from holding or subsidiary company*

Any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report. [Section 197 (14)]

### **Remuneration Drawn in Excess of Prescribed Limit**

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company. [Section 197(9)]

The company shall not waive the recovery of any sum refundable to it under sub-section 9 mentioned above, unless permitted by the Central Government. [Section 197 (10)]

### **Insurance Premium not part of Remuneration**

Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration. [Section 197(13)]

### **Disclosure of Remuneration in Board Report**

Section 197(14) read with Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed. (This disclosure is provided in detail under Chapter 23 – Board's Report and Disclosures).

**Calculation of Net Profit for the purpose of Managerial Remuneration (Section 198)**

Section 198 of the Companies Act, 2013 lays down the manner of calculations of net profits of a company any financial year for purposes of Section 197. Sub- Section (2) specifies the sums for which credit shall be given and sub-section (3) specifies the sums for which credit shall not be given while calculating the net profit.

Similarly, sub-section (4)/(5) specifies the sums which shall be deducted/not deducted while calculating the net profit.

**Recovery of Managerial Remuneration in certain cases (Section 199)**

This is a new provision introduced in the new Act. It provides for recovery of remuneration including stock options received by the specified Managerial Personnel, where the benefits given to them are found to be in excess of what is reflected in the restated financial statements.

It states that without prejudice to any liability incurred under the provisions of this Act or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement under this Act and the rules made there under, the company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per restatement of financial statements.

**Compensation for Loss of Office of Managing or Whole- time Director or Manager (Section 202)**

Section 202 provides that a company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

However, No payment shall be made in the following cases:—

- (a) where the director resigns from his office as a result of the reconstruction/amalgamation of the company and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company/of resulting company from the amalgamation;
- (b) where the director resigns from his office otherwise than on the reconstruction/ amalgamation of the company;
- (c) where the office of the director is vacated due to disqualification;
- (d) where the company is being wound up due to the negligence or default of the director;
- (e) where the director has been guilty of fraud or breach of trust or gross negligence or mismanagement of the conduct of the affairs of the company or any subsidiary company or holding company; and
- (f) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

Any payment made to a managing or whole-time director or manager shall not exceed the remuneration which he would have earned if he had been in office for the remainder of his term or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which he ceased to hold office, or where he held the office for a lesser period than three years, during such period. (Sub-section 3)



Provided that no such payment shall be made to the director in the event of the commencement of the winding up of the company, whether before or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

However, Section 202 not prohibit the payment to a managing or whole-time director, or manager, of any remuneration for services rendered by him to the company in any other capacity. (Sub-section 4)

## SECRETARIAL AUDIT

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Considering the increasing importance of Corporate Governance, Section 204 of the Companies Act, 2013 mandates every listed company and such other class of prescribed companies to annex a Secretarial Audit Report, given by a company secretary in practice with its Board's report.

The Central Government through rules has prescribed such other class of companies as under-

- (a) every public company having a paid-up share capital of fifty crore rupees or more; or
- (b) every public company having a turnover of two hundred fifty crore rupees or more.

It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

The Board of Directors, in their report, shall explain in full any qualification or observation or other remarks made in the Secretarial Audit Report.

Secretarial Audit is an independent, objective assurance intended to add value and improve an organisation's operations. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

## LESSON ROUND-UP

- Under Section 2(51) a Key Managerial Personnel is defined as the Chief executive officer or managing director or the manager or, a company secretary or the whole time director and the chief financial officer in relation to a company
- Every listed Company having a paid up share capital of ₹ 10 crore or more is compulsorily required to have a key managerial personnel.
- The whole time key managerial personnel is to be appointed by the Board and shall not hold office in more than one company however he is permitted to hold such other office with the permission of Board of the company.

- Every director or the key managerial personnel who is in default shall be punishable with a fine which may extend to 50,000 rupees and a further fine which may be extended to 1,000 rupees for every day during which the default continues.
- The Company secretary has been covered under the same section of KMP i.e. section 203
- Every company secretary is expected to adhere not only to the letter of the law but also ensure that the spirit of the law is followed.
- A Company Secretary exercises supervisory and checking role so as to prevent any chance of negligence in implementing various laws applicable to a particular company.
- Companies Act, through its various sections cast upon company secretary various duties and liabilities called statutory duties and statutory liabilities.
- Role of company secretary is three-fold, namely, as a statutory officer, as a coordinator, and as an administrative officer.
- Practicing company secretaries provide plethora of corporate services to the corporate world beginning from the incorporation of a new company to filing of various documents with the authorities concerned, representing the company in front of various government authorities etc. One of the most important roles of practicing company secretaries is to provide advisory services to various companies.
- Practicing members are allowed to advertise the services provided and particulars of his firm subject to the Guidelines for Advertisement by Company Secretary in practice.

**SELF-TEST QUESTIONS**

1. Explain the term Key Managerial Personnel under the Companies Act, 2013. Is it necessary for every company to appoint a Key Managerial Personnel?
2. State the provisions of appointing a Key Managerial Personnel According to Companies Act 2013.
3. What are the provisions on punishment for the contravention of section 203 of the companies Act 2013?
4. Discuss the role of Company Secretary .
5. Enumerate the duties and liabilities of a Secretary.
6. Discuss the role of company secretary as a statutory officer, as co-ordinator and as an administrative officer.
7. State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980.
8. Define Secretary in whole-time practice

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# Lesson 18

## General Meetings

### LESSON OUTLINE

- Introduction
- Brief on Secretarial Standard-2
- Meaning of a Meeting
- Kinds of Company Meetings
- Requisites of Valid Meeting (General Meetings)
- Quorum
- Proxy
- Voting at General Meeting
- Chairman
- Motion
- Methods of ascertaining sense of the Meeting
- Resolutions
- Registration of Resolutions and Agreements
- Passing of resolutions by Postal Ballot/e-Voting
- Adjournment
- Minutes of proceedings of Meetings
- Report on Annual General Meeting

### LEARNING OBJECTIVES

Members of a company or the directors of a company can exercise their powers and can bind the company only when they act as a body at a validly convened and held meeting. An individual member or shareholder, irrespective of his shareholding cannot bind a company by his individual act. In Companies Act, 2013, a new concept of e-voting is introduced. This is a method of voting via electronic means. The Central Government has been empowered to prescribe the class or classes of companies and the manner in which a member may exercise his rights to vote by the electronic means given under Rule 20 Companies (Management and Administration) Rules, 2014. It is to be noted that every gathering or assembly does not constitute a meeting. The meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 2013 and rules framed thereunder.

## INTRODUCTION

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business. There must be at least two persons to constitute a meeting. Therefore, one shareholder usually cannot constitute a company meeting even if he holds proxies for other shareholders. However, in certain exceptional circumstances, even one person may constitute a meeting.

It is to be noted that every gathering or assembly does not constitute a meeting. Company meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 2013 and the rules framed thereunder.

A company is composed of members, though it has its own entity distinct from members. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held Meetings. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures.

The decision making powers of a company are vested in the Members and the Directors and they exercise their respective powers through Resolutions passed by them. General Meetings of the Members provide a platform to express their will in regard to the management of the affairs of the company.

Convening of one such meeting every year is compulsory. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. Shareholder Democracy, Class Action Suits and Protection of interest of investors are the essence and attributes of the Companies Act, 2013.

**Secretarial Standard on General Meetings of companies:** Secretarial Standard 2 (SS-2) on General Meeting issued by the Institute of Company Secretaries of India (ICSI) and approved by central government is to be mandatorily adhered by all companies as per the provision of Section 118(10) of Companies Act, 2013. The objective of secretarial standard is to promote good corporate governance. The standards are basically compilation of good secretarial practices with a view to ensure proper corporate governance. This Standard is applicable to all types of General Meetings of all companies incorporated under the Act except One Person Company (OPC) and class or classes of companies which are exempted by the Central Government through notification.

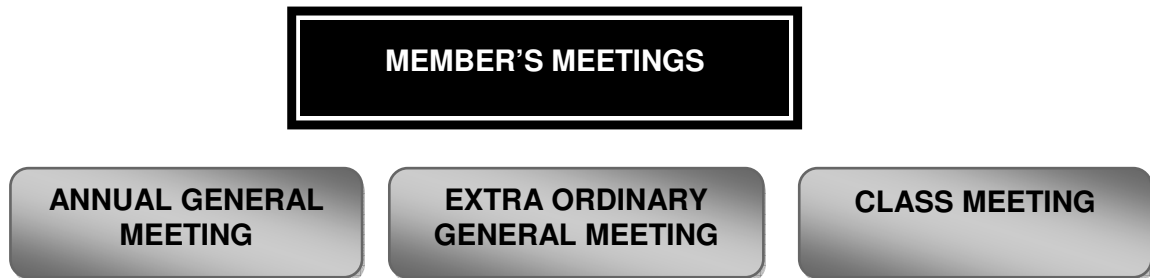
**Scope of Secretarial Standard:** Secretarial Standard is in conformity with the provisions of the Act. The term “Act” has been defined in SS-2 to mean the Companies Act, 2013 (Act No. 18 of 2013) or any previous enactment thereof, or any statutory modification thereto or re-enactment thereof and includes any Rules and Regulations framed thereunder. However, if due to subsequent changes in the Act or Rules, a particular Standard or any part thereof becomes inconsistent with the Act or Rules, the provisions of the Act or Rules shall prevail.”

**Applicability:** Secretarial Standards were issued on 23<sup>rd</sup> April 2015 and are effective from 1<sup>st</sup> July 2015. SS-2 shall only apply to general meetings in respect of which notices are issued on or after 1st July, 2015.

## Members' Meetings

A company is required to hold meetings of the members to take approval of certain business items, as prescribed in the Act.

The meetings to be held for seeking approval to ordinary business and special business are called annual general meeting and extraordinary general meeting. In certain cases, a company may have to hold a meeting of the members of a particular class of members.



### Annual General Meeting (section 96)

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 provides that every company, other than a one person company is required to hold an annual general meeting every year. SS-2 provides that the Board shall, every year, convene or authorize convening of a meeting of its members called the Annual General Meeting to transact items of ordinary business specifically required to be transacted at an annual general meeting as well as special business, if any. If the Board fails to convene its Annual General Meeting in any year, any Member of the company may approach the prescribed authority, which may then direct the calling of the Annual General Meeting of the company. Following are the key provisions regarding the holding of an annual general meeting:

#### *Holding of annual general meeting*

1. Annual general meeting should be held once **in each calendar year**.
2. **First annual general meeting** of the company should be held within 9 months from the closing of the first financial year. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3. **Subsequent annual general meeting** of the company should be held within 6 months from the date of closing of the relevant financial year.
4. The gap between two annual general meetings **shall not exceed 15 months**.

A one person company is exempt from holding an AGM.

Para 2.1 of SS-2 provides similar provisions in respect of frequency of annual general meeting and interval between two annual general meeting.

#### **Last date for holding AGM other than the first AGM i.e. subsequent AGM:**

1. AGM is to be held within 6 months of the close of relevant financial year.
2. Not more than 15 months shall elapse between the date of one AGM and that of the next. In other words, AGM is to be held within 15 months of last AGM.
3. AGM is to be held in each calendar year.

The three time limits given above are separate and cumulative. Non-compliance of any of them would constitute an offence. Therefore, the last date for holding AGM shall be the earliest of the above three limits.

**Extension of validity period of AGM**

In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period not exceeding 3 months. No such extension of time can be granted by the Registrar for the holding of the first annual general meeting.

**Test your knowledge:**

**Question:** The gap between two annual general meetings can never exceed 15 months. Comment

**Answer:** According to section 96(1) of the Companies Act, 2013 gap of not more than 15 months shall elapse between the date of one annual general meeting of the company and that of the next year. According to third proviso to section 96(1), the Registrar may, for any special reason, extend the time within which any annual general meeting, other than the first annual general meeting, shall be held, by a period of not exceeding three months. The company may apply to the Registrar for extension for holding AGM, justifying it as a special reason. The registrar may, after considering it as a special reason, extend the time within which an AGM shall be held which shall be a period not exceeding three months. Accordingly, the gap between the two AGMs shall not elapse a period of 15 months unless the Registrar for special reason has extended the time for holding the AGM. Such extension cannot be more than 3 months.

**Date, Time and place for holding an annual general meeting**

An annual general meeting can be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. It should be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. The Central Government is empowered to exempt any company from these provisions, subject to such conditions as it may impose.

In case of Government company, the Central Government may approve such other place for holding AGM, if the place is other than registered office.

In case of Section 8 company, the time, date and place of each AGM are decided upon before-hand by the Board having regard to the directions, if any, given in this regard by such company in the general meeting (Exemption notification dated 5<sup>th</sup> June 2015).

“National Holiday” for this purpose means and includes a day declared as National Holiday by the Central Government.

**Penalty for default in holding the annual general meeting [Section 99]**

Section 99 provides that if any default is made in complying or holding a meeting of the company, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in case of continuing default, with a further fine which may extend to five thousand rupees for each day during which such default continues.

If any default is made in holding the annual general meeting of a company, any member of the company may make an application to the Tribunal to call or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

**Business to be transacted at annual general meeting:**

Section 102(2)(a) provides that all other businesses transacted at an Annual General Meeting except the following are special business:

- (i) the consideration of financial statements and the reports of the Board of Directors and auditors;
- (ii) the declaration of any dividend;
- (iii) the appointment of directors in place of those retiring;
- (iv) the appointment of, and the fixing of the remuneration of, the auditors.

Explanatory statement is not required for transacting any item of ordinary business. All business except specified above shall be deemed as special business at an AGM.

In case of any other Meeting, all business shall be deemed to be special. Explanatory statement must be annexed to the notice for transacting every items of special business. In case of non-disclosure or insufficient disclosure in Explanatory statement, any benefit accrues to a promoter, director, manager or other key managerial personnel or their relatives, such person shall hold such benefit in trust for the company, and shall compensate the company to the extent of benefit derived by him.

**Extra Ordinary General Meeting (Section 100)**

There are so many matters relating to the business of a company, which requires approval or consent of members in general meeting. It is always not possible for consideration of such matters to wait until the next annual general meeting. The articles of association of the company of the company make provisions for convening general meeting other than the annual general meeting. All general meetings other than annual general meeting are called extraordinary general meetings.

**CALLING OF EGM****BY BOARD****BY BOARD ON  
REQUISITION OF  
SHAREHOLDERS****BY  
REQUISITIONISTS****BY TRIBUNAL**

Following are the key provisions, provided in section 100, regarding calling and holding of an extraordinary general meeting:

*(1) By the Board Suo motu [Section 100 (1)]*

The Board may, whenever it deems fit, call an extraordinary general meeting of the company, as per SS-2 such EGM may be held at any place within India.

*(2) By Board on requisition of members [Section 100 (2)]*

The Board shall, call an extraordinary general meeting on receipt of the requisition from the following number of members:

- (a) in the case of a **company having a share capital**: members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on

that date carries the right of voting;

- (b) in the case of a **company not having a share capital**: members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

**Matter set out for consideration in requisition:** The requisition made as above, shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.

**Time period for calling the meeting:** The Board is required to proceed to call a meeting within 21 days from the date of receipt of a valid requisition, to convene a meeting which should be held within 45 days of such deposit of the requisition with the company.

**(3) By requisitionists [Section 100(4)]**

- (1) If the Board does not within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than 45 days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves. However in such case, the meeting should be held within a period of 3 months from the date of the requisition.

Such requisition shall not pertain to any item of business that is required to be transacted mandatorily through postal ballot.

**Requisition for convening of EGM by members:** The members may requisition convening of an extraordinary general meeting, by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.

**Reimbursement of expenses in calling a meeting:** Reasonable expenses incurred by the requisitionists in calling such a meeting shall be reimbursed by the company to the requisitionists. The company in turn recovers such expenses from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting. [Section 100(6)]

In case, the quorum is not present within half-an-hour from the time appointed for holding a meeting called by requisitionists, the meeting shall stand cancelled. [Section 103(2)(b)]

- (2) The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting.-

The requisitionists should convene meeting at Registered office or in the same city or town where Registered office is situated and such meeting should be convened on working day.

- (3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.
- (4) **Notice to be signed:** The notice shall be signed by all the requisitionists or by a requisitionists duly authorized in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.
- (5) **No explanatory statement annexed to the notice:** No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requisitionists and the requisitionists may disclose the reasons for the resolution(s) which



they propose to move at the meeting.

- (6) **Serving of notice of the meeting:** The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requisitionists deposit with the Company a valid requisition for calling an extraordinary general meeting.
- (7) **No meeting convened:** Where the meeting is not convened, the requisitionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.
- (8) **Mode of giving notice:** The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to, or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

#### **(4) By Tribunal [Section 98]**

Section 98 provides that if for any reason it is impracticable to call a meeting of a company or to hold or conduct the meeting of the company, the Tribunal may, either suo motu or on the application of any director or member of the company who would be entitled to vote at the meeting:

- (a) order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and
- (b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company.

Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. Meeting held pursuant to such order shall be deemed to be a meeting of the company duly called, held and conducted.

### **Class Meetings**

Meetings of members of a company fall into two broad divisions, namely, general meetings and class meetings. Class meetings are meeting of shareholders, holding a particular class of share which is held to pass resolution which will bind only the members of the class concerned. Only members of the class concerned may attend and vote at meeting. Usually the rules to voting apply to class meetings as they govern voting at general meetings. These class meetings must be convened whenever it is necessary to alter or change the rights or privileges of that class as provided by the articles. For effecting such changes, it is necessary that these are approved at a separate meeting of the holders of those shares and supported by a special resolution. Under section 48 of the Companies Act, 2013 (variation of shareholders' rights) class meeting of the holders of different classes of shares shall be held if the rights attaching to these shares are to be varied. Similarly, under Section 232 (Merger and Amalgamation of companies), where a scheme of arrangement is proposed, meeting of several classes of shareholders and creditors are required to be held.

### **Procedure for convening of a valid general meeting**

The business at a meeting is said to have been "validly transacted" if the members of the organisation or body concerned, whether or not they were present, are bound by the decision made there at. They cannot be so bound unless the meeting is validly held. The essentials of a valid meeting are that the meeting should be:

**(a) Properly convened:**

- (i) The meeting must be called by proper authority; and
- (ii) Proper notice must be served in the manner specified under Section 101 and 102 of the Act.

**(b) Properly constituted:**

- (i) Proper quorum must be present in the general meeting (Section 103 of the Act)
- (ii) Proper chairman must preside the meeting (Section 104 of the Act)

**(c) Properly conducted:**

- (i) The business must be validly transacted at the meeting i.e. resolutions must be properly moved and passed, and voting by show of hands and on poll.
- (ii) Proper minutes of the meeting must be prepared. (Section 118 of the Act)

**Notice of Meeting (Section 101)**

A general meeting of a company may be called by giving not less than 21 clear days' notice either in writing or through electronic mode. Notice through electronic mode shall be given in such manner as may be prescribed. In case of section 8 company, 14 days' clear notice is required instead of 21 days.

'Clear days' means days exclusive of the day of the notice of service and of the day on which the meeting is held.

Where a notice of general meeting is sent by post, it shall be deemed to be served at the expiration of 48 hours after the letter containing the same is posted (Rule 35(6) of the Companies (Incorporation) Rules, 2014). Each of the 21 days must be full or complete days. The day on which the notice is deemed to be served on the member, and the day of the general meeting have to be in addition to the 21 days.

In case a valid special notice under the Act has been received from Member(s), the company shall give Notice of the Resolution to all its Members at least seven days before the Meeting, exclusive of the day of dispatch of Notice and day of the Meeting, in the same manner as a Notice of any General Meeting is to be given. Where this is not practicable, the Notice shall be published in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district, at least seven days before the Meeting, exclusive of the day of publication of the Notice and day of the Meeting. In case of companies having a website, such Notice shall also be hosted on the website. **(Para 1.2.6 of SS-2)**

**Test your knowledge**

**Question:** ABC Ltd. issued a notice on 1<sup>st</sup> August, 2015 to hold its AGM on 24<sup>th</sup> August, 2015. Check the validity of the notice referring to the provisions of the relevant act, in case it is sent by post.

**Answer:** Date of holding AGM: 24<sup>th</sup> August, 2015

Date of dispatch of notice: 1<sup>st</sup> August, 2015

Days to be excluded: (a) Day of holding AGM i.e 24<sup>th</sup> August, 2015

(b) Day of dispatch of notice i.e. 1<sup>st</sup> August, 2015

(c) 2 days for service of notice i.e 2<sup>nd</sup> & 3<sup>rd</sup> August, 2015

Number of days notice given: 20 days

Number of days notice required under section 101 of the Act is 21 days. Therefore it is not a case of valid notice. However, shortfall of 1 day can be condoned if consent is given for such shorter notice by at least 95% of the members entitled to vote at such AGM.

### ***Shorter notice***

A general meeting may be called after giving a shorter notice also if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting.

### **Secretarial Standard on calling of General Meeting on shorter notice:**

Para 1.2.7 of SS-2 provides that notice and accompanying documents may be given at a shorter period of time if consent in writing is given thereto, by physical or electronic means, by not less than ninety-five per cent of the Members entitled to vote at such Meeting.

The request for consenting to shorter notice and accompanying documents shall be sent together with the Notice and the Meeting shall be held only if the consent is received **prior** to the date fixed for the Meeting from not less than ninety five per cent of the Members entitled to vote at such Meeting.

## **Contents of Notice**

### ***Place of meeting (Section 96)***

The notice should state the place where the general meeting is scheduled to be held. In case of an annual general meeting, the place of the meeting has to be either the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated. Explanation to Rule 17(2) of Companies (Management and Administration) Rules 2014 states that requisitionists should convene meeting at Registered Office or in the same city or town where the Registered Office is situated and such meeting should be convened on working day.

Para 1.2.4 of SS-2 provides Annual General Meetings 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, whereas other General Meetings may be held at any place within India. In case of government company, AGM shall be held either at the registered office of the company or at such other place as the Central Government may approve.

**Notice shall contain complete particulars of the venue of the Meeting including route map and prominent land mark for easy location. (SS 1.2.4)**

### ***Day of meeting (Section 96)***

The day and date of the meeting should be clearly stated in the notice. In case of an annual general meeting, the day should be one that is not a National Holiday. An extraordinary general meeting can however be held on any day. However, as per Para 1.2.4 of SS-2 a Meeting called by the requisitionists shall be convened **only on a working day.**

### ***Time of meeting (Section 96)***

Exact time of holding the meeting should be given in the notice. An annual general meeting can be called during business hours only, i.e. between 9:00 a.m. and 6:00 p.m. There is no restriction of timings in case of an extraordinary general meeting.

In case of Section 8 Company, the time, date and place of each AGM are decided upon before-hand by the directors having regard to directions, if any, given in this regard by the company in its general meeting.

**Agenda (Section 102)**

A statement of the business to be transacted at the general meeting should be given in the notice. In case, the meeting is to transact a special business, a explanatory statement should be attached about such item.

**Proxy clause with reasonable prominence [Section 105(2)]**

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

In addition to aforesaid provision, Para 1.2.4 of SS-2 provides that in case of companies where Proxy shall be a Member under the Act, a statement to that effect shall appear in the Notice prominently.

**Notice through Electronic Mode (Rule 18 of Companies (Management and Administration) Rules 2014)**

According to the Companies (Management and Administration) Rules, 2014, the company may serve the notice in electronic mode in following manner.

- (1) A company may give notice through **electronic mode**. The expression “electronic mode” shall mean any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.
- (2) A notice may be sent through **e-mail** as a text or as an attachment to e-mail or as a notification providing electronic link or Uniform Resource Locator for accessing such notice.
- (3) (i) The e-mail shall be **addressed to the person entitled to receive such e-mail** as per the records of the company or as provided by the depository:  

**Provided that** the company shall provide an advance opportunity at least once in a financial year, to the member to register his e-mail address and changes therein and such request may be made by only those members who have not got their email ID recorded or to update a fresh email ID and not from the members whose e- mail IDs are already registered.
- (ii) The **subject line in e-mail** shall state the name of the company, notice of the type of meeting, place and the date on which the meeting is scheduled.
- (iii) **If notice is sent in the form of a non-editable attachment to e-mail**, such attachment shall be in the Portable Document Format or in a non-editable format together with a 'link or instructions' for recipient for downloading relevant version of the software.
- (iv) When **notice or notifications of availability of notice are sent by e-mail**, the company should ensure that it uses a system which produces confirmation of the total number of recipients e-mailed and a record of each recipient to whom the notice has been sent and copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as “proof of sending”.
- (v) The **company’s obligation shall be satisfied when it transmits the e-mail** and the company shall not be held responsible for a failure in transmission beyond its control.
- (vi) If a **member entitled to receive notice fails to provide or update relevant e-mail address to**

**the company**, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.

- (vii) The **company may send e-mail** through in-house facility or its registrar and transfer agent or authorise any third party agency providing bulk e-mail facility.
- (viii) The **notice made available on the electronic link or Uniform Resource Locator** has to be readable, and the recipient should be able to obtain and retain copies and the company shall give the complete Uniform Resource Locator or address of the website and full details of how to access the document or information.
- (ix) The notice of the general meeting of the company shall be simultaneously placed on the **website of the company** if any and on the website as may be notified by the Central Government.

*Explanation.*- For the purpose of this rule, it is hereby declared that the extra ordinary general meeting shall be held at a place within India.

#### **Secretarial Standard on issuance of notice:**

Para 1.2.2 of SS-2 provides that Notice shall be sent by hand or by ordinary post or by speed post or by registered post or by courier or by facsimile or by e-mail or by any other electronic means. 'Electronic means' means any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the Member.

Notice shall be sent to Members by registered post or speed post or courier or e-mail and not by ordinary post in the following cases:

- (a) if the company provides the facility of e-voting ;
- (b) if the item of business is being transacted through postal ballot;

If a Member requests for delivery of notice through a particular mode, other than one of those listed above, he shall pay such fees as may be determined by the company in its Annual General Meeting and the Notice shall be sent to him in such mode.

Notice shall be sent to Members by registered post or speed post or email if the Meeting is called by the requisitionists themselves and where the Board had not proceeded to call the Meeting.

#### **Persons entitled to receive Notice**

In terms of Section 101(3), notice of every meeting of the company must be given to:

- (a) every member of the company, legal representative of any deceased member or the assignee of an insolvent member;
- (b) the auditor or auditors of the company; and
- (c) every director of the company.

A private company, which is not, a subsidiary of a public company may prescribe, by its Articles, persons to whom the notice should be given.

It does not always follow that all the members of a company are entitled to receive notice of meetings of the company; the Articles frequently provide that preference shareholders shall not be entitled to receive notice of and vote at general meeting of the company, except in certain circumstances. There is a statutory

obligation to send notice to preference shareholders when their dividend is in arrears for more than a certain period [Section 47(2)]. This obligation arises from the fact that preference shareholders whose dividends are in arrears are entitled to attend and vote at the meeting.

The non-receipt of notice or accidental omission to give notice to any member shall not invalidate the proceedings in the meeting [Section 101(4)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission [*Musselwhite Vs. C.H. Musselwhite & Sons Ltd.*(1962) 32 Comp. Cas 804]. 'Accidental omission' means that the omission must be not only unintended but also not deliberate [*Maharaja Export Vs. Apparels Exports Promotion Council* (1986) 60 Comp. Cas 353.].

**Notice to Directors, Auditors & other specified persons:**

Para 1.2.1 of SS-2 provides that notice in writing of every meeting shall be given to every member of the company. Such Notice shall also be given to the Directors and Auditors of the company, to the Secretarial Auditor, to Debenture Trustees, if any, and, wherever applicable or so required, to other specified persons. Court may direct issuance of Notice to some other persons such as Court-appointed Chairman or observers or persons whose entitlement is under challenge. Considering that Preference Shareholders are Members of the company, Notice of general meetings should also be given to them.

In the case of Members, Notice shall be given at the address registered with the Company or depository. In the case of shares or other securities held jointly by two or more persons, the Notice shall be given to the person whose name appears first as per records of the Company or the depository, as the case may be. In the case of any other person who is entitled to receive Notice, the same shall be given to such person at the address provided by him.

**Secretarial Standard on entitlement to receive notice:**

Para 1.2.1 of SS-2 provides that where the company has received intimation of death of a Member, the Notice of Meeting shall be sent as under:

- (a) where securities are held singly, to the Nominee of the single holder;
- (b) where securities are held by more than one person jointly and any joint holder dies, to the surviving first joint holder;
- (c) where securities are held by more than one person jointly and all the joint holders die, to the Nominee appointed by all the joint holders;
  - (i) In the absence of a Nominee, the notice shall be sent to the legal representative of the deceased Member.
  - (ii) In case of insolvency of a Member, the Notice shall be sent to the assignee of the insolvent Member.
  - (iii) In case the Member is a company or body corporate which is being wound up, Notice shall be sent to the liquidator.

**Statement to be annexed to Notice (Section 102)**

**Secretarial Standard on annexure to notice of General Meeting:**

Para 1.2.5 of SS-2 requires that notice shall clearly specify the nature of the Meeting and the business to be transacted thereat. In respect of items of Special Business, each such item shall be in the form of a

Resolution and shall be accompanied by an explanatory statement which shall set out all such facts as would enable a Member to understand the meaning, scope and implications of the item of business and to take a decision thereon. **In respect of items of Ordinary Business, Resolutions are not required to be stated in the Notice except where the Auditors or Directors to be appointed are other than the retiring Auditors or Directors, as the case may be.**

Further, Para 1.2.10 of SS-2 requires that notice shall be accompanied, by an attendance slip and a Proxy form with clear instructions for filling, stamping, signing and/or depositing the Proxy form.

#### **Contents of Explanatory Statement:**

In case of special business items to be transacted at a general meeting, a statement setting out the following material facts, shall be annexed to the notice calling the meeting:

- (I) (a) the nature of concern or interest, financial or otherwise, if any, in respect of each item of:
  - every director and the manager, if any;
  - every other key managerial personnel; and
  - relatives of every director, manager and key managerial person.
- (b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.
 

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid-up share capital of that company, also be set out in the statement.
- (II) Where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected shall be specified in the explanatory Statement.

**Effect of non-disclosure:** Where as a result of the non-disclosure or insufficient disclosure in any statement referred as above, being made by a promoter, director, manager, if any, or other key managerial personnel, any benefit which accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

If the explanatory statement is vague and tricky, or insufficient and misleading, the resolution passed, is bad in law. [*Central Industrial Alliance Ltd. Vs. Pravin Kantilal Vakil* (1985) 57 Com. Cases 12 (Bom)].

#### **Quorum for Meetings [Section-103]**

Quorum refers to the minimum number of members required to constitute a valid meeting. Following are the minimum numbers provided in section 103, for various categories of companies. However the Articles of Association of the company may provide for a higher number.

- (a) *Public company:*
  - 5 members personally present if the number of members as on the date of meeting is not more than 1000;

- 15 members personally present if the number of members as on the date of meeting is more than 1000 but up to 5000;
- 30 members personally present if the number of members as on the date of the meeting exceeds 5000.

(b) *Private company:*

- 2 members personally present, shall be the quorum for a meeting of the company.

#### **Secretarial Standard on Quorum:**

Para 3.1 of SS-2 provides that where the Quorum provided in the Articles is higher than that provided under the Act, the Quorum shall conform to such higher requirement. Members need to be personally present at a Meeting to constitute the Quorum. Proxies shall be excluded for determining the Quorum.

Para 3.2 of SS-2 provides that a duly authorized representative of a body corporate or the representative of the President of India or the Governor of a State is deemed to be a Member personally present and enjoys all the rights of a Member present in person.

One person can be an authorized representative of more than one body corporate. In such a case, he is treated as more than one Member present in person for the purpose of Quorum. However, to constitute a Meeting, at least two individuals shall be present in person. Thus, in case of a public company having not more than 1000 members with a Quorum requirement of five Members, an authorized representative of five bodies corporate cannot form a Quorum by himself but can do so if at least one more Member is personally present.

Members who have voted by Remote e-voting have the right to attend the General Meeting and accordingly their presence shall be, counted for the purpose of Quorum.

A Member who is not entitled to vote on any particular item of business being a related party, if present, shall be counted for the purpose of Quorum.

The stipulation regarding the presence of a Quorum does not apply with respect to items of business transacted through postal ballot.

Let us remember the concept through a table:

(a) in case of a **public company**,—

Quorum for the meeting	Number of members
5 members personally present	not more than one thousand
15 members personally present	more than one thousand but up to five thousand
30 members personally present	exceeds five thousand

(b) in the case of a **private company**, two members personally present, shall be the quorum for a meeting of the company.

**Consequences of no quorum-** If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company—

- (a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or



to such other date and such other time and place as the Board may determine; or

(b) the meeting, if called by requisitionists (under section 100), shall stand cancelled:

**Notice of an adjourned meeting-** Where the meeting stands adjourned to the same day in the next week at the same time and place, or to such other day, not being a National Holiday, or at such other time and place as the Board may determine, there the company shall give at least 3 days notice to the members either individually or by publishing an advertisement in 2 newspapers (one in English and one in vernacular language).

**No quorum in an adjourned meeting-** If at the adjourned meeting also, a quorum is not present within half-an-hour from the time appointed for holding meeting, **the members present, being not less than two in numbers, will constitute the quorum.**

If a Meeting is adjourned sine-die or for a period of thirty days or more, a Notice of the adjourned Meeting shall be given in accordance with the provisions contained hereinabove relating to Notice.

If a Meeting is adjourned for a period of less than thirty days, the company shall give not less than three days' Notice specifying the day, date, time and venue of the Meeting, to the Members either individually or by publishing an advertisement in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district.

If a Meeting, other than a requisitioned Meeting, stands adjourned for want of Quorum, the adjourned Meeting shall be held on the same day, in the next week at the same time and place or on such other day, not being a National Holiday, or at such other time and place as may be determined by the Board.

The words, personally present exclude proxies. However, the representative of a body corporate appointed under Section 113 or the representative of the President or a Governor of a State under Section 112 is a member 'personally present' for purpose of counting a quorum [*Re. Kelantan Coconut Estate Ltd.*, 1920 W.N. 274].

In case two or more corporate bodies who are members of a company are represented by single individual, each of the bodies corporate will be treated as personally present by the individual representing it. If, for instance, he represents three corporate bodies, his presence will be counted as three members being present in person for purposes of quorum.

It has been held in a Scottish case that one individual may count as more than one member if he attends the meeting in more than one capacity, e.g. as a member holding shares in his own right and as a member entitled to vote in person in respect of a trust holding (*Neil McLeod & Sons Ltd.*, Petitioners, 1976 SC 16).

Para 3.1 of SS-2 requires that quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

#### **Test your knowledge:**

**Question:** The articles of association of XYZ Ltd. having 700 members as on cut off date, prescribe for physical presence of 7 members to constitute quorum of general meetings. Following are the status of persons present in a general meeting of XYZ Ltd to consider the appointment of MD. Check the quorum of the meeting.

(a) Mr. A, the representative of Governor of Maharashtra.

- (b) Mr. B & Mr. C are preference shareholders
- (c) Mr. D representing ABC Ltd. and SKY Ltd.
- (d) Mr. E, Mr. F, Mr. G and Mr. H are proxies of shareholders

**Hint:** (a) Since Mr. A is the representative of the Governor of Maharashtra, shall be treated as a member personally present (Section 112).

(b) Preference shareholders can vote only in relation to such matters which directly affect their rights. In this case, meeting was called to take decision on appointment of MD, which does not affect their rights. Therefore, Mr. B & Mr. C are not members personally present.

(c) Since Mr. D represents two body corporates, he would be treated as two members personally present. (Section 113)

(d) Since Mr. E, Mr. F, Mr. G and Mr. H are proxies of shareholders and members are not personally present. They are not considered while counting quorum.

From the above analysis, it can be concluded that only 3 members are personally present and they do not constitute proper quorum as fixed by the company.

Note: The quorum required in respect of general meeting of a public company is 5 and the quorum can be increased by the articles of the company.

#### **Secretarial Standard on adjournment of meetings (Para-15 of SS-2):**

(1) A duly convened Meeting shall not be adjourned unless circumstances so warrant. The Chairman may adjourn a Meeting with the consent of the Members, at which a Quorum is present, and shall adjourn a Meeting if so directed by the Members.

Meetings shall stand adjourned for want of requisite Quorum. The Chairman may also adjourn a Meeting in the event of disorder or other like causes, when it becomes impossible to conduct the Meeting and complete its business.

(2) At an adjourned Meeting, only the unfinished business of the original meeting shall be considered.

Any Resolution passed at an adjourned Meeting would be deemed to have been passed on the date of the adjourned Meeting and not on any earlier date.

#### **Chairman of Meetings (Section 104)**

Unless the articles of the company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act and the Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the meeting.

#### **Secretarial Standard on appointment and role of Chairman:**

Para 5 of SS-2 provides that the Chairman of the Board shall take the chair and conduct the Meeting. If the Chairman is not present within fifteen minutes after the time appointed for holding the Meeting, or if he is unwilling to act as Chairman of the Meeting, or if no Director has been so designated, the Directors present

at the Meeting shall elect one of themselves to be the Chairman of the Meeting. If no Director is present within fifteen Minutes after the time appointed for holding the Meeting, or if no Director is willing to take the chair, the Members present shall elect, on a show of hands, one of themselves to be the Chairman of the Meeting, unless otherwise provided in the Articles.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of the Act and the Chairman elected on a show of hands shall continue to be the Chairman of the Meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the Meeting.

The Chairman shall ensure that the Meeting is duly constituted in accordance with the Act and the Articles or any other applicable laws, before it proceeds to transact business. The Chairman shall then conduct the Meeting in a fair and impartial manner and ensure that only such business as has been set out in the Notice is transacted. The Chairman shall regulate the manner in which voting is conducted at the Meeting keeping in view the provisions of the Act.

Para 5.2 of SS-2 requires that the Chairman shall explain the objective and implications of the Resolutions before they are put to vote at the Meeting.

The Chairman shall provide a fair opportunity to Members who are entitled to vote to seek clarifications and/or offer comments related to any item of business and address the same, as warranted.

Para 5.3 of SS-2 provides that in case of public companies, the Chairman shall not propose any Resolution in which he is deemed to be concerned or interested nor shall he conduct the proceedings for that item of business.

If the Chairman is interested in any item of business, without prejudice to his Voting Rights on Resolutions, he shall entrust the conduct of the proceedings in respect of such item to any Dis-Interested Director or to a Member, with the consent of the Members present, and resume the Chair after that item of business has been transacted.

Para 4.1.1 of SS-2 provides that if any Director is unable to attend the Meeting, the Chairman shall explain such absence at the Meeting.

Para 4.1.2 of SS-2 requires that Directors who attend General Meetings of the company and the Company Secretary shall be seated with the Chairman.

## **PRESENCE OF STATUTORY AUDITOR AND SECRETARIAL AUDITOR**

Section 146 of the Act requires the presence to Auditors in general meetings unless otherwise exempted, either himself or through his authorized representative, who shall also be qualified to be an auditor and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

Para 4.2 of SS-2 requires that the Auditors, unless exempted by the company, shall, either by themselves or through their authorised representative, attend the General Meetings of the company and shall have the right to be heard at such Meetings on that part of the business which concerns them as Auditors.

The authorized representative who attends the General Meeting of the company shall also be qualified to be an Auditor.

Similarly, para 4.3 of SS-2 requires the secretarial auditor, unless exempted by the company shall, either by himself or through his authorized representative, attend the Annual General Meeting and shall have the right

to be heard at such Meeting on that part of the business which concerns him as Secretarial Auditor.

The authorized representative who attends the General Meeting of the company shall also be qualified to be a secretarial auditor.

### Proxies (Section 105)

A person who is appointed by a member to attend and vote at a meeting in the absence of the member at the meeting is termed as proxy. Thus proxy is an agent of the member appointing him. The term 'proxy' is also used to refer to the instrument by which a person is appointed as proxy. Section 105 of the Companies Act, 2013 provides that a member, who is entitled to attend to vote, can appoint another person as a proxy to attend and vote at the meeting on his behalf. This section also provides the manner of appointing proxy. The provisions are as follows.

- (1) **Who can appoint a proxy:** Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

**The SS added that** where allowed, one or more proxies, to attend and vote instead of himself and a Proxy need not be a Member.

**However, a Proxy shall be a Member in case of companies with charitable objects etc. and not for profit registered under the specified provisions of the Act.**

A Proxy can act on behalf of Members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying Voting Rights.

However, a Member holding more than ten percent of the total share capital of the company carrying Voting Rights may appoint a single person as Proxy for his entire shareholding and such person shall not act as a Proxy for another person or shareholder.

If a Proxy is appointed for more than fifty Members, he shall choose any fifty Members and confirm the same to the company before the commencement of specified period for inspection. In case, the Proxy fails to do so, the company shall consider only the first fifty proxies received as valid.

- (2) **Disabilities of proxy:** A proxy shall not have the right to speak at the meeting. A proxy cannot vote on a show of hands. A proxy is not counted for the purpose of quorum.
- (3) **Rights of proxy:** A proxy has the right to attend the meeting. A proxy has the right to vote only on a poll. A proxy, if eligible under section 109, has the right to demand a poll.
- (4) **Restriction on proxy:** A member of a company registered under section 8 (Not for Profit company) shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

A person appointed as proxy shall not act as proxy on behalf of more than fifty members and members holding in the aggregate more than ten percent of the total share capital of the company carrying voting rights.

A member holding more than 10% of the total share capital of the company carrying voting rights may appoint a single person as proxy, provided that such person shall not act as proxy for any other person or shareholder.

- (5) **Time limit for deposit of proxy forms:** The instrument appointing the proxy must be deposited with the company, 48 hours before the meeting. Any provision contained in the articles, requiring a

longer period than 48 hours shall have effect as if a period of 48 hours had been specified.

**Secretarial standard of proxies:**

(1) **Deposit of proxies:** Para 6.6.1 of SS-2 provides that proxies shall be deposited with the company either in person or through post not later than forty-eight hours before the commencement of the Meeting in relation to which they are deposited and a Proxy shall be accepted even on a holiday if the last date by which it could be accepted is a holiday.

(2) **Records of proxies:** Para 6.9.1 of SS-2 requires that all Proxies received by the company shall be recorded chronologically in a register kept for that purpose.

Para 6.9.2 of SS-2 provides that in case any Proxy entered in the register is rejected, the reasons therefor shall be entered in the remarks column.

(3) The prescribed form for appointing a proxy is Form No. MGT. 11. It needs to be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument should be under its seal or be signed by an officer or an attorney duly authorised by the body corporate. An instrument appointing a proxy, if in MGT-11, shall not be questioned on the ground that it fails to comply with any special requirement specified for such instrument by the article of a company.

Para 6.2.1 requires that an instrument appointing a Proxy shall be either in the Form specified in the Articles or in the Form set out in the Act.

The instrument of Proxy shall be signed by the appointer or his attorney duly authorized in writing, or if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorized by it.

Para 6.2.2 requires that an instrument of Proxy duly filled, stamped and signed, is valid only for the Meeting to which it relates including any adjournment thereof.

Para 6.3 provides that an instrument of Proxy is valid only if it is properly stamped as per the applicable law. Unstamped or inadequately stamped Proxies or Proxies upon which the stamps have not been cancelled are invalid.

Para 6.4.1 requires that the Proxy-holder shall prove his identity at the time of attending the Meeting.

Para 6.4.2 provides that an authorized representative of a body corporate or of the President of India or of the Governor of a State, holding shares in a company, may appoint a Proxy under his signature.

Para 6.5.1 states that a Proxy form which does not state the name of the Proxy shall not be considered valid.

Para 6.5.2 states that undated proxy shall not be considered valid.

Para 6.5.3 provides that if a company receives multiple proxies for the same holdings of a Member, the Proxy which is dated last shall be considered valid; if they are not dated or bear the same date without specific mention of time, all such multiple Proxies shall be treated as invalid.

**Let us Remember:**

The prescribed proxy form is Form No. MGT 11

- (4) **Inspection of proxy:** Every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, is entitled to inspect the proxies lodged with the company, if at least 3 days notice in writing is given to the company. Such notice shall be received at least three days before the commencement of the Meeting. Such inspection can be taken during the period beginning 24 hours before the time fixed for the commencement of the meeting, during the business hours of the company, and ending with the conclusion of the meeting. Such inspection should be allowed between 9:00 am and 6:00 pm during such period.

A fresh requisition confirming to the above requirements, shall be given for inspection of Proxies in case the Original Meeting is adjourned.

- (5) **Revocation of proxy:** If after appointment of proxy, the member himself attends the meeting, it amounts to automatic revocation of proxy. But once the proxy has voted, it cannot be revoked.

Para 6.7.1 provides that if a Proxy had been appointed for the original meeting and such meeting is adjourned, any Proxy given for the adjourned Meeting revokes the Proxy given for the original Meeting.

Para 6.7.2 provides that a proxy later in date revokes any Proxy/Proxies dated prior to such Proxy.

Para 6.7.3 provides that a Proxy is valid until written notice of revocation has been received by the company before the commencement of the Meeting or adjourned Meeting, as the case may be.

An undated notice of revocation of Proxy shall not be accepted. A notice of revocation shall be signed by the same Member (s) who had signed the Proxy, in the case of joint Membership.

A Proxy need not be informed of the revocation of the Proxy issued by the Member.

**Question:** Annual General Meeting of a Public Company was scheduled to be held on 15.12.2015. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favor of Mr. 'X' and Mr. 'Y'. The proxy in favor of 'Y' was lodged on 12.12.2015 and the one in favor of Mr. X was lodged on 15.12.2015. The company rejected the proxy in favor of Mr. Y as the proxy in favor of Mr. Y was of dated 12.12.2015 and thus in favor of Mr. X was of dated 15.12.2015. Is the rejection by the company in order?

**Hint:** As per Section 105 of the Companies Act, 2013 a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2015 (the date of the meeting being 15.12.2015). X deposited the proxy on 15.12.2015.

Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favor of Y is valid since it is deposited in time.

**Question:** The Chairman of the meeting of a public company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 2013 whether the Proxy holder can compel the Chairman to admit the Proxy?

**Hint:** As per Section 105 of the Companies Act, 2013 proxy shall be deposited with the company within 48 hours before the meeting.

Any provisions contained in the Articles of a company that requires a longer period than 48 hours before a meeting of the company for depositing a proxy shall be void. Thus contention of Mr X is valid.

**Question:** Mr. A, a member of XYZ Limited, appoints Mr. B as his proxy to attend the general meeting of the company. Later he (Mr. A) also attends the meeting. Both Mr. A (the member) and Mr. B (the proxy) voted on a particular resolution in the meeting. Mr. A's vote was declared invalid by the chairman stating that since he has appointed the proxy and Mr. B's vote has been considered as valid. Mr. A objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 2013 whether Mr. A's objection shall be taxable.

**Hint:** Decision by Chairman is invalid. Since Mr. A i.e. a member himself attended a meeting and voted on resolution, it will amount to revocation of proxy. Thus any vote put by Mr. B i.e. proxy shall be invalid.

### Restriction on Voting Rights (Section 106)

The articles of a company may provide that a member shall not exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid or on which company has exercised any right or lien. No member can be prohibited from exercising his voting right on any other ground.

### Voting by Show of Hands (Section 107)

At any general meeting, a resolution put to the vote of the meeting shall in the first instance be decided on a show of hands, unless-

- (a) A poll is demanded under section 109 of the Act.
- (b) Voting is carried out electronically under section 108 of the Act.

A declaration by the Chairman of the meeting of the passing of a resolution (that the resolution has been passed or failed, as the case may be) on show of hands and an entry to that effect in the minutes book shall be conclusive evidence of the fact of passing of such resolution. No proof of numbers of votes casts in favor of and against the resolution is required.

### Voting through Electronic Means (Section 108)

General meetings of companies are held at their registered offices and it is not possible for every member specially members holding minor shares to travel up to the registered office of the company and participate in the general meetings of the company.

To eliminate this type of difficulty and to enhance the participation of minority members, concept of e-voting has been introduced by the Companies Act 2013. Now a member can cast his vote easily through electronic mode without physically attending the general meeting.

E-voting do not eliminate members right to physically attend and vote at the general meeting. However member can cast his vote through one mode only. A member after casting his vote through e-voting can go and attend the general meeting but cannot cast vote in that general meeting.

The facility of Remote e-voting does not dispose with the requirements of holding a General Meeting by the company.

**Applicability:** Section 108 of the Act shall apply to such companies as may be prescribed by the Central Government. The prescribed class of companies, for this purpose, are-

- (i) All companies whose equity shares are listed on a recognized stock exchange; and

- (ii) All companies having 1000 or more members.

However, the provisions of section 108 shall not apply company referred to in chapter XB (Companies listed on SME exchange) or chapter XC (Companies listed on institutional trading platform without IPO) of the SEBI (Issue of Capital and Depository Receipt) Regulations, 2009.

Following companies are out of ambit of e-voting:-

1. Companies having whose debenture/preference shares are only listed.
2. Companies listed on SME trading platform.
3. Companies listed on institutional trading platform.

**Legal Requirement:**

- (a) A company to which section 108 is applicable, shall provide to its members facility to exercise their right to vote on resolution proposed at general meetings by electronic means.
- (b) Once a resolution is proposed in general meeting, it shall not be withdrawn.

**Meaning of certain terms:**

Rule 20 of Companies (Management and Administration) Amendment Rules, 2015 defines some of the terms relating to voting through electronic means as follows:

- (i) “cut-off date” means a date not earlier than seven days before the date of general meeting for determining the eligibility to vote by electronic means or in the general meeting;
- (ii) “cyber security” means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorised access, use, disclosures, disruption, modification or destruction;
- (iii) “electronic voting system” means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, in such a manner that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralised server with adequate cyber security;
- (iv) “remote e-voting” means the facility of casting votes by a member using an electronic voting system from a place other than venue of a general meeting;
- (v) “secured system” means computer hardware, software, and procedure that
  - (a) are reasonably secure from unauthorised access and misuse;
  - (b) provide a reasonable level of reliability and correct operation;
  - (c) are reasonably suited to performing the intended functions; and
  - (d) adhere to generally accepted security procedures;
- (vi) “voting by electronic means” includes “remote e-voting” and voting at the general meeting through an electronic voting system which may be the same as used for remote e-voting .

**The Board shall:**

- (a) appoint one or more scrutinisers for e-voting or the ballot process,**

The scrutiniser (s) may be a Company Secretary in Practice, a Chartered Accountant in Practice, a Cost Accountant in Practice, or an Advocate or any other person of repute who is not in the employment of the company and who can, in the opinion of the Board, scrutinise the e-voting process or the ballot process, as the case may be, in a fair and transparent manner.



The scrutiniser (s) so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system.

Prior consent to act as a scrutiniser(s) shall be obtained from the scrutiniser(s) and placed before the Board for noting.

**(b) appoint an Agency;**

**(c) decide the cut-off date for the purpose of reckoning the names of Members who are entitled to Voting Rights;**

The cut-off date for determining the Members who are entitled to vote through Remote e-voting or voting at the meeting shall be a date not earlier than seven days prior to the date fixed for the Meeting.

Only Members as on the cut-off date, who have not exercised their Voting Rights through Remote e-voting, shall be entitled to vote at the Meeting.

**(d) authorise the Chairman or in his absence, any other Director to receive the scrutiniser's register, report on e-voting and other related papers with requisite details.**

The scrutiniser(s) is required to submit his report within a period of three days from the date of the meeting.

The Chairman or any other director so authorized shall countersign the scrutiniser's report so received.

The notice of the meeting shall clearly state that:-

- (i) the company is providing facility for voting by electronic means and the business may be transacted through such voting.
- (ii) the facility for voting, either through voting by electronic means or ballot/polling paper shall also be made available at the meeting and members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting.
- (iii) that the members who have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again.

**(A) Additional Disclosures in notice:**

The notice shall –

- (i) indicate the process and manner for voting by electronic means;
- (ii) indicate the time schedule including the time period during which the votes may be cast by remote e-voting;
- (iii) provide the details about the login ID;
- (iv) specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

**(B) Public notice by way of advertisement:**

- (i) The company shall cause a public notice by way of an advertisement to be published, immediately

on completion of dispatch of notice of general meeting.

- (ii) The public notice shall be published at least twenty-one days before the date of general meeting, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having country-wide circulation.
- (iii) The public notice shall specify the following matter in the said advertisement
  - (a) a statement that the business may be transacted through voting by electronic means;
  - (b) The date and time of commencement of remote e-voting;
  - (c) The date and time of end of remote e-voting;
  - (d) Cut-off date;
  - (e) The manner in which persons who have acquired shares and become members of the company after the despatch of notice may obtain the login ID and password;
  - (f) A statement that –
    - (i) remote e-voting shall not be allowed beyond the said date and time;
    - (ii) the manner in which the company shall provide for voting by members present at the meeting; and
    - (iii) a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again in the meeting; and
    - (iv) a person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;
  - (g) Website address of the company, if any, and of the agency where notice of the meeting is displayed; and
  - (h) Name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means.

The public notice shall be placed on the website of the company, if any, and of the agency;

Such notice shall remain on the website till the date of general meeting.

**(C) Remote e-voting:**

- (i) The facility for remote e-voting shall remain open for not less than three days and shall close at 5.00 p.m. on the date preceding the date of the general meeting.
- (ii) During the period when facility for remote e-voting is provided, the members of the company, holding shares either in physical form or in dematerialised form, as on the cut-off date, may opt for remote e-voting.
- (iii) Once a member has cast his vote on a resolution, he shall not be allowed to change it subsequently or cast the vote again.
  - (a) A member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again.
  - (b) At the end of the remote e-voting period, the facility shall forthwith be blocked.

**(D) Appointment of scrutinizer:**

- (i) The Board of Directors shall appoint one or more scrutinizer(s).
- (ii) The scrutinizer(s) may be a Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate, or any other person who is not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinise the voting and remote e-voting process in a fair and transparent manner. Atleast one of the scrutinisers shall be a member who is present at the Meeting provided such members is available and willing to be appointed.
- (iii) The scrutinizer may take assistance of a person who is not in employment of the company and who is well-versed with the electronic voting system.
- (iv) The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority. For this purpose, prior consent to act as scrutinisier(s) shall be obtained from the scrutinizer(s) and placed before the Board for noting.
- (v) The scrutinizer(s) shall maintain a register to record the assent or dissent received, mentioning the particulars of members.
- (vi) The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutinizer(s) until the Chairman considers, approves and signs the minutes and thereafter, the scrutinizer(s) shall hand over the register and other related papers to the company.

**(E) Voting at General Meeting:**

- (i) During general meeting, a company may opt to provide the same electronic voting system as used during remote e-voting. In such a case, the members attending the general meeting and who have not exercised their right to vote through remote e-voting, shall be entitled to vote using the electronic voting system.
- (ii) At the general meeting, after conclusion of the discussion, the chairman shall, with the assistance of scrutinisers, allow voting on the resolutions, by use of polling paper or by using an electronic voting system for all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility.

**(F) Declaration of result of voting:**

- (i) The scrutinizer shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company.
- (ii) The scrutinizer shall make, not later than three days of conclusion of the meeting, a consolidated scrutinisier's report of the total votes cast in favor or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same.
- (iii) The Chairman or a person authorized by him in writing shall declare the result of the voting forthwith.
- (iv) The result of the voting, with details of the number of votes cast for and against the Resolution, invalid votes and whether the Resolution has been carried or not shall be displayed on the Notice Board of the company at its Registered Office and its Head Office as well as Corporate Office, if any, if such office is situated elsewhere. Further, the results of voting alongwith the scrutinisier's

report shall also be placed on the website of the company, in case of companies having a website and of the Agency, immediately after the results are declared.

- (v) The scrutinisers' register, report and other related papers received from the scrutiniser(s) shall be kept in the custody of the Company Secretary or any other person authorised by the Board for this purpose.
- (vi) The manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, scrutinizer or any other person till the votes are cast in the general meeting.
- (vii) If the requisite number of votes are cast in favor of the resolution, the resolution shall be deemed to be passed on the date of relevant general meeting.
- (viii) The results declared along with the report of the scrutinizer shall be placed on the notice board of the company at its registered office and its head office as well as corporate office, if any, if such office is situated elsewhere and on the website of the company, if any, and on the website of the agency immediately after the result is declared by the Chairman.
- (ix) In case of companies whose equity shares are listed on a recognized stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

### **Demand for Poll (Section 109)**

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the following person(s):

- (a) in the case a company having a share capital: by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than Rs.5,00,000/- or such higher amount as may be prescribed, has been paid-up; and
- (b) in the case of any other company: by any member or members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power.

The Chairman shall get the validity of the demand verified.

The demand for a poll may be withdrawn at any time by the persons who made the demand.

#### *Time for taking poll and declaring the result*

A poll shall be taken forthwith, if it is demanded for adjournment of the meeting or appointment of Chairman of the meeting.

A poll shall be taken at such time, not being later than 48 hours from the time when the demand was made on any other question. The Chairman shall announce the date, venue and time of taking the poll to enable members to have adequate and convenient opportunity to exercise their votes. Further, the Chairman may permit any member who so desires to be present at the time of counting the votes. The Chairman shall inform the members, the modes and the time of such communication, which shall in any case be within 24 hours of closer of meeting in case the date, venue not announced.

Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems

necessary, to scrutinise the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.

The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

**Note:** Sections 102, 103, 104, 105, 106, 107 and 109 shall apply in case of private company unless otherwise specified in respective sections of articles of the company provided otherwise.

### **Manner the Chairman of Meeting get the poll process scrutinised and Report thereon**

*Rule 21 of Companies (Management and Administration) Rules, 2014 provides that the chairman of a meeting shall ensure that –*

- The Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies.
- The Scrutinizers are provided with all the documents received by the Company.
- The Scrutinizers initial the Polling papers and distribute them to the members and proxies present at the meeting. In case of joint shareholders, the polling paper shall be given to the first named holder or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio. The Polling paper shall be in Form No. MGT.12.
- The Scrutinizers keep a record of the polling papers issued.
- The Scrutinizers lock and seal an empty polling box in the presence of the members and proxies.
- The Scrutinizers open the Polling box in the presence of two persons as witnesses after the voting process is over.
- In case of ambiguity about the validity of a proxy, the Scrutinizers decide the validity in consultation with the Chairman.
- The Scrutinizers shall ensure that if a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.
- The Scrutinizers count the votes cast on poll and prepare a report thereon addressed to the Chairman.
- Where voting is conducted by electronic means, the company shall provide all the necessary support, technical and otherwise, to the Scrutinizers in orderly conduct of the voting and counting the result thereof.
- The Scrutinizers' report state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.
- The Scrutinizers submit the Report to the Chairman who shall counter-sign the same.
- The Chairman declare the result of Voting on poll. The result may either be announced by him or a person authorized by him in writing.

The scrutinizer/s appointed for the poll, shall submit a report to the Chairman of the meeting in Form No. MGT No. 13 within 7 days from the date the poll is taken. The report shall be signed by the scrutinizer / all the scrutinizers, in case there is more than one scrutinizer.

### **Postal Ballot (Section 110)**

**Meaning of postal ballot:** As per section 2(65) "postal ballot" means voting by post or through any

electronic mode. It includes voting by shareholders by postal or electronic mode instead of voting personally for transacting businesses in a general meeting of the company.

Each item proposed to be passed through postal ballot shall be in the form of a Resolution and shall be accompanied by an explanatory statement which shall set out all such facts as would enable a Member to understand the meaning, scope and implications of the item of business and to take a decision thereon.

A company shall send a notice and draft resolution by registered post to all shareholders explaining the reasons and requesting them to send their assent or dissent in writing on a postal ballot. If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

**Meaning of requisite majority:** Requisite majority with regard to special resolution means votes cast in favor of the business is three times more than the votes cast against, with regard to ordinary resolution, votes cast in favor is more than the votes cast against.

**Postal ballot mandatory in certain cases:** Every company shall transact such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot.

**Postal ballot optional in certain cases:** A company may use postal ballot for transacting any item of business, other than

- (a) Ordinary business and
- (b) Any business in respect of which directors or auditors have a right to be heard at any meeting.

**Mandatory business to be transacted through postal ballot: [Rule 22 of Companies (Management and Administration) Rules, 2014]**

The following items of business shall be transacted only by means of voting through postal ballot:

- (a) Alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;
- (b) Alteration of articles of association in relation to insertion or removal of provisions defining a private company.
- (c) Change in place of registered office outside the local limits of any city, town or village.
- (d) Change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised.
- (e) Issue of shares with differential rights as to voting or dividend or otherwise.
- (f) Variation in the rights attached to a class of shares or debentures or other securities.
- (g) Buy-back of shares by a company.
- (h) Election of a 'small shareholders' director.
- (i) Sale of the whole or substantially the whole of an undertaking of a company.
- (j) Giving loans or extending guarantee or providing security exceeding 60% of its paid up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account.
- (k) any other resolution prescribed under any applicable law, rules or regulations.

Following companies are not required to transact any business through postal ballot.

- (i) One person company
- (ii) All other companies having members up to 200.

**Extracts of Secretarial Standard on postal ballot:**

Para 16.1 of SS-2 provides that every company, except a company having less than or equal to two hundred Members, shall transact items of business as prescribed, only by means of postal ballot instead of transacting such business at a General Meeting. Ordinary Business shall not be transacted by means of a postal ballot.

Para 16.2 of SS-2 provides that every company having its equity shares listed on a recognized stock exchange other than companies whose equity shares are listed on SME Exchange or on the Institutional Trading Platform and other companies which are required to provide e-voting facility shall provide such facility to its Members in respect of those items, which are required to be transacted through postal ballot. Other companies presently prescribed are companies having not less than one thousand Members.

**Rule 22 of the Companies (Management and Administration) Rules, 2014** lay down the procedure to be followed for conducting business through postal ballot.

**(1) Notice to all shareholders :** The company shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot because postal ballot means voting by post or through electronic means within a period of thirty days from the date of dispatch of the notice.

**(2) Mode of sending documents:** The notice shall be sent

- (a) By Registered Post or speed post, or
- (b) Through electronic means like registered e-mail id or
- (c) Through courier service

**Secretarial Standard on Notice of postal ballot (Para 16):**

Notice of the postal ballot shall be given in writing to every Member of the company. Such Notice shall be sent either by registered post or speed post, or by courier or by e-mail or by any other electronic means at the address registered with the company.

The Notice shall be accompanied by the postal ballot form with the necessary instructions for filling, signing and returning the same. In case the Notice and accompanying documents are sent to Members by e-mail, these shall be sent to the Members' e-mail addresses, registered with the company or provided by the depository, in the manner prescribed under the Act.

Such Notice shall also be given to the Directors and Auditors of the company, to the Secretarial Auditor, to Debenture Trustees, if any, and, wherever applicable or so required, to other specified recipients.

Notice shall specify the day, date, time and venue where the results of the voting by postal ballot will be announced and the link of the website where such results will be displayed.

Notice shall also specify the mode of declaration of the results of the voting by postal ballot.

Notice of the postal ballot shall inform the Members about availability of e-voting facility, if any, and provide necessary information thereof to enable them to access such facility.

In case the facility of e-voting has been made available, the provisions relating to conduct of e-voting shall apply, mutatis mutandis, as far as applicable.

Notice shall describe clearly the e-voting procedure.

Notice shall also clearly specify the date and time of commencement and end of e-voting, if any and contain a statement that voting shall not be allowed beyond the said date and time. Notice shall also contain contact details of the official responsible to address the grievances connected with the e-voting for postal ballot.

Notice shall clearly specify that any Member cannot vote both by post and e-voting and if he votes both by post and e-voting, his vote by post shall be treated as invalid.

**(3) Publishing of an advertisement:** The company shall issue an advertisement to be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, stating that the ballot papers have been dispatched.

The advertisement shall specify the following matters, namely:-

- (a) A statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;
- (b) The date of completion of dispatch of notices;
- (c) The date of commencement of voting (postal and e-voting);
- (d) The date of end of voting (postal and e-voting);
- (e) A statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date; For this purpose the SS-2 provides that the advertisement shall include a statement that any posted ballot form received from the member after thirty days from the date of dispatch of Notice will not be valid.
- (f) A statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof;
- (g) The Contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means; and
- (h) day, date, time and venue of declaration of results and the link of the website where such results will be displayed.

Notice and the advertisement shall clearly mention the record date as on which the right of voting of the Members shall be reckoned and state that a person who is not a Member as on the record date should treat this Notice for information purposes only.

**(4) Notice to be placed on the website:**

The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members.

Such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

**(5) Appointment of scrutinizer:** The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting



process in a fair and transparent manner.

The scrutiniser may be a Company Secretary in Practice, a Chartered Accountant in Practice, a Cost Accountant in Practice, an Advocate or any other person of repute who is not in the employment of the company and, who can in the opinion of the Board, scrutinise the postal ballot process in a fair and transparent manner.

The scrutiniser shall however not be an officer or employee of the company.

The scrutiniser so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system.

Prior consent to act as a scrutiniser shall be obtained from the scrutiniser and placed before the Board for noting.

**(6) Safe custody of registers and papers:** Postal ballot received back from the shareholders shall be kept in the safe custody of the scrutinizer and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.

**(7) Submission of report of the scrutinizer:** The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.

**(8) Maintenance of register by the Scrutinizer:** The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of the shareholder and details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.

**(9) Preservation of postal ballots:** The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the ballot papers and other related papers or register to the company who shall preserve such ballot papers and other related papers or register safely.

**(10) Reply from members:** The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.

**(11) Declaration of result:** The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.

**(12) Resolution deemed to be passed in general meeting:** The resolution shall be deemed to be passed on the date of at a meeting convened in that behalf.

**(13) Applicability of Rule 20:** The provisions of Rule 20 of Companies (Management and Administration) Rules, 2014 regarding voting by electronic means shall apply, as far as applicable, with the necessary changes to this rule in respect of the voting by electronic means.

**A postal ballot form shall be considered invalid if:**

- (a) A form other than one issued by the company has been used;
- (b) It has not been signed by or on behalf of the Member;
- (c) Signature on the postal ballot form doesn't match the specimen signatures with the company

- (d) It is not possible to determine without any doubt the assent or dissent of the Member;
- (e) Neither assent nor dissent is mentioned;
- (f) Any competent authority has given directions in writing to the company to freeze the Voting Rights of the Member;
- (g) The envelope containing the postal ballot form is received after the last date prescribed;
- (h) The postal ballot form, signed in a representative capacity, is not accompanied by a certified copy of the relevant specific authority;
- (i) It is received from a Member who is in arrears of payment of calls;
- (j) It is defaced or mutilated in such a way that its identity as a genuine form cannot be established;
- (k) Member has made any amendment to the Resolution or imposed any condition while exercising his vote. (Para 16.5.3 of SS-2)

### **Rescinding the Resolution**

A Resolution passed by postal ballot shall not be rescinded otherwise than by a Resolution passed subsequently through postal ballot. **(Para 16.8 of SS-2)**

### **Modification to the Resolution**

No amendment or modification shall be made to any Resolution circulated to the Members for passing by means of postal ballot. **(Para 16.9 of SS-2)**

### **Circulation of Members' Resolution (Section 111)**

As per Section 111, a company shall, on requisition in writing of certain number of members, give notice to members of any proposed resolution intended to be moved in the meeting or circulate any statement with respect to matters referred in proposed resolution. The company shall be bound to give notice of resolution only if the requisition is deposited not less than six weeks before the meeting. In case of other requisition not less than 2 weeks before the meeting. The statement need not be circulated if the Central Government declares that the right conferred is being abused to secure needless publicity for defamatory matters. If default is made the company and every officer of the company shall be punishable with fine.

### **Representation of President and Governors in Meetings (Section 112)**

Section 112 of the Act provides that President of India or the Governor of a State, if he is a member of a company, may appoint such person as he thinks fit, to act as his representative at any meeting of the company. The person so appointed shall be deemed to be a members and have the same rights including the right to vote by proxy or postal ballot, as the President or Governor could exercise as a member of the company.

### **Representation of Corporations at Meeting of Companies and of Creditors (Section 113)**

In terms of Section 113, where a body corporate is a member or a creditor including a holder of debentures of the company and it authorises any person as its representative at any meeting of the company or any class of members of the company or at any meeting of creditors of the company, such representative shall be entitled to exercise the same rights and powers including right to vote by proxy and by postal ballot on behalf of the body corporate which he represents.

## Ordinary and Special Resolutions

Section 114 relates to Ordinary and Special Resolution.

### **Ordinary Resolution**

A resolution shall be an ordinary resolution if the notice required under this Act has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, as the case may be, in favour of the resolution, including the casting vote, if any, of the Chairman, by members who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolution by members, so entitled and voting.

### **Special Resolution**

A resolution shall be a special resolution when:

- (a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution;
- (b) the notice required under this Act has been duly given; and
- (c) the votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, by members who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be **not less than three times** the number of the votes, if any, cast against the resolution by members so entitled and voting.

If the notice convening the meeting (where at special business will be transacted) does not state the nature of the special business, the meeting would be deemed to have been convened irregularly. Consequently, that special business cannot be dealt with at the meeting.

### **Test your knowledge:**

**Question:** At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 2013, examine the validity of the Chairman's declaration.

**Hint:** In the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of Section 114 are satisfied, the decision of the Chairman is in order.

## Resolutions requiring Special Notice (Section 115)

Section 115 provides that where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of total voting power or holding shares on which such aggregate sum not exceeding Rs.5,00,000/- as may be prescribed has been paid-up and the company shall give its members notice of the resolution in the following manner as prescribed in Rules.

### **Provisions contained in the Act requiring special notice:**

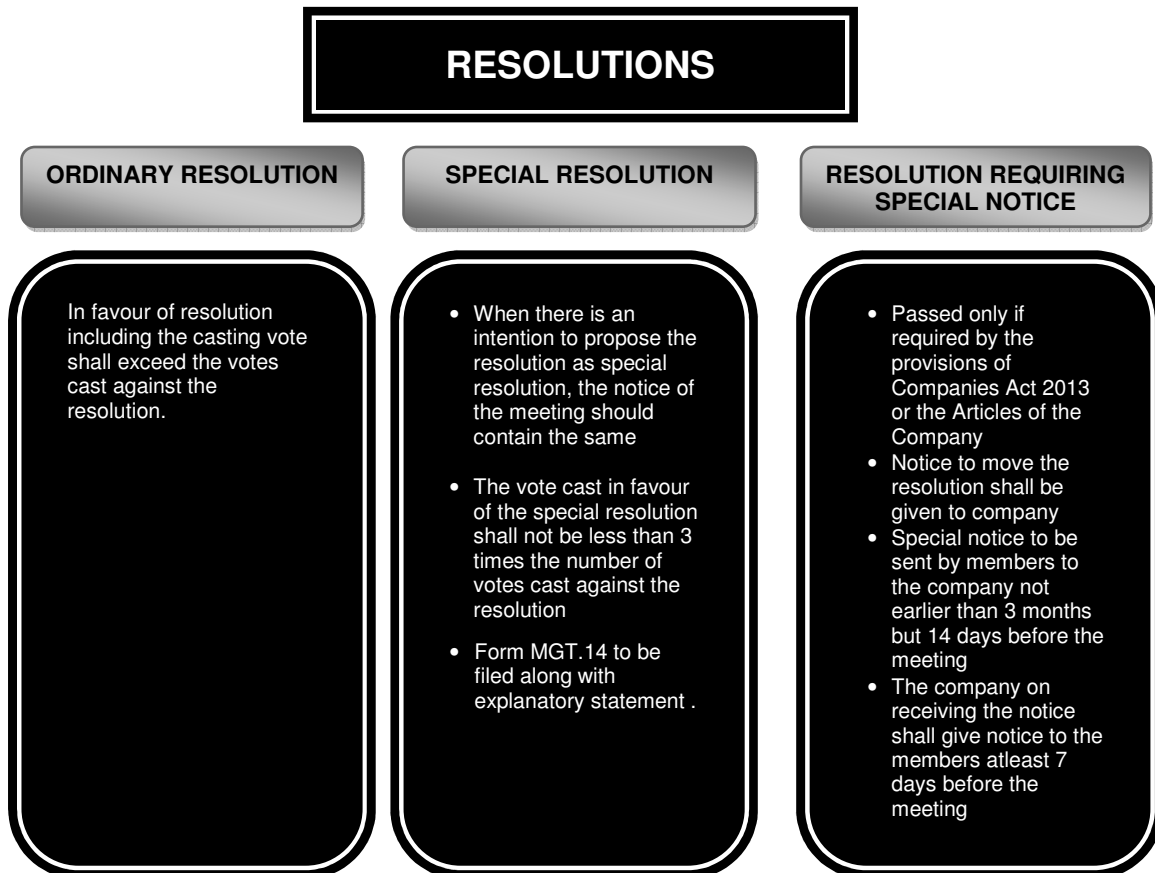
The matters in respect of which special notice is required are:

- (a) A resolution for appointment of a person as auditor at the annual general meeting other than the retiring auditor for providing expressly that the retiring auditor shall not be re-appointed [Section 140(4)];
- (b) A resolution for removing a director before the expiry of the period of his office and appointing someone

in the place of the director so removed [Section 169(2)].

**Procedure for special notice:**

- (A) **Signing of special notice:**—A special notice required to be given to the company shall be signed, either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not more than five lakh rupees has been paid up on the date of the notice.
- (B) **Sending of notice to the company:**—Such notice shall be sent by members to the company not earlier than three months but at least 14 days before the date of the meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.
- (C) **On receipt of notice by the company:**—The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven days before the meeting, exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.
- (C) **Publication of notice:**— Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated. Such notice shall also be posted on the website, if any, of the Company. Such notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.



### Resolutions passed at Adjourned Meeting

As per Section 116 where a resolution is passed at an adjourned meeting of a company; or the holders of any class of shares in a company; or the Board of Directors, the resolution shall be treated as passed on the day it was actually passed and not on any earlier date.

### Resolutions and Agreements to be filed with the Registrar

Section 117 provides that a copy of every resolution and an agreement in respect of matters specified therein together with the explanatory statement shall be filed in Form No. MGT.14 with the Registrar within thirty days of its passing. The Registrar shall register the same and in case of any default, a company and every officer who is in default including the liquidator shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

*Resolutions and agreements to be filed with the Registrar are as under:*

- (a) **special resolutions;**
- (b) **resolutions which have been agreed to by all the members of a company**, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;
- (c) **any resolution of the Board of Directors of a company** or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
- (d) **resolutions or agreements which have been agreed to by any class of members** but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;
- (e) **resolutions passed by a company according consent to the exercise by its Board of Directors** of any of the powers under clause (a) and clause (c) of sub-section (1) of section 180;
- (f) **resolutions requiring a company to be wound up voluntarily** passed in pursuance of section 59 of the Insolvency and Bankruptcy Code;
- (g) resolutions passed in pursuance of sub-section (3) of section 179 provided that no person shall be entitled under Section 399 to inspect or obtain copies of such resolutions; and

This sub-clause is not applicable to private companies vide exemption notifications dated 5<sup>th</sup> June, 2015.

- (h) any other resolution or agreement as may be prescribed and placed in the public domain.

### Maintenance of Minutes of Meetings

The minutes refer to a written record of business transacted at a meeting. Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute

discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting and containing fair and correct summary of the proceeding thereat.

*As per section 118(10) every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.*

### **Secretarial Standard on Minutes**

**Procedure of maintenance of minutes:** Minutes shall be recorded in books maintained for that purpose. **(Para 17.1.1 of SS-2)**

A distinct Minutes Book shall be maintained for Meetings of the Members of the company, creditors and others as may be required under the Act. **(Para 17.1.2 of SS-2)**

Resolutions passed by postal ballot shall be recorded in the Minutes book of General Meetings.

**Precautions to be taken while preparing the minutes:**

**(1) Uniformity in the manner of maintaining minutes:** Minutes may be maintained in electronic form in such manner as prescribed under the Act and as may be decided by the Board. Minutes in electronic form shall be maintained with Time stamp. (Para 17.1.3 of SS-2). Time stamp under SS-2 has been defined to mean the current time of an event that is recorded by a secured computer system and is used to describe the time that is printed to a file or other location to help keep track of when data is added, removed, sent or received.

Every company shall, however, follow a uniform and consistent form of maintaining the Minutes. Any deviation in such form of maintenance shall be authorized by the Board.

**(2) Page Numbering:** The pages of the Minutes Books shall be consecutively numbered. (Para 17.1.4 of SS-2)

This shall be followed irrespective of a break in the Book arising out of periodical binding in case the Minutes are maintained in physical form. This shall be equally applicable for maintenance of Minutes Book in electronic form with Time stamp.

In the event any page or part thereof in the Minutes Book is left blank, it shall be scored out and initialled by the Chairman who signs the Minutes.

Minutes shall not be pasted or attached to the Minutes Book, or tampered with in any manner. (Para 17.1.5 of SS-2)

**(1) Binding of minutes:** Minutes of Meetings, if maintained in loose-leaf form, shall be bound periodically depending on the size and volume. (Para 17.1.6 of SS-2)

There shall be a proper locking device to ensure security and proper control to prevent removal or manipulation of the loose leaves.

**(2) Place of keeping minutes:** Minutes Books shall be kept at the Registered Office of the company or at such other place, as may be approved by the Board. (Para 17.1.7 of SS-2)

**Para 17.2 of SS-2 prescribes for Contents of Minutes**

**(i) General Contents**

Minutes shall state, at the beginning the Meeting, name of the company, day, date, venue and time of

commencement and conclusion of the Meeting. In case a Meeting is adjourned, the Minutes shall be entered in respect of the original Meeting as well as the adjourned Meeting. In respect of a Meeting convened but adjourned for want of Quorum a statement to that effect shall be recorded by the Chairman or any Director present at the Meeting in the Minutes.

Minutes shall record the names of the Directors and the Company Secretary present at the Meeting.

The names of the Directors shall be listed in alphabetical order or in any other logical manner, but in either case starting with the name of the person in the Chair.

## **(ii) Specific Contents**

Minutes shall, inter alia, contain:

- (a) The Record of election, if any, of the Chairman of the Meeting.
- (b) The fact that certain registers, documents, the Auditor's Report and Secretarial Audit Report, as prescribed under the Act were available for inspection.
- (c) The Record of presence of Quorum.
- (d) The number of Members present in person including representatives.
- (e) The number of proxies and the number of shares represented by them.
- (f) The presence of the Chairmen of the Audit Committee, Nomination and Remuneration Committee and Stakeholders Relationship Committee or their authorised representatives.
- (g) The presence if any, of the Secretarial Auditor, the Auditors, or their authorised representatives, the Court/Tribunal appointed observers or scrutinisers.
- (h) Summary of the opening remarks of the Chairman.
  - (i) Reading of qualifications, observations or comments or other remarks on the financial transactions or matters which have any adverse effect on the functioning of the company, as mentioned in the report of the Auditors.
  - (j) Reading of qualifications, observations or comments or other remarks as mentioned in the report of the Secretarial Auditor.
- (k) Summary of the clarifications provided on various Agenda Items.
  - (l) In respect of each Resolution, the type of the Resolution, the names of the persons who proposed and seconded and the majority with which such Resolution was passed. Where a motion is moved to modify a proposed Resolution, the result of voting on such motion shall be mentioned. If a Resolution proposed undergoes modification pursuant to a motion by shareholders, the Minutes shall contain the details of voting for the modified Resolution.
- (m) In the case of poll, the names of scrutinisers appointed and the number of votes cast in favour and against the Resolution and invalid votes.
- (n) If the Chairman vacates the Chair in respect of any specific item, the fact that he did so and in his place some other Director or Member took the Chair.
- (o) the time of commencement and conclusion of the Meeting.

### **Minutes of E-Voting and postal ballot:**

Para 17.2.2.2 of SS-2 provides that in respect of Resolutions passed by e-voting or postal ballot, a brief

report on the e-voting or postal ballot conducted including the Resolution proposed, the result of the voting thereon and the summary of the scrutiniser's report shall be recorded in the Minutes Book and signed by the Chairman or in the event of death or inability of the Chairman, by any Director duly authorised by the Board for the purpose, within thirty days from the date of passing of Resolution by e-voting or postal ballot.

### **17.3. Recording of Minutes**

Minutes shall contain a fair and correct summary of the proceedings of the Meeting. The Company Secretary shall record the proceedings of the Meetings. Where there is no Company Secretary, any other person authorised by the Board or by the Chairman in this behalf shall record the proceedings.

The Chairman shall ensure that the proceedings of the Meeting are correctly recorded.

The Chairman has absolute discretion to exclude from the Minutes, matters which in his opinion are or could reasonably be regarded as defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of the company.

**Para 17.3.2 of SS-2 provides** that minutes shall be written in clear, concise and plain language.

Minutes shall be written in third person and past tense. Resolutions shall however be written in present tense. Minutes need not be an exact transcript of the proceedings at the Meeting.

Para 17.3.3 of SS-2 provides that each item of business taken up at the Meeting shall be numbered.

Numbering shall be in a manner which would enable ease of reference or cross-reference.

### **Para 17.4 of SS-2 prescribes for entry in the Minutes Book**

Minutes shall be entered in the Minutes Book within thirty days from the date of conclusion of the Meeting. In case a Meeting is adjourned, the Minutes in respect of the original Meeting as well as the adjourned Meeting shall be entered in the Minutes Book within thirty days from the date of the respective Meetings.

The date of entry of the Minutes in the Minutes Book shall be recorded by the Company Secretary. Where there is no Company Secretary, it shall be entered by any other person authorised by the Board or the Chairman. Minutes, once entered in the Minutes Book, shall not be altered.

### **Para 17.5 of SS-2 prescribes for Signing and Dating of Minutes**

Minutes of a General Meeting shall be signed and dated by the Chairman of the Meeting or in the event of death or inability of that Chairman, by any Director who was present in the Meeting and duly authorised by the Board for the purpose, within thirty days of the General Meeting.

The Chairman shall initial each page of the Minutes, sign the last page and append to such signature the date on which and the place where he has signed the Minutes. Any blank space in a page between the conclusion of the Minutes and signature of the Chairman shall be scored out.

If the Minutes are maintained in electronic form, the Chairman shall sign the Minutes digitally.

Rule 25 of Companies (Management and Administration) Rules, 2014 contains provisions with regards to minutes of meetings.

**(A) Distinct minute book for each type of meeting:** A distinct minute book shall be maintained for each type of meeting namely:

- (i) general meetings of the members;



- (ii) meetings of the creditors;
- (iii) meetings of the Board; and
- (iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

**(B) Manner of maintenance of minutes:** Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

**(C) Manner of signing of minutes:** Each page of every minute book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

**(D) Preservation of minutes book:** Minute books of general meetings shall be kept at the registered office of the company. Minutes of the Board and committee meetings shall be kept at the registered office or at such other place as may be approved by the Board.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act.

### Inspection of Minute book of General Meeting (Section 119)

**(1) Place of keeping minutes book:** In terms of Section 119, the minute's book of general meetings or of a resolution passed by postal ballot shall

- (a) be kept at the registered office of a company; and
- (b) shall be open for inspection to members during business hours without any charge subject to such restrictions as the company may, by its articles or in general meeting, impose so, however, that shall not be less than two hours in each business day are allowed for inspection.

**(2) Issue of copy of minutes to the member:** Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, with a copy of any minutes of any general meeting, on payment of such sum as may be specified in the articles of the company but not exceeding a sum of ten rupees for each page or part of any page. A member who has made a request for provision of soft copy in respect of minutes of any previous general meetings held during a period of immediately preceding three financial years shall be entitled to be furnished, with the same free of cost.

- (i) Refusal of inspection or furnishing of copy of minutes: If any inspection under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for each such refusal or default, as the case may be.
- (ii) In case of default: In the case of any such refusal or default, the Tribunal may, without prejudice to any action being taken under sub-section (3), by order, direct an immediate inspection of the minute-books or direct that the copy required shall forthwith be sent to the person requiring it.
- (iii) Secretarial Standard on Inspection and Extracts of Minutes (Para 17.6.1):

Directors and Members are entitled to inspect the minutes of all General Meetings including resolutions passed by postal ballot.

The Company Secretary in Practice appointed by the company, the Secretarial Auditor, the Statutory Auditor, the Cost Auditor or the Internal Auditor of the company can inspect the Minutes as he may consider necessary for the performance of his duties.

Inspection of Minutes Book may be provided in physical or in electronic form.

While providing inspection of Minutes Book, the Company Secretary or the official of the company authorised by the Company Secretary to facilitate inspection shall take all precautions to ensure that the Minutes Book is not mutilated or in any way tampered with by the person inspecting.

- (iv) Extract of the Minutes shall be given only after the Minutes have been duly signed. However, any Resolution passed at a Meeting may be issued even pending signing of the Minutes, provided the same is certified by the Chairman or any Director or the Company Secretary.

Where a Member requests for the copy of the Minutes in electronic form, in respect of any previous General Meetings held during a period immediately preceding three financial years, the company shall furnish the same on payment of not exceeding Rs. 10 per page.

Copies of the Minutes or the extracts thereof as requisitioned by the Member, duly certified by the Company Secretary or where there is no Company Secretary, an officer duly authorised by the Board in this behalf, may be provided in physical or electronic form.

### **Maintenance and Inspection of Document in Electronic Form (Section 120)**

According to section 120 of the Companies Act, 2013, where any document, record, register, minutes, etc.,—

- (a) required to be kept by a company; or
- (b) allowed to be inspected or copies to be given to any person by a company under this Act, may be kept or inspected or copies given, as the case may be, in electronic form in such form and manner as may be prescribed.

According to the rules provided on the maintenance and inspection of document in electronic form under the

Rule 27 of Companies (Management and Administration) Rules, 2014 –

- (1) Companies required to maintain the documents in electronic form: , every listed company or a company having not less than one thousand share holders, debenture holders and other security holders, may maintain its records, as required to be maintained under the Act or rules made there under, in electronic form.
- (2) **Maintenance of records according to the Board of Directors:** The records in electronic form shall be maintained in such manner as the Board of directors of the company may think fit, provided that-
  - the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made there under;
  - the information as required under the provisions of the Act or the rules made there under should be adequately recorded for future reference;
  - the records must be capable of being readable, retrievable and reproducible in printed form;
  - the records are capable of being dated and signed digitally wherever it is required under the provisions of the Act or the rules made there under;
  - the records, once dated and signed digitally, shall not be capable of being edited or altered;
  - the records shall be capable of being updated, according to the provisions of the Act or the rules made there under, and the date of updation shall be capable of being recorded on every updation.

It may be noted that the term “records” means any register, index, agreement, memorandum, minutes or any other document required by the Act or the rules made there under to be kept by a company.

### **Secretarial Standard on preservation of minutes and other records (Para 18)**

- (1) Minutes of all Meetings shall be preserved permanently in physical or in electronic form with Time stamp.

Where, under a scheme of arrangement, a company has been merged or amalgamated with another company, Minutes of all Meetings of the transferor company, as handed over to the transferee company, shall be preserved permanently by the transferee company, notwithstanding that the transferor company might have been dissolved.

- (2) Office copies of Notices, scrutiniser’s report, and related papers shall be preserved in good order in physical or in electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board.

Office copies of Notices, scrutiniser’s report, and related papers of the transferor company, as handed over to the transferee company, shall be preserved in good order in physical or electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board and permission of the Central Government, where applicable.

- (3) Minutes Books shall be kept in the custody of the Company Secretary.

Where there is no Company Secretary, Minutes shall be kept in the custody of any Director duly authorised for the purpose by the Board.

### Security of Records maintained in electronic form

- (1) **Persons responsible for security of records in electronic form:** The Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsible for the maintenance and security of electronic records.
- (2) **Duties of persons responsible for security of records in electronic form:** The person who is responsible for the maintenance and security of electronic records shall-
- provide adequate protection against unauthorized access, alteration or tampering of records;
  - ensure against loss of the records as a result of damage to, or failure of the media on which the records are maintained;
  - ensure that the signatory of electronic records does not repudiate the signed record as not genuine;
  - ensure that computer systems, software and hardware are adequately secured and validated to ensure their accuracy, reliability and consistent intended performance;
  - ensure that the computer systems can discern invalid and altered records;
  - ensure that records are accurate, accessible, and capable of being reproduced for reference later;
  - ensure that the records are at all times capable of being retrieved to a readable and printable form;
  - ensure that records are kept in a non-rewriteable and non-erasable format like pdf. version or some other version which cannot be altered or tampered;
  - ensure that at least two backups, taken at a periodicity of not exceeding one day, are kept of the updated records kept in electronic form, every backup is authenticated and dated and such backups shall be securely kept at such places as may be decided by the Board;
  - limit the access to the records to the managing director, company secretary or any other director or officer as may be authorized by the Board in this behalf;
  - ensure that any reproduction of non-electronic original records in electronic form is complete, authentic, true and legible when retrieved;
  - arrange and index the records in a way that permits easy location, access and retrieval of any particular record; and
  - take necessary steps to ensure security, integrity and confidentiality of records.

### Inspection and Copies of Records maintained in Electronic Form

Where a company maintains its records in electronic form, any duty imposed by the Act or rules made there under to make those records available for inspection or to provide copies of the whole or a part of those records, shall be construed as a duty to make the records available for inspection in electronic form or to provide copies of those records containing a clear reproduction of the whole or part thereof, as the case may be.

### Penalty

If any default is made in compliance with any of the provisions of this rule, the company and every officers or such other person who is in default shall be punishable with fine which may extend to five thousand rupees

and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which such contravention continues.

### Report on Annual General Meeting (Section 121)

Section 121 of the Companies Act, 2013 provides the preparation of report on each annual general meeting which is to be filed with the registrar.

**(1) Report to be prepared by the listed public company:** Every listed public company is required to prepare a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of the Act and the rules made thereunder.

**(2) Filing of the report with the Registrar:** A copy of the report is to be filed with the Registrar in Form No. MGT. 15 within thirty days of the conclusion of annual general meeting along with the prescribed fee or with such additional fees as may be prescribed, within the time as specified, under section 403.

**(3) Default in filing of the report:** If the company fails to file the report before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

According to Rule 31 of Companies (Management and Administration) Rules, 2014, the report shall be prepared in the following manner:

- (1)(a) The report on AGM shall be prepared in addition to the minutes of the general meeting.
- (b) The report shall contain fair and correct summary of the proceedings of the AGM.

**(2) Signing of the report:**

The report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary.

**(3) Contents of the report:**

Such report shall contain the details in respect of the following:

- The day, date, hour and venue of the annual general meeting.
- Confirmation with respect to appointment of Chairman of the meeting.
- Number of members attending the meeting.
- Confirmation of quorum.
- Confirmation with respect to compliance of the Act and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting.
- Business transacted at the meeting and result thereof with a brief summary of the discussion.
- Particulars with respect to any adjournment, postponement of meeting, change in venue.
- Any other points relevant for inclusion in the Report.

### Applicability to One Person Company

Section 122 provides that the provisions of section 98 and sections 100 to 111 shall not apply to a One Person Company. Any business which is required to be transacted at Annual General Meeting or other

general meeting of a company by means of ordinary or special resolution, it shall be sufficient if, in case of One Person Company, the resolution is communicated by the member to the company and entered in the minute book. Such minute book shall be signed and dated by the member and such date shall be deemed to be the date of the meeting.

### LESSON ROUND-UP

- An annual general meeting is required to be held every year by every company whether public or private, limited by shares or by guarantee, with or without share capital or unlimited company.
- In case of default is made in holding the annual general meeting of a company under section 96, the Tribunal may call or direct the calling of an annual general meeting.
- Class meetings are those meetings which are held by holders of a particular class of shares e.g. preference shares.
- It is mandatory for a company to pass resolution by postal ballot in respect of such items of business as the central government may by notification declare transacted only by the postal ballot.
- For a General Meeting to be valid, it must be duly convened, properly constituted and the business must be validly transacted.
- In case of public company the quorum shall depend on number of members as on the date of meeting:-
  - If members not more than 1000—quorum shall be 5
  - If members more than 1000 but less than 5000- quorum shall be 15
  - If members more than 5000- quorum shall be 30
- In case of private company 2 members personally present shall be the quorum of the meeting.
- The central government is vested with the power to prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.
- Chairman plays a very important role in a meeting as he is responsible for successful conduct of a meeting
- A motion becomes a resolution only after the requisite majority of members have adopted it.
- Various methods which may be adopted for taking votes on a motion properly placed before a meeting are by show of hands, by poll, by postal ballot and by electronic voting.
- There are three kinds of resolutions under the Act (a) Ordinary Resolution (S. 114), (b) Special Resolution (S. 114) (c) Resolution requiring special notice (S. 115)
- In accordance with Section 117 of the Act, certain resolutions are required to be filed with the Registrar for its recording within 30 days of its passing at the meeting.
- There are certain businesses, specified under Section 110 of the Act, which are required to be passed through postal ballot.
- Postponement is the act of the convening authority whereas the adjournment is the act of meeting itself.
- Every company is required to keep minutes of the proceedings of general meetings and of the meetings of Board of Directors and its Committees.
- Every listed company is required to prepare a report on AGM.







# Lesson 19

## Loans and Investments by Companies

### LESSON OUTLINE

- Introduction to investment
  - Loans and investments by companies
  - Comparison of section 186 with section 185
  - Applicability of section 186 to Section 8 company
  - Applicability of section 186 to a guarantee company not having share capital
  - Register of loans made, guarantees given, securities provided and investments made
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- Loan to Directors by companies
  - Punishment for contravention and exemptions.
  - Investments to be held in company's own name and exemptions
  - Register of investments not held in company's own name

### LEARNING OBJECTIVES

As per Section 186 of the Companies Act 2013, a company cannot, unless otherwise prescribed, make investment through more than 2 layers of investment companies except to comply with law and in case of acquisition of a foreign company. Compliance with this requirement may involve significant restructuring in many cases. Besides the section prescribes the limits beyond which special resolution is to be obtained for loans or investments etc.,

After reading this lesson you will be able to understand the provisions of the Companies Act, 2013 (the Act) in relation to loans and investments by companies, the conditions wherein such loans and investments can/cannot be made. It also gives provisions for register of loans made, guarantees given, securities provided and investments made as also register of investments not held in company's own name. The lesson further lists the circumstances wherein companies are not required to keep the investments in its own name.

## INTRODUCTION

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, for the purpose of this study, the term 'Investments' is used in a limited sense to mean the investment of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount. Thus apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.

Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013 by inserting Section 186. As of now, an overall limit of 60% of paid-up share capital plus free reserves and securities premium account or 100% of free reserves and securities premium account, whichever is more has been fixed.

### Let us understand some terminologies used in Section 186 of the Companies Act 2013

#### Free reserves

As per section 2(43) “free reserves” means such reserves which, as per the latest audited balance Sheet of a company, are available for distribution as dividend:

Provided that—

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves;

#### “body corporate” or “corporation

As per Section 2(11) “body corporate” or “corporation” includes a company incorporated outside India, but does not include—

- (i) a co-operative society registered under any law relating to co-operative societies; and
- (ii) any other body corporate (not being a company as defined in this Act),

which the Central Government may, by notification, specify in this behalf;

#### Investment Company & Infrastructure facilities

As per explanation to Section 186

- (a) the expression “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities;

(b) the expression “infrastructure facilities” means the facilities specified in Schedule VI.

As per Schedule VI, the term “infrastructural projects” or “infrastructural facilities” includes the following projects or activities:—

(1) Transportation (including inter modal transportation), includes the following:—

- (a) roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services;
- (b) rail system, rail transport providers, metro rail roads and other railway related services;
- (c) ports (including minor ports and harbours), inland waterways, coastal shipping including shipping lines and other port related services;
- (d) aviation, including airports, heliports, airlines and other airport related services;
- (e) logistics services.

(2) Agriculture, including the following, namely:—

- (a) infrastructure related to storage facilities;
- (b) construction relating to projects involving agro-processing and supply of inputs to agriculture;
- (c) construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality.

(3) Water management, including the following, namely:—

- (a) water supply or distribution;
- (b) irrigation;
- (c) water treatment.

(4) Telecommunication, including the following, namely:—

- (a) basic or cellular, including radio paging;
- (b) domestic satellite service (i.e., satellite owned and operated by an Indian company for providing telecommunication service);
- (c) network of trunking, broadband network and internet services.

(5) Industrial, commercial and social development and maintenance, including the following, namely:—

- (a) real estate development, including an industrial park or special economic zone;
- (b) tourism, including hotels, convention centres and entertainment centres;
- (c) public markets and buildings, trade fair, convention, exhibition, cultural centres, sports and recreation infrastructure, public gardens and parks;
- (d) construction of educational institutions and hospitals;
- (e) other urban development, including solid waste management systems, sanitation and sewerage systems.

(6) Power, including the following:—

- (a) generation of power through thermal, hydro, nuclear, fossil fuel, wind and other renewable sources;

- (b) transmission, distribution or trading of power by laying a network of new transmission or distribution lines.

(7) Petroleum and natural gas, including the following:—

- (a) exploration and production;
- (b) import terminals;
- (c) liquefaction and re-gasification;
- (d) storage terminals;
- (e) transmission networks and distribution networks including city gas infrastructure.

(8) Housing, including the following:—

- (a) urban and rural housing including public / mass housing, slum rehabilitation, etc;
- (b) other allied activities such as drainage, lighting, laying of roads, sanitation and facilities.

(9) Other miscellaneous facilities/services, including the following:—

- (a) mining and related activities;
- (b) technology related infrastructure;
- (c) manufacturing of components and materials or any other utilities or facilities required by the infrastructure sector like energy saving devices and metering devices;
- (d) environment related infrastructure;
- (e) disaster management services;
- (f) preservation of monuments and icons;
- (g) emergency services (including medical, police, fire and rescue).

(10) such other facility service as may be prescribed.

### **Securities**

As per Section 2(81) "securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;

As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956, "**securities**" include—

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
  - (ia) derivative;
  - (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
  - (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
  - (id) units or any other such instrument issued to the investors under any mutual fund scheme; (ii) Government securities;
- (ii) (a) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interest in securities;

**LOANS AND INVESTMENTS BY COMPANIES (Section 186)****Not more than two layers of investment companies - Section 186(1)**

A company shall unless otherwise prescribed, make investment through not more than two layers of investment companies. [Sub-section (1) of section 186]

However, the aforesaid provisions shall not affect,—

- (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
- (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force. [Proviso to sub-section (1) of section 186]

Therefore, Section 186 (1) restricts a company from making investment through more than 2 layers of investment companies.

As stated above, for the purpose of Section 186 of the Act, Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.

The definition of Investment Company is exhaustive. Further, the restriction under section 186(1) is on Investment through Investment Companies only .

Therefore, Investment through any Company other than the Investment Company is not covered under sub-section (1) of Section 186 of the Act.

**Restriction on providing loans, guarantees and investment - Section 186(2)**

No Company shall, directly or indirectly:

- (a) give any loan to any person or other body corporate;
- (b) give any guarantee, or provide security, in connection with a loan to any other person body corporate or person; and
- (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more unless the same is previously authorised by a special resolution passed in a general meeting.

**Paid-up share capital**

As per Section 2(64) of the Act, “paid-up share capital” or “share capital paid-up” **means** such aggregate amount of money credited as paid-up as is equivalent to the amount received as paidup in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

**The definition of paid up share capital is exhaustive. Paid up share capital includes both equity and preference share capital.**

**Free reserves**

Free Reserves are also defined exhaustively under Section 2(43).

As per Section 2(43), “free reserves” **means** such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend: Provided that

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

The Ministry of Corporate Affairs has clarified vide its general Circular No, 04/2015 dated 10th March 2015 that loans and/or advances made by the companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013. This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

#### **Loan/investment to be made with the approval of all the directors at the Board Meeting [Section 186(5)]**

No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all directors present at the meeting.



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

Section 186 except sub-section (1) therein does not apply to a Banking Company.

- True
- False

**Correct answer: True**

*Note:* Every proposal for making loan to any other body corporate, exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more, shall be approved at the meeting of the Board with the consent of all the directors present at the meeting and also to be approved by the shareholders at the general meeting by way of special resolution. [Section 186(3)]

#### **Disclosure in financial statements [Section 186(4)]**

The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

#### **Prior Approval of Financial Institution [Section 186(5)]**

The company has to obtain prior approval of the public financial institution concerned where any term loan is subsisting. Section 186(5) provides that no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, alongwith the investments, loans, guarantee or security proposed to be made or given

does not exceed the limit of 60% specified above and there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution. [Proviso Section 186(5)]

### **Prior approval by Special Resolution**

#### **Section 186(3) read with Rule 13 states that**

(1) Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under section 186 no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

Explanation.- For the purpose of this sub-rule, it is clarified that it would sufficient compliance if such special resolution is passed within one year from the date of notification of this section.

(2) A resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition:

Provided, that the company shall disclose to the members in the financial statement the full particulars in accordance with the provision of sub-section (4) of section 186.

Rule 11 of Companies (Meetings of Board and its Powers) Rules, 2014 states that

when a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of sub-section (3) of section 186 shall not apply.

### **Loans and investments by intermediaries etc [Section 186(6)]**

No company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

Pursuant to the above provisions no stock broker, sub-broker, share transfer agent, banker to issue, Registrar to an issue, Merchant Baker, underwriter, portfolio manager, investment advisor or any intermediary associated with capital market and which is registered under section 12 of the SEBI Act, shall make loans or investments or give guarantees or provide security in excess of the limits specified above. [Rule 11(3)]

### **Rate of interest [Section 186(7)]**

Loan given under this section shall carry the rate of interest not lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

Further, General circular No. 06/2015 dated 9th April 2014 issued by the Ministry of Corporate Affairs states as under:

Attention of this Ministry has been drawn to General Circular No 06/2013 dated 14.03.2013 vide which it was

clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the yield on prevailing bank rate, there was no violation of Section 372A(3) of Companies Act, 1956. Stakeholders have requested for similar clarification w.r.t. corresponding section 186(7) of the Companies Act, 2013.

The matter has been examined in the Ministry and it is hereby clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year -Government Security closest to the tenor of the loan, there is no violation of sub-section (7) of section 186 of the Companies Act, 2013.

#### **Default subsists with respect to repayment of deposits [Section 186(8)]**

No company, which is in default in repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall give any loan or give any guarantee, or provide any security or make an acquisition till such default is subsisting.

This prohibition will operate in respect of any default made under Section 73 to 76 and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.

#### **REGISTER OF LOANS MADE, GUARANTEES GIVEN, SECURITIES PROVIDED AND INVESTMENTS MADE**

Sub-section (9) of section 186 provides that every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.

#### **Rule 12 states that**

- (1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.
- (2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.
- (3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.
- (4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.
- (5) For the purpose of sub-rule (4), the register can be maintained either manually or in electronic mode.
- (6) The extracts from the register maintained under sub-section (9) of section 186 may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

#### **Inspection of Register**

Sub-section (10) of section 186 provides that the register referred to in sub-section (9) shall be kept at the registered office of the company and —

- (a) shall be open to inspection at such office; and



- (b) extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

### Offence and Penalty

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees. [Section 186(3)]

### Exemptions

Sub-section (11) of section 186 provides that nothing contained in section 186, except sub-section (1), shall apply—

- (a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;
- (b) to any acquisition—
- (i) made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities:  
Provided that exemption to non-banking financial company shall be in respect of its investment and lending activities;
  - (ii) made by a company whose principal business is the acquisition of securities;
  - (iii) of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.
  - (iv) made by banking company or an insurance company or a housing finance company, making acquisitions of securities in the ordinary course of its business.

### Exemption from Applicability of Section 186 to Government Company

In view of the Central Government's notification dated 5<sup>th</sup> June 2015 under Section 462 of the Companies Act, 2013, **Section 186 shall not apply to :**

- (a) a Government company engaged in defence production;
- (b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

**Note:** Except the government companies falling under the above mentioned conditions, all other companies are required to comply with the provisions of Section 186. In cases where there is no share capital, computation shall be based upon the free reserves of the company, if any.

### Section 185- Loan to Directors, etc

No company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

These provisions shall apply to—

- (a) The giving of any loan by the company to a managing or whole-time director—
  - (i) As a part of the conditions of service extended by the company to all its employees; or
  - (ii) Pursuant to any scheme approved by the members by a special resolution; or
- (b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India.
- (c) any loan made by holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or
- (d) any guarantee given or security provided by holding company in respect of loan made by any bank or financial institution to its subsidiary company.

This exception is available to subsidiary only where the loan made under clause (c) and (d) are utilized by the subsidiary company for its principal business activities.

The expression “to any other person in whom director is interested” here refers to —

- (a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
- (b) any firm in which any such director or relative is a partner;
- (c) any private company of which any such director is a director or member;
- (d) any body corporate at a general meeting of which not less than twenty five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or
- (e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

If any loan is advanced or a guarantee or security is given or provided in contravention of the above mentioned provisions, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

Exemption to applicability of Section 185

The provisions of section 185 shall not apply to following companies:

Private Company	Government Company	Nidhi Company
(a) The Private Company in whose share capital no other body corporate has invested any money; (b) if the borrowings of such private company from banks or	The Government company shall obtain approval of the Ministry or Department of the Central Government which is administratively in charge of the company or, as the case may be,	In case of Nidhi companies, the loan given to a director or his relative in their capacity as members and such transaction must be disclosed in the annual accounts by a note.

<p>financial institution or any body corporate is less than twice of its paid up share capital or fifty crore rupees whichever is lower.; and</p> <p>(c) such private company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.</p>	<p>the State Government before making any loan or giving any guarantee or providing any security under the section.</p>	
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(2) For the purposes of clause (a) of sub-section (11) of section 186, the expression “business of financing of companies” shall include, with regard to a Non-Banking Financial Company registered with Reserve Bank of India, “business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business”.

### Section 186 compared with Section 185

As per Section 185 of the Act, no company can directly or indirectly advance any loan, including any loan represented by book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with the loan taken by him or such other person

It should be noted that the provisions of Section 185 of the Companies Act will be applicable in case a loan guarantee or security is provide by the company to its director or any other person in whom the director is interested. Whereas the section 186, prescribe the limits up to which the company can make Loans and investments.

Further, Loans and advances made by the companies to their employees, other than managing and whole time directors ( which is governed by Section 185) are not governed by the requirement of Section 186 of the Act, if such loan/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy of the company if any..

Loan, Guarantee or Security provided by a company to another private company in which a director of the first company is a director or member. As a result, such a loan would be void unless it is given to a managing director or whole-time director pursuant to a scheme approved by the members by way of a special resolution. Also in cases where one or more directors of the a company exercise 25% or more of the total voting power in any other body corporate, no loan can be given by such company to that body corporate as it is prohibited under section 185.

### REVIEW QUESTIONS



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

Every proposal for making loan to any other body corporate, in excess of the limits exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more, is not liable for approval at the general meeting.

- True
- False

**Correct answer: False**

### INVESTMENTS TO BE HELD IN COMPANY'S OWN NAME

According to Sub-section (1) of Section 187, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name.

The requirement that the investment made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. In a case where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. Therefore, the investments by the company as a trustee and held in the name of the beneficiaries is allowed.

As per proviso to section 187(1), the company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

### CASE LAW

Where the shares of a company were registered in the joint names of the company and one of its directors, it was held that the director was a nominee of the company for that purpose and could only act jointly as he had no rights of his own. [Exchange Travel (Holdings) Ltd. Re, (1991) BCLC 728 (Ch D)].

If company holds shares in dematerialised form, the name of depository is entered in the register of members as member of the company and the name of the investing company as the beneficial owner of the said shares.

### Exemptions from applicability of Section 187(1)

1. In terms of the provisions of Section 187(2), Section 187(1) does not prevent a company:
  - (a) from depositing with the bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or
  - (b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof. However, if within a period of 6 months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or
  - (c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.
  - (d) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate

agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

### REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME

According to sub-section (3) of section 187 where in pursuance of clause (d) of sub-section (2), any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Therefore, a company is only required to maintain a register for securities not held in the name of the company, when the investments are held in the name of a depository.

Accordingly when any shares or securities in which investments have been made by a company are not held by it in its own name as a beneficial owner when such investments are held in the name of a depository pursuant to Section 187(2)(d), the company shall forthwith enter in a register maintained by it for the purpose, the prescribed particulars.

### Companies (Meetings of Board and its Powers) Rules, 2014

#### Rule 14 of Companies (Meetings of Board and its Powers) Rules, 2014 states that

(1) Every company shall, from the date of its registration, maintain a register in Form MBP 3 and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(2) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(3) The register shall be maintained at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

(4) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

### PUNISHMENT

According to section 187(4), if a company contravenes the provisions of section 187, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

#### Let us Remember

The company has to maintain register of loans, investments in Form MBP-2 and register of Investment beneficially held by the company but not held in the name of the company in MBP-3.

### LESSON ROUND-UP

- 'Investments' has been used in a limited sense in the lesson to mean the investing of money in shares, stock, debentures or other securities.
- The power to invest the funds of the company is the prerogative of the Board of Directors. However, the Board must not misuse its powers. The Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.
- The provisions for restrictions on investments and loans by companies would also apply to Section 8 companies and guarantee companies not having a share capital.
- Approvals for making investments and loans would have to be taken in accordance with the specific provisions of the Companies Act. A blanket approval of the shareholders for the purpose would not suffice.
- The Companies Act provides for the particulars to be provided in the register of loans made, guarantees given, securities provided and investments made and the manner in which it is to be kept.
- Provisions have also been given in relation to inspection of such register and penalties imposable in case of defaults in maintaining the required registers.
- However, there are certain exemptions wherein these provisions would not be applicable.
- As per the Act, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name. This requirement is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. However, in certain circumstances, the Act exempts the companies from complying with the above provisions.
- When any shares or securities in which investments have been made by a company are not held by it in its own name as a beneficial owner when such investments are held in the name of a depository pursuant to permissible conditions given in the Act, the company shall forthwith enter in a register maintained by it for the purpose, particulars as specified in the Act.
- In case of default, the company is punishable with fine and every officer of the company who is in default shall be punishable with imprisonment or with fine or with both.

### GLOSSARY

<b>Dematerialization</b>	The move from physical certificates to electronic book keeping. The share certificates are being removed and retired from circulation in exchange for electronic recording.
<b>Rematerialization</b>	This is the reverse of dematerialization, in rematerialization the share certificates are being moved from electronic book keeping to physical certificate.

### SELF-TEST QUESTIONS

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

1. Discuss the law relating to loans and investments by companies.







# Lesson 20

## Deposits

### LESSON OUTLINE

- What is Deposit?
- Who is depositor?
- Acceptance of deposit
- Acceptance of deposit from members
- Exemption for Private companies
- Acceptance of Deposit from Public
- Who is an Eligible Company?
- Terms and conditions for acceptance of deposits
- Issue of Advertisements or Circulars
- Deposit Insurance
- Creation of Security
- Trustee for Depositors
- Application for Deposits by Depositors
- Nomination by depositors
- Deposit Receipts
- Repayment of Deposit
- Deposit Repayment Reserve Account
- Repayment of Deposits accepted before the commencement of the Act
- General provisions regarding premature repayment of deposits
- Registers of Deposits
- Return of deposits to be filed with the Registrar
- Penal rate of interest
- Punishment for Contravention
- Other remedies provided under Companies Act 2013

### LEARNING OBJECTIVES

The provisions of Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 regulate aspects as to ceiling of total deposits, circular/advertisement, exemptions etc.

After reading this chapter you will be able to understand the meaning of deposits, procedural and regulatory aspects involved in accepting, renewal and repayment of deposits and consequences of failures in this regard.

*“Bank failures are caused by depositors who don't deposit enough money to cover losses due to mismanagement”.*

*– Dan Quayle*

## Introduction

Companies aim to secure finance by different cost-effective methods to suit their financial requirements. Companies have always been attracted towards financing through deposits and, at times, problems have arisen in the context of such deposits. In order to control the malpractices, the Companies Act, 2013 has introduced strict provisions under the deposit regime.

Sections 73 to 76 of the Companies Act 2013 read with the Companies (Acceptance of Deposits) Rules, 2014 regulate the invitation, acceptance and repayment of deposits by Companies.

## Applicability

The provisions under Sections 73 to 76 of the Companies Act 2013 and the Companies (Acceptance of Deposits) Rules, 2014 shall apply to all companies except -

- a banking company and
- a non- banking financial company as defined in the Reserve Bank of India Act, 1934 and
- a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 2013; and
- such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

[Section 73(1) read with Rule 1(3)]

## What is Deposit?

According to the Section 2(31) of the Act read with Rule 2(c) of Companies (Acceptance of Deposits) Rules, 2014 “deposit” *includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include-*

- (i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;
- (ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 (42 of 1999) and rules and regulations made there under;
- (iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking institution notified by the Central Government under section 51 of the Banking Regulation Act, 1949, or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or in clause (b) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934;

(iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934;

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

**Explanation-** For the purposes of this sub-clause, it is hereby clarified that -

(a) Without prejudice to any other liability or action, if the securities for which application money or advance for such securities was received cannot be allotted within sixty days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within fifteen days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

(b) any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the Private company:

Provided that the director of the company or relative of the director of the private company, as the case may be, from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within ten years:

Provided that if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;

(ixa) any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognised stock exchange as per applicable regulations made by Securities and Exchange Board of India;

(x) any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(xi) any non-interest bearing amount received and held in trust;

(xii) any amount received in the course of, or for the purposes of, the business of the company,-

(a) as an advance for the supply of goods or provision of services accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

Provided that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply;

- (b) as advance, accounted for in any manner whatsoever, received in connection with consideration for an immovable property under an agreement or arrangement, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;
- (c) as security deposit for the performance of the contract for supply of goods or provision of services;
- (d) as advance received under long term projects for supply of capital goods except those covered under item (b) above:
- (e) as an advance towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;
- (f) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;
- (g) as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications;

Provided that if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules:

*Explanation.*- For the purposes of this sub-clause the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions, namely:-

- (a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance;
- (b) the loan is provided by the promoters themselves or by their relatives or by both; and
- (c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter;

(xiv) any amount accepted by a Nidhi company in accordance with the rules made under section 406 of the Act.

*Explanation.*- For the purposes of this clause, any amount.-

- (a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or
- (b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be considered as deposits unless specifically excluded under this clause

(a)“depositor” means

- (i) any member of the company who has made a deposit with the company in accordance with the provisions of sub-section (2) of section 73 of the Act, or
  - (ii) any person who has made a deposit with a public company in accordance with the provisions of section 76 of the Act;
- (e) "eligible company" means a public company as referred to in sub-section (1) of section 76, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the Public for acceptance of deposits:
- Provided that an eligible company, which is accepting deposits within the limits specified under clause (c) of sub-section (1) of section 180, may accept deposits by means of an ordinary resolution;
- (f) "fees" means fees as specified in the Companies (Registration Offices and Fees) Rules, 2014;
  - (g) "Form" or 'e-Form" means a form set forth in Annexure to these rules which shall be used for the matter to which it relates;
  - (h) "section" means section of the Act;
  - (i) "trustee" means the trustee as defined in section 3 of the Indian Trusts Act, 1882 (12 of 1882).
- (xv) any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982 (40 of 1982);
- (xvi) any amount received by the company under any collective investment scheme in compliance with regulations framed by the Securities and Exchange Board of India;
- (xvii) an amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person.

Explanation.- For the purposes of this sub-clause,-

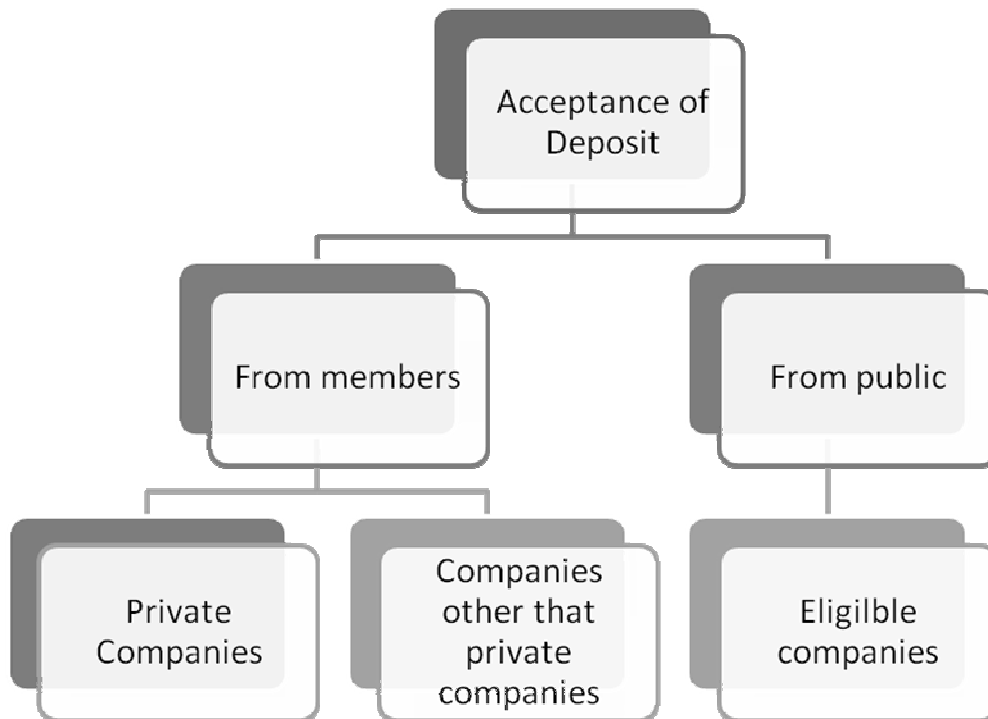
- I. "start-up company" means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification number G.S.R. 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;
  - II. "convertible note" means an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.
- (xviii) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

### Who is depositor?

'Depositor' means-

- (i) any member of the company who has made a deposit with the company in accordance with sub-section (2) of section 73 of the Act, or
- (ii) any person who has made a deposit with a public company in accordance with section 76 of the Act. [Rule 2(1)(d)]

## Acceptance of deposit



### Acceptance of deposit from members

Section 73(2) states that a company may accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members,

- subject to the passing of a resolution in general meeting,
- subject to such rules as may be prescribed in consultation with the Reserve Bank of India and
- subject to the fulfillment of following conditions under Section 73(2)
  - (a) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as prescribed under Rule 4 of Companies (Acceptance of deposits) Rules, 2014.
  - (b) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;
  - (c) depositing such sum which shall not be less than 15% of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;
  - (d) providing such deposit insurance in such manner and to such extent as prescribed under Rule 5 of Companies (Acceptance of deposits) Rules, 2014.
  - (e) certifying that the company has not committed any default in the repayment of deposits accepted

either before or after the commencement of this Act or payment of interest on such deposits; and

- (f) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company. In case when a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as “unsecured deposits” and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

### Exemption for Private Companies

The MCA vide notification no. G.S.R. 464 dated 5th June 2015 has allowed private companies to accept deposits from its members, monies not exceeding 100% of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified without complying with Section 73(2) (a) to (e). Thus a private company will have to follow only the condition mentioned in Section 73(2) (f).

### Acceptance of Deposit from Public

Eligible companies, may accept deposits from persons other than its members

- subject to the fulfillment of all requirements provided in Section 73(2)
- subject to such rules as may be prescribed in consultation with the Reserve Bank of India and

Such a company shall be required to obtain the rating (including its net-worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits. [First Proviso to Section 76(1)]

Every company accepting secured deposits from the public shall within 30 days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favor of the deposit holders in accordance with such rules as may be prescribed. [Second Proviso to Section 76(1)]

Section 76(2) states that all the provisions for acceptance of deposits shall, mutatis mutandis, apply to the acceptance of deposits from public under this section.

### Who is an Eligible Company?

As per Rule 2(1)(e) of Companies (Acceptance of Deposits) Rules, 2014, “Eligible company” means a public company having a net worth of not less than 100 crore rupees or a turnover of not less than 500 crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits;

Provided that an eligible company, which is accepting deposits within the limits specified under clause (c) of sub-section (1) of section 180, may accept deposits by means of an ordinary resolution;

### Terms and conditions for acceptance of deposits [Rule 3]

- (1) **Time period:** No company under section 73(2) and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice, within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit.

However, a company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to following conditions:

- (a) such deposits shall not exceed 10 per cent of the aggregate of the paid up share capital, free reserves *and securities premium account* of the company, and
  - (b) such deposits are repayable not earlier than three months from the date of such deposit or renewal thereof. [Rule 3(1)]
- (2) Joint names:** Deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor", if the depositors desires so. [Rule 3(2)]
- (3) Acceptance Limit for Deposits:**
- (i) No company (except private company) referred to in section 73(2) shall accept or renew any deposits from its Members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds 25% of the aggregate of the paid-up share capital, free reserves *and securities premium account* of the company. [Rule 3(3)]
 

Provided that a private company may accept from its members monies not exceeding 100% of aggregate of the paid up share capital, free reserves and securities premium account and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified.
  - (ii) No Eligible company shall accept or renew
    - Any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds 10% of the aggregate of the paid-up share capital, free reserves *and securities premium account* of the company;
    - Any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in (a), outstanding on the date of acceptance or renewal exceeds 25% aggregate of the paid-up share capital, free reserves *and securities premium account* of the company. [Rule 3(4)]
  - (iii) No Government company eligible to accept deposits under section 76 shall accept or renew any deposit, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds 35% of the aggregate of its paid up share capital, free reserves *and securities premium account* of the company. [Rule 3(5)]
- (4) Rate of interest and brokerage:** No company under section 73(2) or any Eligible company shall invite or accept or renew any deposits in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies. [Rule 3(6)]

Only the person who is authorized, in writing, by a company to solicit deposits on its behalf and through whom deposits are actually procured will be entitled to the brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of these Rules. [Explanation to Rule 3(6)]

- (5) Alteration of terms and conditions:** The Company shall not reserve to itself either directly or



indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted. [Rule 3(7)]

#### (6) Credit Rating:

Every eligible company shall obtain, at least once in a year, credit rating for deposits accepted by it and a copy of the rating shall be sent to the Registrar of Companies along with the return of deposits in Form DPT-3. The credit rating shall not be below the minimum investment grade rating or other specified credit rating for fixed deposits, from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, issued by the Reserve Bank of India, as amended from time to time. [Rule 3(8)]

Name of the agency	Minimum investment Grade Rating
(a) The Credit Rating Information Services of India Ltd.	FA - (FA Minus)
(b) ICRA Ltd.	MA- (MA Minus)
(c) Credit Analysis and Research Ltd.	CARE BBB(FD)
(d) Fitch Ratings India Private Ltd	tA-(ind)(FD)
(e) Brickwork Ratings India Pvt Ltd (Brickwork)	BWR FBBB
(f) SME Rating Agency of India Ltd.	SMERA A

### Issue of Advertisements or Circulars [Rule 4]

#### (1) Issue of circular for inviting deposit:

- (i) Every company referred in section 73(2) (except Private company) or any Eligible company intending to invite deposit from its members shall issue a circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1. [Rule 4(1)]
- (ii) In addition to issue of such circular to all members, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated. [Rule 4(1)]
- (iii) Every eligible company intending to invite deposits shall issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper having wide circulation and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated and shall also place such circular on the website of the company, if any. [Rule 4(2)]
- (iv) Every company inviting deposits from the public shall upload a copy of the circular on its website, if any. [Rule 4(3)]

#### (2) Authority to issue circular for inviting deposit: A circular or circular in the form of advertisement inviting deposits shall be issued on the authority and in the name of the Board of directors of the

company. [Rule 4(4)]

- (3) **Registration of copy of circular with the registrar:** A copy of circular or a circular in the form of advertisement signed by a majority of the directors of the company at the time the Board approved the circular or circular in the form of advertisement, or their agents, duly authorised by them in writing shall be delivered to the Registrar for registration at least thirty days prior to issue of such circular. [Rule 4(5)]
- (4) **Validity of Circular:** A circular or circular in the form of advertisement issued shall be valid
- until the expiry of 6 months from the date of closure of the financial year in which it is issued or
  - until the date on which the financial statement is laid before the company in annual general meeting or,
  - where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act,
- whichever is earlier, and a fresh circular or circular in the form of advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year. [Rule 4(6)]
- (5) **Issue Date and Effective Date:** The date of the issue of the newspaper in which the advertisement appears shall be taken as the date of issue of the advertisement and the effective date of issue of circular shall be the date of dispatch of the circular. [Explanation to the Rule 4(6)]

### Deposit Insurance [Rule 5]

- (1) **Entering into Contract for Deposit Insurance before issue of Circular:** Every company referred in section 73(2) (except Private company) or any Eligible company inviting deposits shall enter into a contract for providing deposit insurance at least 30 days before the issue of circular or advertisement or at least 30 days before the date of renewal, as the case may be.
- However the companies may accept deposits without deposit insurance contract till the 31<sup>st</sup> March, 2018 or till the availability of a deposit insurance product, whichever is earlier. [Rule 5(1)]
- (2) **Amount of Deposit Insurance:** The amount specified in the deposit insurance contract shall be the amount in respect of both principal amount and interest due thereon. [Explanation to the Rule 5(1)]
- (3) The deposit insurance contract shall specifically provide that in case the company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits and the interest thereon by the insurer up to the aggregate monetary ceiling as specified in the contract. [Rule 5(2)].
- In the case of any deposit and interest not exceeding 20,000 rupees, the deposit insurance contract shall provide for payment of the full amount of the deposit and interest and in the case of any deposit and the interest thereon in excess of 20,000 rupees, the deposit insurance contract shall provide for payment of an amount not less than 20,000 rupees for each depositor. Proviso to [Rule 5(2)]
- (4) The amount of insurance premium paid on the insurance of such deposits shall be borne by the company itself and shall not be recovered from the depositors by deducting the same from the principal amount or interest payable thereon. [Rule 5(3)]
- (5) If any default is made by the company in complying with the terms and conditions of the deposit insurance contract which makes the insurance cover ineffective, the company shall either rectify the default immediately or enter into a fresh contract within thirty days and in case of non-compliance,

the amount of deposits covered under the deposit insurance contract and interest payable thereon shall be repaid within the next 15 days and if such a company does not repay the amount of deposits within said 15 days it shall pay 15% interest per annum for the period of delay and shall be treated as having defaulted and shall be liable to be punished in accordance with the provisions of the Act.

### Creation of Security [Rule 6]

- (1) Every company referred to in section 73(2) including Private Company and every eligible company inviting secured deposits shall
  - provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company
  - for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance. [Rule 6(1)]
- (2) The amount of deposits and the interest payable secured by way of a charge on its assets referred in Schedule III of the Act excluding intangible assets shall not exceed the market value of such assets as assessed by a registered valuer.
- (3) The total value of the security either by way of deposit insurance or by way of charge or by both shall not be less than the amount of deposits accepted and the interest payable thereon.
- (4) Valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the SEBI or an independent chartered accountant in practice having a minimum experience of ten years.
- (5) The security (not being in the nature of a pledge) for deposits shall be created in favour of a *trustee for depositors* on:
  - (a) specific movable property of the company, or
  - (b) specific immovable property of the company wherever situated, or any interest therein. [Rule 6(2)]

### Trustee for Depositors

- (1) **Appointment of Trustee for Depositors:** Every company referred to in section 73(2) and every eligible company inviting secured deposits before issue a circular or advertisement appoint one or more deposit trustees for depositors for creating security for the deposits. [Rule 7(1)]
- (2) **Consent of deposit trustees with respect to their appointment:** A written consent shall be obtained from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustee for depositors has given their consent to the company to be so appointed. [Rule 7(1)]
- (3) **Deposit trust deed:** The Company shall execute a deposit trust deed in Form No. DPT-2 at least 7 days before issuing the circular or circular in the form of advertisement. [Rule 7(2)]
- (4) **Certain persons not to be appointed as deposit trustees:** No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the deposit holders, if the proposed trustee -
  - (a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

- (b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
  - (c) has any material pecuniary relationship with the company;
  - (d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;
  - (e) is related to any person specified in clause (a) above. [Rule 7(3)]
- (5) Removal of Trustee for Depositors:** No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board. In case the company is required to appoint independent directors, at least one independent director shall be present in such meeting of the Board. [Rule 7(4)]
- (6) Duties of deposit trustees:** It shall be the duty of every deposit trustee to-
- (a) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon;
  - (b) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act;
  - (c) ensure that the company does not commit any breach of covenants and provisions of the trust deed;
  - (d) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits;
  - (e) take steps to call a meeting of the holders of depositors as and when such meeting is required to be held;
  - (f) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance;
  - (g) do such acts as are necessary in the event the security becomes enforceable;
  - (h) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances. [Rule 8]
- (7) Meeting of depositors through trustee for depositors:** The meeting of all the depositors shall be called by the deposit trustee on-
- (a) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;
  - (b) the happening of any event, which constitutes a default or which in the opinion of the deposit trustee affects the interest of the depositors. [Rule 9]

### **Application for Deposits by Depositors**

- Every company shall accept, or renew any deposit, whether secured or unsecured, only if an application containing a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person, is submitted by the intending depositor for the acceptance of such deposit. [Rule 10]

### Nomination by depositors

A depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death and the provisions of section 72 shall, as far as may be, apply to the nomination made under this Rule [Rule 11].

### Deposit Receipts

- Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a deposit receipt for the amount received by the company, within a period of 21 days from the date of receipt of money or realisation of cheques. **[Rule 12(1)]**
- Deposit receipt shall be signed by an officer of the company duly authorized by the Board in this behalf and shall state the date of deposit, the name and address of the depositor, the amount received by the company as deposit, the rate and periodicity of interest payable thereon and the date on which the deposit is repayable. **[Rule 12(2)]**

### Repayment of Deposit

- Every deposit accepted by a company shall be repaid with interest in accordance with the terms and conditions of the agreement. [Section 73(3)]
- When a company fails to repay the deposit or part thereof or any interest thereon under sub-section (3), the depositor concerned may apply to the Tribunal/CLB for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal/CLB may deem fit. [Section 73(4)]

### Deposit Repayment Reserve Account

- Every company referred in section 73(2) (except Private Company) or any Eligible Company inviting accepting deposits from members has to deposit before the 30th day of April of each year, a amount of not less than 15% of its deposits maturing during a financial year and the financial year next following, in a scheduled bank in a separate bank account to be called as deposit repayment reserve account. [Section 73(2)(c) and Rule 13]
- This deposit repayment reserve account shall not be used by the company for any purpose other than repayment of deposits. [Section 73(5)]
- The amount remaining deposited shall not at any time fall below 15% of the amount of deposits maturing, until the end of the current financial year and the next financial year. [Rule 13]

### Repayment of Deposits accepted before the commencement of the Act

- (1) In respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—
  - (a) File in Form DPT-4, within a period of three months from date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and [Section 74(1) and Rule 20]

- (b) repay within one year from the date on which such payments are due [Section 74(1)]
- (2) The Tribunal/CLB may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit. [Section 74(2)]
- (3) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal/CLB under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both. [Section 74(3)]
- (4) When a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in Section 74(3) and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors. [Section 75(1)]
- (5) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon. [Section 75(2)]

### **General provisions regarding premature repayment of deposits**

- (1) When a company makes a repayment of deposits, on the request of the depositor, after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted, the rate of interest payable on such deposit shall be reduced by one per cent. from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run and the company shall not pay interest at any rate higher than the rate so reduced. [Rule 15]
- (2) Nothing contained in this rule shall apply to the repayment of any deposit before the expiry of the period for which such deposit was accepted by the company, if such repayment is made solely for the purpose of—
- (a) complying with the provisions of rule 3; or
- (b) providing war risk or other related benefits to the personnel of the naval, military or air forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under article 352 of the Constitution [Proviso to Rule 15]
- (3) When a company referred to in under section 7392) or any eligible company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of a higher rate of interest, the company shall pay interest to such depositor at the higher rate if such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit. For the purposes of this rule, where the period for which the deposit had run contains any part of a year, then, if such part is less than six

months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year.  
[Second Proviso to Rule 15]

### **Registers of Deposits [Rule 14]**

- (1) Every company accepting deposits shall, from the date of such acceptance, keep at its registered office one or more separate registers for deposits accepted/renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:
  - (a) Name, address and PAN of the depositor/s;
  - (b) Particulars of guardian, in case of a minor;
  - (c) Particulars of the nominee;
  - (d) Deposit receipt number;
  - (e) Date and amount of each deposit;
  - (f) Duration of the deposit and the date on which each deposit is repayable;
  - (g) Rate of interest;
  - (h) Due date(s) for payment of interest;
  - (i) Mandate and instructions for payment of interest and for non-deduction of tax at source, if any;
  - (j) Date or dates on which payment of interest will be made;
  - (k) Details of deposit insurance including extent of deposit insurance;
  - (l) Particulars of other security/ charge created;
  - (m) Any other particulars relating to the deposit;
- (2) Entries in the register shall be made within 7 days from the date of issuance of the deposit receipt and such entries shall be authenticated by a director or secretary of the company or by any other officer authorized by the Board for this purpose.
- (3) The registers shall be preserved in good order for a period of not less than 8 years from the financial year in which the latest entry is made in the register.

### **Return of deposits to be filed with the Registrar [Rule 16]**

Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.

### **Disclosures in the financial statement [Rule 16A]**

- (1) Every company, other than a private company, shall disclose in its financial statement by way of notes, about the money received from the director.
- (2) Every private company shall disclose in its financial statement by way of notes, about the money received from the directors, or relatives of directors.

### **Penal rate of interest [Rule 17]**

Every company shall pay a penal rate of interest of 18% per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

### Punishment for Contravention

- (1) Where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or

if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal/CLB under section 73,-

- (a) the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than 1 crore rupees but which may extend to 10 crore rupees; and
- (b) every officer of the company who is in default shall be punishable with imprisonment which may extend to 7 years or with fine which shall not be less than 25 lakh rupees but which may extend to 2 crore rupees, or with both:
- (c) If it is proved that the officer of the company, who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

[Section 76(A)] [Inserted wide Companies (Amendment) Act, 2015]

- (2) If any company contravenes any provisions of Companies (Acceptance of Deposit) Rules, 2014 for which no punishment is provided in the Act, then the company and every officer in default shall be punishable with fine which may extend to ₹ 5000/- and in case contravention is continuing one, with a further fine which may extend upto ₹ 500/- per day for every day after the first day during which the default continues. [Rule 21]

### Other remedies provided under Companies Act 2013

As per Section 245(1)(g) requisite number of depositor or depositors may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the depositors for seeking orders including claiming damages or compensation or demand any other suitable action from or against—

- the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
- the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
- any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
- to seek any other remedy as the Tribunal may deem fit.

Section 245(2) states that when the depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.



Section 245(3) (ii) states that the requisite number of depositors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

### LESSON ROUND UP

*The provisions of Companies Act 2013 read with rules made under Chapter V, has brought several revamping aspects to protect the interest of depositors. The gist of provisions discussed above is as follows.*

- Company may accept deposit from its members by passing a resolution in general meeting and subject to conditions as may be prescribed in the Rules including Credit rating, Deposit insurance etc., Private Company may not be required to pass resolution in general meeting provided it satisfies the requirement for such exemption.
- Public companies may accept deposits, if it has a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits.
- No company under sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more deposit trustees for creating security for the deposits.
- Contract providing for deposit insurance at least thirty days before the issue of circular or advertisement.
- Companies accepting deposit from members or eligible companies as defined, has to fulfill the conditions specified in Companies(Acceptance of Deposits)Rules 2014.

### GLOSSARY

Repatriation	Capital flow from a foreign country to the country of origin. This usually refers to returning returns on a foreign investment in case of a corporation, or transferring foreign earnings home in case of an individual.
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### SELF TEST QUESTIONS

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

1. Explain the manner in which the Companies Act, 2013 regulates and controls the invitation for and acceptance of deposits by the companies from their members and the public at large.
2. Discuss the limits of accepting 'deposits' as prescribed under the Companies (Acceptance of Deposits) Rules, 2014 as amended up-to-date.
3. What are the legal requirements if a company wants to invite deposits from the public?
4. What transactions are not deemed to be deposits?
5. What are the particulars to be included in a circular or circular in the form of advertisement inviting deposits by a company?
6. What is the validity period of such a circular or circular in the form of advertisement inviting deposits by a company?
7. What kind of deposits are not deposits as per the definition of 'deposits' under the Companies (Acceptance of Deposits) Rules, 2014?



# Lesson 21

## Accounts and Audit

### LESSON OUTLINE

- Accounts of Companies
- Requirement of keeping books of account.
- Financial statements
- Consolidated financial statements
- National Financial Reporting Authority (NFRA)
- Corporate social responsibility
- Internal audit
- Appointment, qualification, disqualification, removal of auditors
- Casual vacancy in the office of auditor
- Audit Report
- Branch audit
- Auditing standards
- Powers of tribunal
- Cost records and audit

### LEARNING OBJECTIVES

The health of a business is shown by the books of account of the company. The company is maintaining the records through the books as required by statute or as per the need of the hour. But, the maintenance of the books of account is not enough. The verification and checking is also important.

The checking of books of account is known as auditing. The auditing is also known as post mortem of books. It is helpful in the future planning. The auditing is done by the auditor. In India, the statutory audit is conducted by statutory auditor. It is mandatory in nature. Every company is required to audit its books of account. It is not only statutory audit which is in existence; now a days, the cost audit, Secretarial audit, management audit etc. are also conducted by the companies. It is helpful in the formulation of the company's policies.

After reading this lesson, you will be able to understand the provisions about keeping books of account, inspection of books of account and other provisions for balance sheet and profit and loss account under the Companies Act. It also discusses provisions for audit and auditors, their appointment, qualifications, resignation, removal, duties and liabilities.

*Accounting does not make corporate earnings or balance sheets more volatile. Accounting just increases the transparency of volatility in earnings.*

*– Diane Garnick*

## ACCOUNTS OF COMPANIES

The shareholders provide capital to the company for running the business. They are in a way, the owners of the company. But, all of them cannot take part in managing the affairs of the company as their number is usually much more. But they have every right to know as to how their money has been dealt with by the directors in a particular period. This is why perhaps compulsory disclosure through annual information to the shareholders by the directors about the working and financial position of the company enables them to exercise a more intelligent and purposeful control over the affairs of the company. For preparation of annual accounts the maintenance of proper books of account is a must. Section 128 of the Companies Act, 2013 contains the provisions for books of account etc. to be kept by company.

### REQUIREMENT OF KEEPING BOOKS OF ACCOUNT (SECTION 128)

Maintenance of books of account would mean records maintained by the company to record the specified financial transaction. It has been specifically provided that every company shall keep proper books of account. This section specifies the main features of proper books of account as under –

- (i) The company must keep the books of account with respect to items specified in clauses (i) to (iv) of sub-section 2(13) of the Companies Act, 2013 hereinafter referred as Act, which defines “books of account”.
- (ii) The books of account must show all money received and expended, sales and purchases of goods and the assets and liabilities of the company.
- (iii) The books of account must be kept on accrual basis and according to the double entry system of accounting.
- (iv) The books of account must give a true and fair view of the state of the affairs of the company or its branches.

“books of account” as defined in Section 2(13) includes records maintained in respect of—

- (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- (ii) all sales and purchases of goods and services by the company;
- (iii) the assets and liabilities of the company; and
- (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

### Place of Keeping Books of Account

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place. Such intimation to be made in Form AOC 5 to the Registrar of Companies.

### Maintenance of Books of account in electronic form

- The maintenance of books of account and other books and papers in electronic mode is permitted and is optional. Such books of accounts or other relevant books or papers maintained in electronic

mode shall remain accessible in India so as to be usable for subsequent use (the Companies (Accounts) Rules, 2014, hereinafter referred in this Chapter as Rules) [Rule 3(1)].

- The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered [Rule 3(2)].
- The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches [Rule 3(3)].
- The information in the electronic record of the document shall be capable of being displayed in a legible form [Rule 3(4)].
- There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:
- Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis. [Rule 3(5)]

The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement -

- (a) the name of the service provider;
- (b) the internet protocol address of service provider;
- (c) the location of the service provider (wherever applicable);
- (d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider. [Rule 3(6)]

### **Books of Account in Respect of Branch Office**

The branches of the company, if any, in India or outside India shall also keep the books of account in the same manner as specified in sub-section (1), for the transaction effected at the branch office. Further the branch offices are required to send the proper summarized return at quarterly intervals to the company at its registered office and kept open to directors for inspection.

### **Accrual basis and Double-entry system of accounting**

According to sub-section (1), books of account are required to be kept on accrual basis and in accordance with the double entry system of accounting.

### **Inspection by directors**

As provided in sub-section (3) of Section 128, any director can inspect the books of accounts and other books and papers of the company during business hours.

The expression "Books and Papers" has been defined in section 2(12) which includes accounts, deeds, vouchers, writings and documents. The company is, therefore, required to make available the aforesaid books and papers for inspection by any directors. Such inspection may be done by any type of director-nominee, independent, promoter or whole time.

The proviso to sub-section 3 provides that a director of the Company can inspect the books of accounts of

the subsidiary, only on authorisation by way of the resolution of Board of Directors. Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought and the period for which such information is sought (Rule 4(2)). The said information shall be provided to director within 15 days of receipt of request (Rule 4(3)). The director can seek the information only individually and not by or through his attorney holder or agent or representative (Rule 4(4)).

The right to inspect books of accounts and other books and papers under this section has been provided to the directors only.

### **Period for which books to be preserved**

The books of accounts, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year. In case of a company incorporated less than eight years before the financial year, the books of accounts for the entire period preceding the financial year together with the vouchers shall be so preserved. The provisions of Income Tax Act shall also be complied with in this regard.

As per proviso to sub-section 5, where an investigation has been ordered in respect of a company under Chapter XIV of the Act related to inspection, inquiry or investigation, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.

### **Persons responsible to maintain books**

The person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of accounts etc. shall be: (sub-section 6)

- (i) Managing Director,
- (ii) Whole-Time Director, in charge of finance
- (iii) Chief Financial Officer
- (iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

### **Penalty**

In case the aforementioned persons referred to in sub-section (6) (i.e. MD, WTD, CFO etc.) fail to take reasonable steps to secure compliance of section 128 and contravene such provisions, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or both.

## **SECTION 129: FINANCIAL STATEMENT**

This Section seeks to provide that the financial statements shall give a true and fair view of the state of affairs of the companies in the form as provided for different class or classes in Schedule III and shall comply with accounting standards. Insurance companies, banking company, companies engaged in generation / supply of electricity or any other class of companies shall make financial statements in the form as has been specified in or under the Act governing such companies. The financial statement shall be laid in the annual general meeting of that financial year. In case of subsidiary companies, the company shall prepare a consolidated financial statement of the Company and all subsidiaries and lay before the annual general meeting. The Central Government shall have the power to exempt a class or classes of companies from any of the requirements of this section. The section also provides the penalty where company contravenes the provision of this section.

## Definition of Financial Statement

Financial Statement is defined under Section 2 (40), to include -

- Balance Sheet
- Profit and Loss account or Income and Expenditure account
- Cash flow Statement
- Statement of change in equity, if applicable
- any explanatory notes annexed to or forming part of financial statements, giving information required to be given and allowed to be given in the form of notes.

However, the financial statement with respect to one person company, small company and dormant company, may not include the cash flow statement.

Financial statements should be prepared for financial year and shall be in form as per Schedule III.

## True and Fair view

As per provisions of sub-sections (1) and (2), every financial statement of the company must give true and fair view of the state of affairs of the company at the end of financial year. True and Fair view in respect of financial statement means-

- financial statements and items contained should comply with accounting standards notified under section 133;
- financial statement shall be in form or forms as provided for different class or classes of companies in Schedule III;
- in case of any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, not treated to be disclosing a true and fair view of the state of affairs of the company, merely by the reason of the fact that they do not disclose -
  - in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
  - in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
  - in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
  - in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

## Other Requirements for Financial Statements

- (a) Financial statements shall lay before the board of the directors in every annual general meeting of a company.
- (b) Where a company has one or more subsidiaries, in addition to financial statement provided in sub-section 2, it shall prepare a consolidated financial statement of the company with salient features of financial statements of subsidiary and subsidiaries in such form as prescribed and the same shall be laid before board in annual general meeting.

- (c) Central Government may prescribe for the consolidation of accounts of companies.
- (d) Where financial statements of the company do not comply with the applicable accounting standards, the company shall disclose the following:
  - (i) the deviation from the accounting standards
  - (ii) the reason for such deviation and
  - (iii) financial effects arising out of such deviation
- (e) Central Government may exempt any class or classes of the companies from complying with any of the requirements of this section or the rules there under, either conditionally or unconditionally as may be specified in the notification.
- (f) Central Government may notify the class of companies to mandatorily file their financial statements in Extensible Business Reporting Language (XBRL) format and also the manner of such filing. (Rule 9.3(1))
- (g) Financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes.

### **Persons responsible for Compliance**

The persons responsible to take all reasonable steps to secure compliance by the company with the requirement of Section 129 are (sub-section 7)-

- Managing Director
- Whole-Time Director
- CFO
- Other person of a company charged by the Board with the duty of complying with requirements of section 129.

Where any of the aforementioned officers are absent, all the directors shall be responsible and punishable.

### **Penalty**

In case persons referred to in sub-section (7) fail to take reasonable steps to secure compliance or contravene provisions of Section 129, they shall in respect of each offence be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

### **Form of Financial Statements (Schedule III)**

The financial statements shall be in the form or forms as may be provided for different class or classes of companies. Schedule III contains general instructions for preparation of balance sheet and statement of profit and loss account.

### **Consolidated Financial Statements**

The Companies Act 2013 has made preparation of consolidated accounts mandatory for all companies including unlisted companies and private companies having one or more subsidiaries or associates or joint ventures.

According to sub section 3 of the section 129 of the Companies Act, 2013, where a company has one or more subsidiaries or associates or joint ventures, it shall, in addition to its financial statements for the



financial year, prepare a consolidated financial statement of the company and of all the subsidiaries or associates or joint ventures in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary/ies or associate/s or joint venture/s in Form AOC-1 (Rule 5).

### **MANNER OF CONSOLIDATION OF ACCOUNTS**

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable Accounting Standards, subject however, that if the company is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act (Rule 6).

However nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:-

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
- (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Provided also that nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1<sup>st</sup> April, 2014.

### **RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS**

Section 130 provides for provisions relating to re-opening or re-casting of books of accounts of the company. Accordingly,

- (i) A company shall not re-open its books of account and shall not recast its financial statements, unless an application in this regard is made by any one or more of the following -
  - (a) the Central Government, or
  - (b) the Income-tax authorities, or
  - (c) the Securities and Exchange Board of India (SEBI), or
  - (d) any other statutory regulatory body or authority or any person concerned, and
  - (e) an order in this regard is made by a court of competent jurisdiction or the Tribunal.
- (ii) The re-opening and recasting of financial statements is permitted only for the following reasons –
  - (a) the relevant earlier accounts were prepared in a fraudulent manner; or
  - (b) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

- (iii) The Court or the Tribunal, as the case may be, shall give the notice to-
  - (a) the Central Government,
  - (b) the Income-tax authorities,
  - (c) the Securities and Exchange Board,
  - (d) any other statutory regulatory body or authority concerned and shall take into consideration the representations, if any, made by Central Government or the income tax authorities, Securities and Exchange Board or the body or authority concerned before passing any order under this section.
- (iv) The accounts so revised or re-cast under this section shall be final.

It may be noted that the Tribunal will include National Company Law Tribunal (NCLT). This provision provides for both, reopening of books after accounts have been closed and recast of financial statements.

Director's report of the year in which such provisions are invoked, should provide for the reasons or circumstances in which such revisions were warranted.

### **VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT**

Section 131 allows the directors to prepare revised financial statement or a revised Board's report in respect of any of the three preceding financial years after obtaining approval of the Tribunal, if it appears to them that the company's financial statement or the Board's Report do not comply with the requirements of Section 129 or Section 134.

Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

- (a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and
- (b) the making of any necessary consequential alternation.

The Central Government may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular—

- (a) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;
- (b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;
- (c) require the directors to take such steps as may be prescribed.

### **NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA) (This section is yet to be notified)**

Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards. The Companies Act, 1956 empowers the Central Government to form a Committee for recommendations on Accounting Standards which is National Advisory Committee on Accounting Standards (NACAS). This is now being renamed with enhanced independent oversight powers and authority as National Financial Reporting Authority (NFRA).

NFRA shall be responsible for monitoring and enforcing compliance of auditing and accounting standards and for that purpose, oversee the quality of professions associated with ensuring such compliances. The Authority shall investigate professional and other misconducts which may be committed by Chartered Accountancy members and firms. There is also a provision for appellate authority.

The National Financial Reporting Authority shall be a quasi – judicial body to regulate matters related to accounting and auditing. With increasing demand of non – financial reporting, it may be referred to as a National level business Reporting Authority to regulate standards of all kind of reporting- financial as well as non – financial, by the companies in future.

National Financial Reporting Authority shall give its recommendations on accounting standards and auditing standards. It shall only recommend and it is the Central Government who shall prescribe such standards.

### Objective

The objectives of National Financial Reporting Authority inter alia shall be as follows:

- (1) Make recommendations on formulation of accounting and auditing policies and standards for adoption by companies, class of companies or their auditors;
- (2) Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;
- (3) Oversee the quality of service of professionals associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service, and
- (4) Perform such other functions as may be prescribed in relation to aforementioned objectives.

These objectives simply bring chartered accountants, cost accountants, management accountants, company secretaries as well as independent directors / members audit committees under jurisdiction of NFRA.

### Constitution of NFRA

The constitution of National Financial Reporting Authority, which is supposed to be constituted as an oversight regulatory body to recommend accounting and auditing standards, shall be governed by sub - section (3) and (4) of section 132. Accordingly,

- (i) It shall consist of a chairperson, who shall be a person of eminence & having expertise in accountancy, auditing, finance, business administration, business law, economics or similar disciplines, to be nominated by Central Government, and such other prescribed members not exceeding 15.
- (ii) The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full – time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.
- (iii) The head office of National Financial Reporting Authority shall be at New Delhi and it may, meet at such other places in India, as it deems fit.
- (iv) Its accounts shall be audited by Comptroller and Auditor General of India (CAG) and such accounts as certified by CAG, together with audit report, shall be forwarded annually to the Central Government.

For the constitution of National Financial Reporting Authority, the Act doesn't prescribe for nomination of members from MCA, ICSI, ICAI, ICMAI, as opposed to what was prescribed under the Companies Act, 1956 in respect of constitution of National Advisory Committee on Accounting Standards. The same shall be

prescribed by Central Government so far as terms, conditions and manner of appointment is concerned. Members appointed could be full time members or part time members.

### **Jurisdiction, Powers of and Imposition of Penalties by NFRA**

The National Financial Reporting Authority shall have jurisdiction over bodies corporate and persons for matters of professional and other misconduct committed, by any member or firm of Chartered Accountants registered under the Chartered Accountants Act, 1949. No other institute or body (including professional institutes) shall initiate or continue any proceeding in such matters of misconduct where the authority has initiated an investigation under this section.

The Authority shall have powers as are vested in a civil court under Code of Civil Procedure in respect of following matters:

1. Discovery and production of books of accounts and other documents
2. Summoning and enforcing the attendance of persons and examining them on oath
3. Inspection of any books, registers and other documents of any person
4. Issuing commission for examination of witness or documents.

Sub-section (4) is a non-obstante clause, providing a bar on anybody or any institute, in initiating or continuing the proceedings in matters relating to misconduct as referred to in Chartered Accountants Act 1949.

The Authority shall have powers to make an order in relation to:

- A. Imposing penalty of
  - (i) not less than one lakh rupees which may extend to five times of the fees received in case of individuals and
  - (ii) not less than ten lakh rupees which may extend to ten times of the fees received in case of firms
- B. Debarring member or the firm from engaging himself or itself from practice for a period of six months to ten years.

### **Appeals and Appellate Authority**

Any person aggrieved by any order of the National Financial Reporting Authority may prefer appeal to Appellate Authority, set up for this purpose.

The Appellate Authority shall consist of a chairperson and not more than two members. However, the Appellate Tribunal constituted under the Chartered Accountants Act, 1949 will not act as Appellate Tribunal under this section.

### **SECTION 133: CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS**

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Until the NFRA is constituted under Section 132 of the Companies Act, 2013, the Central Government may prescribe the standards of Accounting or any addendum

thereto, as recommended by the Institute of Chartered Accountants of India, constituted under Section 3 of the Chartered Accountants Act, 1949 in consultation with and after examination of the recommendation made by National Advisory Committee on Accounting Standards constituted under Section 210A of the Companies Act, 1956.

- On 6th Feb. 2015 the Ministry of Corporate Affairs (MCA), the Central Government, in consultation with the National Advisory Committee on Accounting Standards (NACAS), notified the Companies (Indian Accounting Standards) Rules, 2015 in exercise of the powers conferred by section 133 and section 469 of the Companies Act, 2013 and sub-section (1) of section 210A of the Companies Act, 1956. These rules came into force on 1st April 2015.

As a result of this notification, notifying the Companies (Indian Accounting Standards) Rules, 2015, there shall be two separate sets of Accounting Standards –

1. Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006

### **Indian accounting Standards (Ind AS)**

Indian Accounting Standards (Ind AS) are the accounting standards prescribed under Section 133 of the Companies Act, 2013. 39 Indian Accounting Standards (Ind AS) are specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015. These accounting standards are converged with corresponding International Financial Reporting Standards.

### **Applicability under Rule 3 of the Companies (Indian Accounting Standards) Rules, 2015**

- |  |   |
|--|---|
| <ol style="list-style-type: none"> <li>1. Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015</li> <li>2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.</li> </ol> | <ul style="list-style-type: none"> <li>- shall be applicable to classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.</li> <li>- shall be applicable to the companies other than the classes of companies specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.</li> </ul> |
|--|---|

### **Classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015**

#### **(i) Ind AS applicable on voluntary basis**

Any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter on voluntary basis.

#### **(ii) Ind AS applicable on mandatory basis for the accounting periods beginning on or after April 1, 2016**

The following companies shall mandatorily comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on

31st March, 2016, or thereafter, namely:-

- Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange) in India or outside India and having net worth of rupees five hundred crore or more;
- Unlisted companies having net worth of rupees five hundred crore or more;
- holding, subsidiary, joint venture or associate companies of companies covered above.

**(iii) Ind AS applicable on mandatory basis for the accounting periods beginning on or after April 1, 2017**

The following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely:-

- Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange) in India or outside India and having net worth of less than rupees five hundred crore;
- Unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.
- holding, subsidiary, joint venture or associate companies of companies covered above.

The companies whose securities are listed or in the process of listing on SME exchanges shall not be required to apply Ind AS. Such companies shall continue to comply with the existing Accounting Standards unless they choose otherwise. SME exchange is the exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

“Comparatives” means comparative figures for the preceding accounting period.

**Companies exempted under Rule 5 of the Companies (Indian Accounting Standards) Rules, 2015**

The following companies are not required to apply Indian Accounting Standards (Ind AS) for preparation of their financial statements either voluntarily or mandatorily -

- (i) Insurance companies
- (ii) Banking companies and
- (iii) Non-banking finance companies

**SECTION 134: FINANCIAL STATEMENT, BOARD'S REPORT ETC.**

Section 134 deals with financial statements as well as board's report. The Board's Report shall be prepared based on the stand alone financial statements of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

The auditor's report is to be attached to every financial statement. A report by the Board of directors containing details on the matters specified, including director's responsibility statement, shall be attached to

every financial statement laid before company. The Board's report and every annexure has to be duly signed. A signed copy of every financial statement shall be circulated, issued or published along with all notes or documents, the auditor's report and Board's report. The clause also provides for penal provisions for the company and every officer of the company, in case of any contravention.

### Requirements as to financial statements

- Financial statement of the company including consolidated financial statements, if applicable, should be approved by the Board of Directors, before such statements are signed.
- Financial statement should be signed on behalf of the board by atleast
  - chairperson of company, duly authorised board, or
  - two directors of whom one should be the managing director, and
  - chief executive officer, if he is director, chief financial officer and company secretary, if any in the company
- One person company's financial statements shall be signed by only one director.
- Such sign is required for submission of financial statements to the auditor for his report.
- Auditors report is required to be attached to every financial statement.
- Board report shall be attached to the statements laid before the company in general meeting.

*The details of prescriptions under Companies Act regarding Board's Report including disclosures are dealt in lesson 23.*

### Penal provisions

Any contravention of provisions of Section 134 is punishable to the following extent –

- (a) company is punishable with fine of not less than rupees fifty thousand but which may extend upto rupees twenty five lakhs, and
- (b) every officer in default is punishable with –
  - (i) imprisonment upto a term of three years, or
  - (ii) monetary fine from fifty thousand rupees to rupees five lakh, or
  - (iii) both (i) and (ii) above

### SECTION 135 : CORPORATE SOCIAL RESPONSIBILITY

As per section 135 of the Companies Act 2013, the CSR provision will be applicable companies which fulfills any of the following criteria during any of the three preceding financial years =

- Companies having net worth of rupees five hundred crore or more, or
- Companies having turnover of rupees one thousand crore or more or
- Companies having a net profit of rupees five crore or more

The CSR Rules have widen the ambit for compliance obligations to include the holding and subsidiary companies as well as foreign companies whose branches or project offices in India which fulfills the criteria specified above.

According to the CSR Rules, the CSR provision will also be applicable to every company including its holding

or subsidiary, and a foreign company having its branch office or project office in India having net worth of rupees five hundred crore (500 Crore) or more, or turnover of rupees one thousand crore (1000 crore) or more or a net profit of rupees five crore (5 Crore) or more during any financial year.

If a company ceases to be a company covered under subsection (1) of section 135 of the Act for three consecutive financial years shall not be required to -

- (a) constitute a CSR Committee; and
- (b) comply with the provisions contained in sub-section (2) to (5) of the said section till such time it meets the criteria specified in sub-section (1) of section 135.

Thus, the CSR Rules specify that a company which does not satisfy the specified criteria for a consecutive period of three financial years is not required to comply with the CSR obligations, implying that a company not satisfying any of the specified criteria in a subsequent financial year would still need to undertake CSR activities unless it ceases to satisfy the specified criteria for a continuous period of three years.

### **CSR Committee**

Companies that trigger any of the aforesaid conditions must constitute a Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a company. Section 135 of the 2013 Act requires the CSR Committee to consist of at least three directors, including at least one independent director. However, CSR Rules exempts unlisted public companies and private companies that are not required to appoint an independent director from having an independent director as a part of their CSR Committee.

Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.

The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India and the other person nominated by the foreign company.

The Board's report shall disclose the composition of the Corporate Social Responsibility Committee.

### **CSR Policy**

CSR Policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

The Rules provide that the CSR Policy of a company shall, inter alia include the following, namely:

- A list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedule for the same; and
- Monitoring process of such projects or programs.

But the activity should not be undertaken in pursuance of normal course of business of a company. The Board shall ensure that the activities included by the company in its CSR Policy are related to the activities mentioned in Schedule VII of the Act.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of business profit of a company.



The Board after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website. The Board of every company ensures that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

### CSR Expenditure

- The Board of every company shall ensure that the company spends, in every financial year, **at least two per cent of the average net profits** of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.
- If the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount.
- The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.
- Expenditure incurred on specified activities that are carried out in India only will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities.
- Expenditure incurred in undertaking normal course of business will not form a part of the CSR expenditure. Companies would need to clearly distinguish those activities which are undertaken specifically in pursuance of normal course of business and those that are done incrementally as part of the CSR initiatives.
- Any surplus arising out of CSR activities will not be considered as business profit for the spending company.
- Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

### CSR Activities

- The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.
- The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under section 8 of the Act by the company, either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company, or otherwise. Provided that---
  - (i) If such trust, society or company is not established by the company either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects:
  - (ii) the company has specified the projects or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

- A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a positions to report separately on such projects or programs in accordance with these rules.
- The CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.
- The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.
- Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through institutions with established track records of atleast three financial years but such expenditure, including expenditure on administrative overheads, shall not exceed five percent of total CSR expenditure of the company in one financial year.
- Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

### List of CSR Activities

Some activities are specified in Schedule VII as the activities which may be included by companies in their Corporate Social Responsibility Policies. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities as illustratively. These are activities related to:

- (i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.
- (ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
- (iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- (iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;
- (v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- (vi) measures for the benefit of armed forces veteran, war widows and their dependents;
- (vii) training to promote rural sports nationally recognized sports and Olympic sports;
- (viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

- (ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- (x) rural development projects.
- (xi) slum area development where 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

However, in determining CSR activities to be undertaken, preference would need to be given to local areas and the areas around where the company operates.

As per Clarification issued by MCA on 18th June, 2014; following may be noted with regard to provisions mentioned under section 135:

- One-off events such as marathons/ awards/ charitable contribution/ advertisement/sponsorships of TV programmes etc. do not be qualified as part of CSR expenditure.
- Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) are not count as CSR expenditure under the Companies Act.

### Computation of net profit

The net worth, turnover and net profits are to be computed in terms of Section 198 of the 2013 Act as per the profit and loss statement prepared by the company in terms of Section 381 (1) (a) and Section 198 of the 2013 Act. Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

- **Indian company:** The CSR Rules have clarified the manner in which a company's net worth will be computed to determine if it fits into the 'spending' norm. In order to determine the 'net profit', dividend income received from another Indian company or profits made by the company from its overseas branches have been excluded. Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the preceding three financial years.
- **Foreign company:** The CSR Rules prescribe that in case of a foreign company that has its branch or a project office in India, CSR provision will be applicable to such offices. CSR Rules further prescribe that the balance sheet and profit and loss account of a foreign company will be prepared in accordance with Section 381(1)(a) and net profit to be computed as per Section 198 of the Companies Act. It is not clear as to how the computation of net worth or turnover would be arrived at in case of a branch or project office of a foreign company

It has been clarified that if net profits are computed under the Companies Act, 1956 they needn't be recomputed under the 2013 Act. Profits from any overseas branch of the company, including those branches that are operated as a separate company would not be included in the computation of net profits of a company. Besides, dividends received from other companies in India which need to comply with the CSR obligations would not be included in the computation of net profits of a company.

### Disclosure Requirements

It is mandatory for companies to disclose in Board's Report, an annual report on CSR. The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual

report on the CSR activities of the company in the format prescribed containing following particulars –

- A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
- The Composition of the CSR Committee.
- Average net profit of the company for last three financial years
- Prescribed CSR Expenditure
- Details of CSR spent during the financial year.
- In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
- A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

If the company has been unable to spend the minimum required on its CSR initiatives, the reasons for not doing so are to be specified in the Board Report. If a company has a website, the CSR policy and the report containing details of such activities have to be made available on the company's website for informational purposes.

**FORMAT FOR THE ANNUAL REPORT ON CSR ACTIVITIES TO BE INCLUDED IN THE BOARD REPORT**

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The Composition of the CSR Committee.
3. Average net profit of the company for last three financial years.
4. Prescribed CSR Expenditure (two percent of the amount as in item 3 above)
5. Details of CSR spent during the financial year.
  - (a) Total amount to be spent for the financial year;
  - (b) Amount unspent, if any;
  - (c) Manner in which the amount spent during the financial year is detailed below:

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S No	CSR project or activity identified	Sector in which the project is covered	Projects or programs (1) Local area or other (2) Specify the State	Amount outlay (budget) project or programs wise	Amount spent on the projects or programs <b>Sub-heads:</b> (1) Direct expenditure	Cumulative expenditure upto the reporting period.	Amount spent: Direct or through implementing agency

			and district where projects or programs was taken		on projects or programs (2) Overheads:		
1							
2							
3							
	<b>TOTAL</b>						

\* Give details of implementing agency

6. In case the company has failed to spend the two percent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.

7. A responsibility statement of the CSR committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and policy of the company.

Sd/-

(Chief Executive Officer or Managing Director or Director)

Sd/-

(Chairan CSR Committee)

Sd/-

(Person specified under clause (d) of sub section (1) of section 380of the Act)  
(wherever applicable)

**With regard to the Provisions of Section 135, MCA has provided the following Frequently asked Questions on Corporate Social Responsibilities**

Sl. No.	FAQs
1.	<b>Whether CSR provisions of the Companies Act, 2013 is applicable to all companies?</b>
	<p>CSR provisions of the Companies Act, 2013 is applicable to every company registered under the Companies Act, 2013 and any other previous Companies law having</p> <ul style="list-style-type: none"> <li>• Net worth of rupees five hundred crore or more, or</li> <li>• Turnover of rupees one thousand crore or more, or</li> <li>• A net ptofit of rupees five crore or more</li> </ul> <p>during any financial year</p>
2.	<b>What is meaning of `any financial year` mentioned above?</b>
	<p>“Any Financial year” referred under Sub-section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014 implies any of the three preceding financial years (<b>refer General Circular No. 21/2014, dated : 18.06.2014</b>)</p>
3.	<b>Whether CSR expenditure of a company can be claimed as a business expenditure?</b>

	<p>The amount spent by a company towards CSR cannot be claimed as a business expenditure. The Finance Act, 2014 provides that any expenditure incurred by an assessee on the activities relating to Corporate Social Responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.</p>
<b>4.</b>	<b>Whether the 'average net profit' criteria for section 135(5) is Net profit before tax or Net profit after tax?</b>
	<p>Computation of net profit for section 135 is as per section 198 of the Companies Act, 2013 which is primarily PROFIT BEFORE TAX (BT).</p>
<b>5.</b>	<b>Can the CSR expenditure be spent on the activities beyond Schedule VII?</b>
	<p><b>General Circular No. 21/2014 dated June 18, 2014</b> of MCA has clarified that the statutory provision and provisions of CSR Rules, 2014, is to ensure that activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act, 2013. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities. The General Circular also provides an illustrative list of activities that can be covered under CSR. In a similar way many more can be covered. It is for the Board of the company to take a call on this.</p>
<b>6.</b>	<b>What tax benefit can be availed under CSR?</b>
	<p>No Specific Tax Exemptions Have Been Extended To CSR Expenditure Per Se. The Finance Act, 2014 Also Clarifies That Expenditure On CSR does not form part of business expenditure. While no specific tax exemption has been extended to expenditure incurred on CSR, spending on several activities like contributions to Prime Minister's Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc., which find place in Schedule VII, already enjoy exemptions under different sections of the Income Tax Act, 1961.</p>
<b>7.</b>	<b>Which activities would not qualify as CSR?</b>
	<ul style="list-style-type: none"> <li>• The CSR projects or programs or activities that benefit only the employees of the company and their families.</li> <li>• One-off events such as marathons/awards/charitable contribution/advertisement/sponsorships of TV programmes etc.</li> <li>• Expenses incurred by companies for the fulfillment of any other Act/Statute of regulations (such as Labour Laws, Land Acquisition Act, 2013, Apprentice Act, 1961 etc.)</li> <li>• Contribution of any amount directly or indirectly to any political party.</li> <li>• Activities undertaken by the company in pursuance of its normal course of business.</li> <li>• The project or programmes or activities undertaken outside India.</li> </ul>

8.	<b>Whether a holding or subsidiary of a company which fulfils the criteria under section 135(1) has to comply with section 135, even if the holding and subsidiary itself does not fulfill the criteria.</b>
	Holding or subsidiary of a company does not have to comply with section 135(1) unless the holding or subsidiary itself fulfills the criteria.
9.	<b>Whether provisions of CSR are applicable on Section 8 company, if it fulfills the criteria of section 135(1) of the Act.</b>
	Section 135 of the Act reads “ <b>Every company.....</b> ”, i.e. no specific exemption is given to section 8 companies with regard to applicability of section 135, hence section 8 companies are required to follow CSR provisions.
10.	<b>Can contribution of money to a trust/Society/Section 8 Companies by a company be treated as CSR expenditure of the company?</b>
	<p><i>General Circular No. 21/2014 Of MCA Dated June 18, 2014 Clarifies That</i></p> <p>Contribution To Corpus Of A Trust/Society/Section 8 Companies Etc. Will Qualify As CSR Expenditure As Long As:</p> <p>(a) The Trust/Society/Section 8 company etc. is created exclusively for undertaking CSR activities or</p> <p>(b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.</p>
11.	<b>Whether display of CSR policy of a company on website of the company is mandatory or not?</b>
	As per section 135(4) the Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approves the CSR policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company’s website, if any ( <b>refer Rule 8 &amp; 9 of CSR Policy, Rules 2014</b> ).
12.	<b>Whether reporting of CSR is mandatory in Board’s Report?</b>
	The Board’s Report of a company qualifying under section 135(1) pertaining to a financial year commencing on or after the 1 <sup>st</sup> day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure. ( <b>refer Rule 9 of CSR Policy, Rules 2014</b> ).
13.	<b>Whether it is mandatory for Foreign Company to give report on CSR activity?</b>
	In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR.
14.	<b>Whether contribution towards disaster relief qualifies as CSR or not?</b>

	(May please refer point no. 7 to the annexure to General Circular dated 16.06.2014 issued by Ministry of Corporate Affairs).
<b>15.</b>	<b>Whether contribution in kind can be monetized to be shown as CSR expenditure?</b>
	Section 135 prescribes "...shall ensure that company spends .....". The company has to spend the amount.
<b>16.</b>	<b>If a company spends in excess of 2% of its average net profit of three preceding years on CSR in a particular year, can the excess amount spent be carried forward to the next year and be offset against the required 2% CSR expenditure of the next year?</b>
	Any excess amount spent (i.e., more than 2% as specified in Section 135) cannot be carried forward to the subsequent years and adjusted against that year's CSR expenditure.
<b>17.</b>	<b>Can the unspent amount from out of the minimum required CSR expenditure be carried forward to the next year?</b>
	The Board is free to decide whether any unspent amount from out of the minimum required CSR expenditure is to be carried forward to the next year. However, the carried forward amount should be over and above the next year's CSR allocation equivalent to at least 2% of the average net profit of the company of the immediately preceding three years.
<b>18.</b>	<b>What is the role of Government in monitoring implementation of CSR by companies under the provision of the Companies Act, 2013?</b>
	The main thrust and spirit of the law is not to monitor but to generate conducive environment for enabling the corporates to conduct themselves in a socially responsible manner, while contributing towards human development goals of the country.  The existing legal provisions like mandatory disclosures, accountability of the CSR Committee and the Board, provisions for audit of the accounts of the company etc., provide sufficient safeguards in this regard. Government has no role to play in monitoring implementation of CSR by companies.
<b>19.</b>	<b>Whether government is proposing to establish any mechanism for third parties to monitor the quality and efficacy of CSR expenditure as well as to have an impact assessment of CSR by Companies?</b>
	Government has no role to play in engaging external experts for monitoring the quality and efficacy of CSR expenditure of companies. Boards/CSR Committees are fully competent to engage third parties to have an impact assessment of its CSR programme to validate compliance of the CSR provisions of the law.
<b>20.</b>	<b>Can CSR funds be utilized to fund Government Scheme?</b>
	The objective of this provision is indeed to involve the corporates in discharging their social responsibility with their innovative ideas and management skills and with greater efficiency and better outcomes. Therefore, CSR should not be interpreted as a source of financing the



	<p>resource gaps in Government Scheme. Use of corporate innovations and management skills in the delivery of 'public goods' is at the core of CSR implementation by the companies. In-principle, CSR fund of companies should not be used as a source of funding Government Schemes. CSR projects should have a larger multiplier effect than that under the Government schemes.</p> <p>However, under CSR provision of the Act and rules made thereunder, the Board of the eligible company is competent to take decision on supplementing any Government Scheme provided the scheme permits corporates participation and all provisions of Section 135 of the Act and rules thereunder are complied by the company.</p>
<b>21.</b>	<b>Who is the appropriate authority for approving and implementation of the CSR programmes/projects of a Company? What is Government's role in this regard?</b>
	<p>Government has no role to play in this regard. Section 135 of the Act, Schedule VII and Companies CSR Policy Rules, 2014 read with General Circular dated 18.06.2014 issued by the Ministry of Corporate Affairs, provide the broad contour with which eligible companies are required to formulate their CSR policies including activities to be undertaken and implement the same in the right earnest. Therefore, all CSR programmes/projects should be approved by the Boards on the recommendations of their CSR Committees. Changes, if any, in the programme/project should also be undertaken only with the approval of the committee/Board.</p>
<b>22.</b>	<b>How can companies with small CSR funds take up CSR activities in a project/programme mode?</b>
	<p>A well designed CSR project or programme can be managed with even small fund. Further, there is a provision in the CSR Policy Rules, 2014 that such companies can combine their CSR programs with other similar companies by way of pooling their CSR resources. <b>(refer Rule 4 in Companies (CSR Policy) Rules, 2014).</b></p>
<b>23.</b>	<b>Whether involvement of employees of the company in CSR project/programmes of a company can be monetized and accounted for under the head of 'CSR expenditure'?</b>
	<p>Contribution and involvement of employees in CSR activities of the company will no doubt generate interest/pride in CSR work and promote transformation from Corporate Social Responsibility (CSR) as an obligation to Socially Responsible Corporates (SRC) in all aspects of their functioning. Companies therefore, should be encouraged to involve their employees in CSR activities. <b>However, monetization of pro bono services of employees would not be counted towards CSR expenditure.</b></p>

### **SECTION 136: RIGHT OF MEMBER TO COPIES OF AUDITED FINANCIAL STATEMENT**

This section seeks to provide that a copy of financial statements including consolidated financial statement, if any, auditor's report along with annexures/ attachments shall be sent to every member, every trustee for the debenture holder and all other persons who are so entitled, twenty one days before the date of general meeting. This right to have copies of financial statements is over and above the provisions of Section 101 which provides for right to receive notice of general meeting.

The Ministry of Corporate Affairs vide General Circular No. 11/2015 dated 21st July, 2015 has issued clarification with regard to circulation and filing of financial statement under relevant provisions (Section 101, 136 & 137) of the Companies Act, 2013.

The MCA has clarified that a company holding a general meeting after giving a shorter notice as provided under section 101 of the Companies Act, 2013 may also circulate financial statements (to be laid/considered in the same general meeting) at such shorter notice. A company, under section 136(1) may also provide a copy of the financial statements, including consolidated financial statements, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, at such shorter notice.

### **Obligation of listed company**

Proviso to sub-section (1) provides that in the case of a company whose shares are listed on a recognised stock exchange, provisions shall be deemed to have been complied with, if the copies of the documents are made available for inspection at its registered office, during working hours, for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting.

In case of section 8 company - in Sub-section (1) of Section 136 for the words "twenty one days", the words "fourteen days" shall be substituted. - Notification dated 5th June, 2015.

In case of Nidhi company - Section 136 (1) shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the Nidhi is situated stating the date, time and venue of Annual General Meeting and the financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy.

Every listed company is required to supply a copy of the complete financial statements with auditor's report and director's report, to such shareholders who ask for full financial statements.

Every listed company is also required to place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

### **Financial statements of subsidiaries**

Every company (listed or unlisted) having subsidiary or subsidiaries shall:

- (d) place separate audited financial statements in respect of each of its subsidiary on its website, if any.
- (e) provide copy of separate audited financial statements if any shareholder demands a copy of the separate audited financial statements in respect of each of its subsidiary.

### **Right to inspect**

Every company shall be under an obligation to allow every member or trustee of the holder of any debentures issued by the company to inspect the financial statements and documents to be attached thereto stated under sub-section (1) at its registered office during business hours.

In case of listed companies, copies of documents shall be available for inspection at its registered office during working hours for a period of 21 days before the date of meeting and company may send the salient

features of financial statements to members and debenture trustees in prescribed form. That will be sufficient compliance of sub section (1).

### **Penal provisions**

If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of –

- (i) twenty-five thousand rupees and
- (ii) every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

Both penalties shall be imposed simultaneously.

### **SECTION 137: COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR**

Section 137 requires every company to file the financial statements including consolidated financial statement together with Form AOC- 4 and AOC-4(CFS) with the Registrar within 30 days from the day on which the annual general meeting held and adopted the financial statements with such fees or additional fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

The Ministry of Corporate Affairs vide General Circular No. 11/2015 dated 21st July, 2015 has issued clarification with regard to circulation and filing of financial statement under relevant provisions (Section 101, 136 & 137) of the Companies Act, 2013.

The MCA has issued clarification that, in case of a foreign subsidiary, which is not required to get its accounts audited as per legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding/parent Indian may place/file such unaudited accounts to comply with requirements of Section 136(1) and 137(1) as applicable. This is subject to a condition that the accounts have to be translated in English, if the original accounts are not in English and the format should be, as far as possible, in accordance with requirements of the Companies Act 2013. If it is not possible, a statement indicating the reasons for deviation may be placed along with such accounts.

If the financial statements are not adopted at the annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents be filed with the Registrar within thirty days of the date of annual general meeting. The Registrar shall take them in his record as provisional, until the adoption at annual general meeting.

The One Person Company shall file the copy of financial statements duly adopted by its members within a period of one hundred and eighty days from the closure of financial year.

The company shall also attach the accounts of subsidiaries incorporated outside India and which have not established their place of business in India with the financial statements.

The class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format and the Central Government may specify the manner of such filing under such notification for such class of companies (Rule 12(2)).

If annual general meeting has not been held, the financial statement duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last days before which the annual general meeting should have been held.

If company fails to comply with the requirement of submission of financial statement before Registrar, the

company shall be punishable with fine of one thousand rupees for every day during which failure continues subject to maximum of rupees ten lakh. The managing director and CFO if any, and, in the absence of such managing director or CFO, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, in the absence of such director, all directors of the company shall be punishable with imprisonment for a term which may extend upto six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees or with both.

## **SECTION 138: INTERNAL AUDIT**

### *Classes of companies requiring Internal Audit*

The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate:-

- (a) every listed company;
- (b) every unlisted public company having –
  - (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or
  - (ii) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (c) every private company having –
  - (i) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section. The internal auditor may or may not be an employee of the company.

The term “Chartered Accountant” or “Cost Accountant” may be, whether engaged in practice or not.

The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

### **Who can be an Internal Auditor**

- (a) a Chartered Accountant or;
- (b) a Cost Accountant or;
- (c) such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

For this sub-section, Chartered Accountant means a Chartered Accountant, who is a member of the Institute of Chartered Accountants of India and has a valid certificate of practice and Cost Accountant means a member of The Institute of Cost Accountants of India. Other professionals, as may be decided by the company's board, may also be appointed as an internal auditor.

Following classes of companies are required to appoint internal auditor-

1. All Listed Company	2. Public Company with				Private Company with	
	Paid up capital	Turnover	Outstanding loans and borrowings	Outstanding deposits	Turnover	Outstanding loans and borrowings
	50 Cr or more or	200 Cr or more or	100 Cr or more or	25 Cr or more	200 Cr or more or	100 Cr or more.

**SECTION 148 : MAINTENANCE OF COSTING AND STOCK RECORDS**

A company engaged in production, processing, manufacturing or mining activity, is also required to maintain particulars relating to utilization of material, labour or other items of cost as the Central Government may prescribe for such class of companies.

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## AUDIT AND AUDITORS

### Appointment of Auditors

The Board of Directors of a company shall appoint an individual or firm as the first auditor of a company, other than a Government company, within thirty days from the date of registration of the company. The appointment of first auditor shall be ratified by members at the first annual general meeting. The auditor so appointed shall hold the office from the conclusion of that meeting till the conclusion of sixth annual general meeting and thereafter till the conclusion of every sixth meeting. The appointment of auditors shall be ratified by members at every annual general meeting.

In the case of failure of the Board to appoint the first auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

Any casual vacancy (except as a result of the resignation of an auditor) in the office of an auditor of a company, other than a Government company, shall be filled by the Board of Directors within thirty days. If casual vacancy is as a result of the resignation of an auditor, the Board of Directors shall fill the vacancy within thirty days but such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

A retiring auditor may be re-appointed at an annual general meeting, if—

- (a) he is not disqualified for re-appointment;
- (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
- (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

If at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

### Manner and procedure of selection and appointment of auditors

In case of a company that is required to constitute an Audit Committee under section 177, such committee, and, in cases where such a committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

- Before considering the appointment of auditor, the Audit Committee or the Board, as the case may be, shall consider any pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court. Further they may call for such other information from the proposed auditor as it may deem fit.
- Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
- If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of auditor to the members in the AGM otherwise; it shall refer back the

recommendation to the committee for reconsideration citing reasons for such disagreement.

- Thereafter if the Audit Committee decides not to reconsider its original recommendation, then Board shall record reasons for its disagreement with the Audit committee and send its own recommendation for consideration of the members in the AGM and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.
- The auditor appointed in the AGM meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.
- Such appointment shall be subject to ratification in every AGM till the sixth AGM by way of passing of an ordinary resolution. If the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.

### **Conditions for appointment and Notice to Registrar-**

Rule 4 of the Companies (Audit and Auditors) Rules, 2014 hereinafter referred in this chapter as Rule

As per second proviso of section 139(1) read with rule 4 stipulates that written consent of the auditor must be taken before appointment. The auditor appointed shall submit a certificate that:

- (a) the individual/firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
- (b) the proposed appointment is as per the term provided under the Act;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Act;
- (d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

The Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Act.

The Company shall inform the auditor concerned of his or its appointment and also file a notice of such appointment with the Registrar in Form ADT-1 within 15 days of the meeting in which the auditor is appointed.

### **APPOINTMENT OF AUDITOR IN GOVERNMENT COMPANY- Section 139(5), 139(7), 139(8), 139 (11)**

The appointment of auditor in Government company or government controlled (directly/indirectly) company shall be held in accordance with the following provisions:

The First auditor shall be appointed by the Comptroller and Auditor General within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days. In case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

The Act also provides that in case the Company has an Audit Committee, then all appointments of Auditor including filling of casual vacancy, shall be made after taking into account the recommendations of the Committee.

### **ELIGIBILITY & QUALIFICATIONS OF AUDITOR**

Section 141 (1) & (2) of the Act prescribed the following eligibility and qualifications of auditor which are as under:-

- (i) Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.
- (ii) Where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

### **DISQUALIFICATIONS OF AUDITOR**

Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of a company, namely:

- A body corporate, except LLP;
- An officer or employee of the company;
- Any partner/employee of officer or employee of company;
- A person who himself or his relative/partner is holding any security or interest in the company, or any company which is its holding, subsidiary, associate;
- A person whose relative is holding security or interest not exceeding Rs. one Lac face value in companies as mentioned above. Provided that this condition be also applicable in the case of a company not having share capital or other securities, wherever relevant. Provided further that in the event of acquiring any security or interest by a relative, above the threshold limit i.e. ₹ one lac, the corrective action to maintain the limits (Rs. one lac) shall be taken by the auditor within 60 days of such acquisition or interest;
- A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment;
- A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment;
- A person or a firm who, whether directly or indirectly, has "business relationship" with the company, or its subsidiary, or its holding or associate company;

The term "business relationship" shall be construed as any transaction entered into for a commercial



purpose, except –

- (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- (ii) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
- A person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- A person who is in full time employment elsewhere;
- Person who is auditor of more than 20 companies. In case of private company - after the words twenty companies", the following words shall be inserted:  
"other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than one hundred crore rupees"
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

According to section 141 (4) where a person appointed as an auditor of a company incurs any of the disqualifications mentioned as above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

### **Mandatory Rotation of Auditors Section 139 (2) and Rule 5**

The Companies Act, 2013 has introduced the system of rotation of auditors which is applicable to-

- all listed companies;
- all unlisted public companies having paid up share capital of rupees 10 crore or more;
- all private limited companies having paid up share capital of rupees 20 crore or more;
- all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crore or more.

The concept of rotation of auditors shall not apply to one person companies and small companies.

All the companies mentioned above shall not appoint or re-appoint an individual as an auditor of the company for more than 1 term of 5 consecutive years. An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the date of completion.

All the companies mentioned above shall not appoint or re-appoint an audit firm as an auditor of the company for more than 2 terms of 5 consecutive years. An audit firm which has completed its 2 terms of 5

consecutive years shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms. If any firm/LLP which has one or more partners who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during the 5 year period. In other words, if two or more audit firms have common partner(s), and one of these firms has completed its 2 terms of 5 consecutive years, none of such audit firms shall be eligible for re-appointment as auditor in the same company for 5 years.

No audit firm shall be appointed as auditor of the company for a period of five years, if same firm presently having a common partner(s) to the previous audit firm, whose tenure has expired in a company immediately preceding the financial year.

The right of the company to remove the auditor or the right of the auditor to resign from such office of the company is not affected by this sub-section. Thus, an auditor can resign or be removed by the shareholders before completion of his term as discussed above. The firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008.

### **ROTATION OF AUDITORS- Section 139(3)**

Members of a company can provide for following by passing a resolution:

- (a) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
- (b) The audit shall be conducted by more than one auditor.

A transition period of 3 years from the commencement of the Act has been prescribed for the company existing on or before the commencement of the Act, to comply with the provisions of the rotation of auditor.

### **ROTATION OF AUDITORS ON EXPIRY OF THEIR TERM -Section 139 (4) and Rule 6**

Rotation of auditors on expiry of auditor's term then same procedure will be followed as required for appointment of auditors. The procedure is as under:-

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

For the purpose of rotation, the period for which the auditor is holding office prior to the commencement of this act will also be counted in calculating the period of 5 years or 10 years as the case may be. The incoming auditor/audit firm shall not be eligible if such auditor/audit firm is associated with the outgoing auditor/audit firm under the same network of audit firms i.e. includes the firms operating/ functioning under the same brand name, trade name or common control, hitherto or in future. If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Where a company has appointed two or more persons as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

**RE-APPOINTMENT OF RETIRING AUDITOR- Section 139 (9)**

At any annual general meeting, a retiring auditor shall be reappointed as auditor of the company except under the following circumstances:

- (a) he is not qualified for re-appointment.
- (b) he has given the company a notice in writing of his unwillingness to be re-appointed.
- (c) a special resolution has been passed at that meeting appointing somebody else instead of him or providing expressly that retiring auditor shall not be re-appointed.

Section 139 (10) lays that where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

**CASUAL VACANCY IN THE OFFICE OF AUDITOR - Section 139 (8)**

The provisions for filling of casual vacancy in the office of auditor are as follows:

- (a) The Board of the company shall have power to fill the casual vacancy in the office of auditor within 30 days.
- (b) In case casual vacancy has occurred due to resignation of auditor, such appointment should also be approved by the company in general meeting convened within 3 months of the recommendation of the Board and auditor shall hold the office till the conclusion of the next annual general meeting.
- (c) In case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor- General of India, such vacancy should be filled by the Comptroller and Auditor-General of India within 30 days. In case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.
- (d) Appointment of auditors to fill casual vacancy shall be made after taking into account the recommendation of the audit committee.

**REMOVAL OF AUDITOR-Section 140 (1) and Rule 7**

The auditor appointed under section 139 may be removed from his office before the expiry of the term only by –

- (i) Obtaining the prior approval of the Central Government by filling an application in form ADT-2 within 30 days of resolution passed by the Board
- (ii) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.
- (iii) The auditor concerned shall be given a reasonable opportunity of being heard.

**RESIGNATION OF AUDITOR- Section 140 (2), 140 (3)and Rule 8**

The auditor who has resigned from the company shall file a statement in Form ADT-3 indicating the reasons and other facts as may be relevant with regard to his resignation as follows:

- (i) In case of other than Government Company, the auditor shall within 30 days from the date of resignation, file such statement to the company and the registrar.

- (ii) In case of Government Company or government controlled company, auditor shall within 30 days from the resignation, file such statement to the company and the Registrar and also file the statement with the Comptroller and Auditor General of India (CAG).

The onus to file such statement containing relevant facts and reasons for resignation is on the resigning auditor and any contravention of sub clause (2) is punishable with monetary fine which could be minimum ₹50,000 and maximum ₹5 lakh.

### **REMUNERATION OF AUDITOR – Section 142**

Section 142 of the Act prescribed that the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. Board may fix remuneration of the first auditor appointed by it. The remuneration will be in addition to the out of pocket expenses incurred by the auditor in connection with the audit of the company and any remuneration paid to him for any other service rendered by him at the request of the company.

### **AUDITOR'S RIGHT TO ATTEND GENERAL MEETING Section 146**

All notices of any general meeting shall be forwarded to the auditor of the company and he must attend any general meeting either by himself or through his authorised representative (qualified to be an auditor) and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

### **POWERS AND DUTIES OF AUDITORS**

Section 143(1) provided that Every auditor can access at all times to the books of accounts, vouchers and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f). It is the duty of every auditor to make proper enquiry regarding these matters, besides other matters and if he is satisfied, it is not necessary to disclose this fact in his report. However, on enquiry, if he finds some adverse features, it is his duty to report the same. Specific enquiries to be made by the auditor under this sub-Section are as under–

(a) *Loans and Advances made by the Company*

Auditor shall inquire into “whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its members.” It is applicable to all loans and advances made on the basis of security. The auditor should verify that the security held against the loans and advances made by the company are legally enforceable and also ascertain the valuation of securities to see whether the loan is fully secured or partly secured.

(b) *Transactions represented by book entries*

Auditor is required to inquire “whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company”. He should verify the all book entry transactions and determine whether such transactions have actually taken place and are not prejudicial to the interest of the company.

(c) *Sale of investments*

Auditor should inquire, “whether so much of the assets of the company (except an investment company or a banking company) as consists of shares, debentures and other securities, have been

sold at a price less than that at which they were purchased by the company”. Auditor must verify the cases where securities are sold at a price less than their cost of acquisition and if he finds that such sale is bona fide and the price realised is considered to be reasonable, having regards to the circumstances of each case, no further reporting is required.

(d) *Loans and Advances shown as deposits*

Auditor must verify “whether loans and advances made by the company have been shown as deposits”. The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.

(e) *Charging of Personal expenses to revenue account*

Auditor should inquire as to “whether personal expenses have been charged to revenue account”. Auditor must ensure that no personal expenses of directors and officers of the company have been charged to revenue account.

(f) *Allotment of shares for cash*

Auditor should inquire as to “whether cash has actually been received in respect of shares stated to have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading”. In this connection, auditor must ensure in respect of shares allotted in cash by the company that cash has actually been received in respect of such allotment by the company.

He should verify and report the cases where cash was not received and that the position, as stated in books of accounts and balance sheet, is correct, regular and not misleading.

Auditor will have access to books of accounts and vouchers, not only to those kept at registered office of the company but also to those kept at any other place. Such access shall be available at all times. Also, auditor of a holding company shall have access to the books of all of its subsidiary companies for the purpose of consolidation of financial statements of holding company and its subsidiaries.

## AUDIT REPORT

Section 143 (2) prescribed that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company. The Audit report should take into consideration the provisions of this Act, the Accounting and Auditing standards and matters which are required under this Act or rules made thereunder or under any order made u/s 143(11).

The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company’s affair as at the end of the financial year and the profit or loss and the cash flow for the year and such other matters as may be prescribed.

Section 143 (3) laid down that auditor’s report shall also state other details which are as under:

- (a) whether he has sought and obtained all the information and explanations which were necessary and if not, the details thereof and the effect of such information on the financial statements;
- (b) whether, in his opinion, proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

- (c) whether the branch audit report prepared by a person other than the company's auditor has been sent to him;
- (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, the financial statements comply with the accounting standards;
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- (g) whether any director is disqualified from being appointed as a director under section 164 (2);
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
- (j) Rule 11 prescribed that Auditor's Report shall also include their views and comments on the following matters, namely:-
  - (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
  - (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
  - (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
  - (iv) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.

The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. {Section 143 (4)}

For the financial years commencing on or after 1st April, 2015, the report of the auditor shall state about existence of adequate internal financial controls system and its operating effectiveness:

Provided that auditor of a company may voluntarily include the statement referred to in this rule for the financial year commencing on or after 1st April, 2014 and ending on or before 31st March, 2015.

### **POWERS OF COMPTROLLER AND AUDITOR—GENERAL OF INDIA IN CASE GOVERNMENT COMPANY [Section 143 (5) to 143 (7)]**

In case of Government Company, the Audit Report among other things, shall include the directions, if any, issued by the Comptroller and Auditor –General of India (CAG), the action taken and the impact thereof on the Company's accounts and financial statement.

The CAG shall have a right to the conduct a supplementary audit of financial statement of the company and

comment upon or supplement such audit report within 60 days from the date of receipt of the audit report u/s 143 (5).

Provided that any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements u/s 136 (1) and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

The CAG may, by an order, cause test audit to be conducted of the accounts of company covered u/s 139 (5) or 139 (7) and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

### **BRANCH AUDIT - SECTION 143 (8) AND RULE 12**

Branch Auditor: Accounts of branch office can be audited by –

1. The company's auditor; or
2. Any other person, qualified to be and appointed as an auditor as per the provisions of the Act as branch auditor; or
3. In case of foreign branch, by the company's auditor or by an accountant or a competent person appointed in accordance with the prevailing laws of the foreign country.

The branch auditor shall prepare a report on the accounts of the branch examined by him and the company's auditor shall deal with such report in his audit report in a manner as he considers necessary.

Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.-

- (1) The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143 i.e. right of access to books of accounts, ensure about the mandatory books of accounts maintained, prepare auditors' report and state the reasons of qualification in report, if any etc .
- (2) The branch auditor shall submit his report to the company's auditor.
- (3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

### **AUDITING STANDARDS - SECTION 143 (9) & (10)**

Every auditor must comply with the auditing standards. While the Central Government prescribes the Auditing Standards or addendums thereto, it shall consult with and take recommendations of the Institute of Chartered Accountants of India (ICAI) and the National Financial Reporting Authority (NFRA). Till such time the Auditing Standards are notified by the Central Government, the auditing standards specified by the ICAI are deemed to be the auditing standards.

### **Companies (Auditor's Report) Order, 2015**

Section 143 (11) of the Companies Act, 2013 provides that the Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

Accordingly, in exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 the central government vide notification S.O. 990(E).- dated 10th April, 2015 issued the Companies (Auditor's Report) Order, 2015 applicable to every company including a foreign company. The order is not applicable to-

- Banking company,
- Insurance company,
- Company licensed to operate under section 8 of the Companies Act, 2013,
- One Person Company and Small Company
- Private limited company (with a paid up capital and reserves not more than rupees fifty lakh and which does not have loan outstanding exceeding rupees twenty five lakh from any bank or financial institution and does not have a turnover exceeding rupees five crore at any point of time during the financial year)

### **Contents of the Auditors Report**

The order further provides that every report made by the auditor under section 143 of the Companies Act, on the accounts of every company examined by him to which this Order applies for the financial year commencing on or after 1st April, 2014, shall contain the following matters:

- Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- Whether physical verification of inventory has been conducted at reasonable intervals by the management;
- Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
- Whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;
- Whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act. If so,
- Whether receipt of the principal amount and interest are also regular; and
- If overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;
- Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.
- In case the company has accepted deposits, whether the directives issued by the Reserve Bank of



India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed there under, where applicable, have been complied with? If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

- Where maintenance of cost records has been specified by the Central Government under sub-section (l) of section 148 of the Companies Act, whether such accounts and records have been made and maintained:
- Is the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.
- In case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).
- Whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made thereunder has been transferred to such fund within time.
- Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;
- Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported:
- Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;
- Whether term loans were applied for the purpose for which the loans were obtained;
- Whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

#### **Reasons to be stated for unfavourable or qualified answers-**

- Where, in the auditor's report, the answer to any of the questions referred above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be.
- Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

#### **REPORTING OF FRAUDS BY AUDITOR- Section 143(12) to 143 (15) & Rule 13**

Section 143(12) and Rule 13 provides that If an auditor of a company, in the course of the performance of his

duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to Central Government.

(1) The auditor shall report the matter to the Central Government as under:-

- (a) the auditor shall report the matter to the Board or the Audit Committee, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;
- (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
- (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(2) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same.

(3) The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number.

(4) The report shall be in the Form ADT-4.

(5) In case of a fraud involving lesser than the amount specified above, the auditor shall report the matter to Audit Committee or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

(5) The fraud reported to the Audit Committee or the Board during the year shall be disclosed in the Board's Report specifying the following-

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

(6) The provision of this rule shall also apply, *mutatis mutandis*, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively.

#### **AUDITOR NOT TO RENDER CERTAIN SERVICES (PROHIBITED SERVICES)-Section 144**

An auditor shall provide to the company only such other services as are approved by the Board of Directors/ the audit committee, but which shall not include any of the following services (whether such services are

rendered directly or indirectly to the company or its holding company or subsidiary company, namely:-

- (a) accounting and book keeping services;
- (b) internal audit;
- (c) design and implementation of any financial information system;
- (d) actuarial services;
- (e) investment advisory services;
- (f) investment banking services;
- (g) rendering of outsourced financial services;
- (h) management services; and
- (i) any other kind of services as may be prescribed.

#### **APPOINTMENT OF AUDITOR OTHER THAN RETIRING AUDITOR BY SPECIAL NOTICE- Section 140 (4)**

Special notice shall be required from members proposing to move a resolution at the next annual general meeting to appoint a person other than the retiring auditor or to provide that the retiring auditor shall not be re-appointed.

Such special notice shall not be required in case where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139.

Following points are relevant for the purpose of special notice:

- (i) Company, on receipt of such special notice for removing auditor, should forthwith send a copy of the same to the retiring auditor.
- (ii) If the auditor makes a representation in writing to the company and requests for its notification to the members, the company shall
  - (a) state the fact of representation in any notice of resolution, and
  - (b) send copy of representation to members to whom notice of meeting is sent, whether before or after the receipt of representation by the company.
  - (c) if the copy of representation is not so sent, copy thereof should be filed with the Registrar.
- (iii) such representation should be of a reasonable length and not too long.
- (iv) For circulation to members, it should not be received by the company too late.
- (v) Auditor may require the company to read out the representation in the meeting if it is not so notified to members because it was too late or because of company's default.

Provided that If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting. *{ This Proviso is yet to be notified }*

#### **POWERS OF TRIBUNAL- Section 140 (5)**

A National Company Law Tribunal (NCLT) can either –

- (i) suo moto or

- (ii) on an application from Central Government, or
- (iii) on an application from person concerned,

can direct the company to change the auditor if it is satisfied that the Auditor of a Company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

In the case of application being made by the Central Government and the NCLT being satisfied that change of auditor is required, it shall within 15 days of the receipt of such application, make an order that the Auditor shall not function as an auditor of the company and the Central Government may appoint another auditor in his place. This will happen only when an application is made by the Central Government and not by any other person.

Where the auditor, whether individual or firm, against whom the final order as aforementioned is passed by the NCLT under this section, he shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of such order. Further, the auditor shall also be liable for action under Section 447 which provides for punishments for frauds. *{This Proviso is yet to be notified}*

It has been clarified by way of explanation that in case a firm is appointed as auditor of the company, the liability shall be of the firm and every partner or partners who acted in fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers shall be liable and not be eligible to be appointed as auditor of any company for a period of 5 years.

### **SIGNING OF AUDIT REPORTS - Section 145**

Auditor shall sign the auditor's report of the company. Any qualifications, observations or comments on financial transactions matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

### **PUNISHMENT FOR CONTRAVENTION – Section 147**

#### *For the Company*

1. If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000 and every officer in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 1,00,000 or with both.

#### *For the Auditor*

2. If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000. if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company/shareholders/creditors/authorities, he shall be punishable with imprisonment for a term which may extend to 1 year and with fine which shall not be less than Rs. 1,00,000 which may extend to Rs. 25,00,000.
3. Where an auditor has been convicted under sub-section (2), he shall be liable to refund the remuneration received by him to the company; and pay for damages to the company/ statutory

bodies/authorities/to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

4. The Central Government shall specify any statutory body/ authority/an officer for ensuring prompt payment of damages to the company/ statutory bodies/authorities/ any other persons by issuing notification and such body shall after payment of damages to such company/persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the notification.
5. Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner(s) of audit firm have acted in a fraudulent manner/abetted/ colluded in any fraud by, or in relation to or by, the company/its directors/ officers, the civil/criminal liability as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

### **COST RECORDS & AUDIT– Section 148**

Section 148(1) states that notwithstanding anything contained in Chapter X of Companies Act 2013, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

However the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

Section 148(2) states that if the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

Section 148(3) states that the audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed.

Further that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records and the auditor conducting the cost audit shall comply with the cost auditing standards.

For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

Section 148(4) states that an audit conducted under this section shall be in addition to the audit conducted under section 143.

Section 148(5) states the qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

Further the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

Section 148(6) states that a company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

Section 148(7) states that if, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Section 148(8) states that if any default is made in complying with the provisions of this section,—

- (a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
- (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

Application of Cost Record – Rule 3 of the Companies (Cost records and Audit) Rules, 2015, provides that for the purposes of sub-section (l) of section 148 of the Act, the class of companies, including foreign companies defined in clause (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in the table below, having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of account, namely:-

**(A) Regulated Sectors**

Sl. No.	Industry/ Sector/ Product/ Service	Central Excise Tariff Act Heading (wherever applicable)
1.	Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997); including activities that requires authorisation or license issued by the Department of Telecommunications, Government of India under Indian Telegraph Act, 1885 (13 of 1885);	Not applicable
2.	Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003);	Generation- 2716; Other Activity- Not Applicable
3.	Petroleum products; including activities regulated by the Petroleum and Natural Gas Regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006);	2709 to 2715; Other Activity- Not Applicable
4.	Drugs and pharmaceuticals;	2901 to 2942; 3001 to 3006

5.	Fertilisers;	3102 to 3105
6.	Sugar and industrial alcohol;	1701; 1703; 2207

**(B) Non-regulated Sectors**

Sl. No.	Industry/ Sector/ Product/ Service	Central Excise Tariff Act Heading (wherever applicable)
1.	Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items;  Explanation. - For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules.	8401; 8801 to 8805; 8901 to 8908
2.	Turbo jets and turbo propellers;	8411
3.	Arms and ammunitions and Explosives;	3601 to 3603; 9301 to 9306
4.	Propellant powders; prepared explosives (other than propellant powders); safety fuses detonating fuses; percussion or detonating caps; igniters; electric detonators;	3601 to 3603
5.	Radar apparatus, radio navigational aid apparatus and radio remote control apparatus;	8526
6.	Tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent, or more by the Government or Government agencies;	8710
7.	Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports;	Not applicable
8.	Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);	Not applicable
9.	Iron and Steel;	7201 to 7229; 7301 to 7326
10.	Roads and other infrastructure projects corresponding to para No. (1) (a) as specified in <u>Schedule VI</u> of the Companies Act, 2013 (18 of 2013);	Not applicable
11.	Rubber and allied products; including products regulated by the	4001 to 4017

	Rubber Board constituted under the Rubber Act, 1947 (XXIV of 1947);	
12.	Coffee and tea;	0901 to 0902
13.	Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signalling equipment's of all kind;	8601 to 8608
14.	Cement;	2523; 6811 to 6812
15.	Ores and Mineral products;	2502 to 2522; 2524 to 2526; 2528 to 2530; 2601 to 2617
16.	Mineral fuels (other than Petroleum), mineral oils etc.;	2701 to 2708
17.	Base metals;	7401 to 7403; 7405 to 7413; 7419; 7501 to 7508; 7601 to 7614; 7801 to 7802; 7804; 7806; 7901 to 7905; 7907; 8001; 8003; 8007; 8101 to 8113
18.	Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals;	2801 to 2853; 2901 to 2942; 3801 to 3807; 3402 to 3403; 3809 to 3824
19.	Jute and Jute Products;	5303, 5310
20.	Edible Oil;	1507 to 1518
21.	Construction Industry as per para No. (5) (a) as specified in <u>Schedule VI</u> of the Companies Act, 2013 (18 of 2013);	Not applicable
22.	Health services, namely functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories;	Not applicable
23.	Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business.	Not applicable
24.	Milk powder;	0402
25.	Insecticides;	3808
26.	Plastics and polymers;	3901 to 3914; 3916 to 3921; 3925
27.	Tyres and tubes;	4011 to 4013
28.	Paper;	4801 to 4802
29.	Textiles;	5004 to 5007; 5106 to 5113; 5205 to 5212; 5303; 5310; 5401 to 5408; 5501 to 5516
30.	Glass;	7003 to 7008; 7011; 7016
31.	Other machinery and Mechanical Appliances;	8402 to 8487



32.	Electricals or electronic machinery;	8501 to 8507; 8511 to 8512; 8514 to 8515; 8517; 8525 to 8536; 8538 to 8547
33.	Production, import and supply or trading of following medical devices, namely:- <ol style="list-style-type: none"> <li>i. Cardiac stents;</li> <li>ii. Drug eluting stents;</li> <li>iii. Catheters;</li> <li>iv. Intra ocular lenses;</li> <li>v. Bone cements;</li> <li>vi. Heart valves;</li> <li>vii. Orthopaedic implants;</li> <li>viii. Internal prosthetic replacements;</li> <li>ix. Scalp vein set;</li> <li>x. Deep brain stimulator;</li> <li>xi. Ventricular peripheral shud;</li> <li>xii. Spinal implants;</li> <li>xiii. Automatic impalpable cardiac deflobillator,</li> <li>xiv. Pacemaker (temporary and permanent);</li> <li>xv. Patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device;</li> <li>xvi. Cardiac re-synchronize therapy ;</li> <li>xvii. Urethra spinicture devices;</li> <li>xviii. Sling male or female;</li> <li>xix. Prostate occlusion device; and</li> <li>xx. Urethral stents:</li> </ol>	9018 to 9022

Provided that nothing contained in serial number 33 shall apply to foreign companies having only liaison offices.

Provided further that nothing contained in this rule shall apply to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006).

**Applicability for Cost Audit:-** Rule 4 of the Companies (Cost records and Audit) Rules, 2015

(1) Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or services for which cost records are required to be maintained under rule 3 is rupees twenty five crore or more.

(2) Every company specified in item (B) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual

product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crore or more.

(3) The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3, and-

- (i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or
- (ii) Which is operating from a special economic Zone.
- (iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005;

Cost Audit: Rule 6 of the Companies (Cost records and Audit) Rules, 2015

(1) The category of companies specified in rule 3 and the threshold limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

Provided that before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate from him or it, as provided in sub-rule (1A), shall be obtained;

(1A) The cost auditor appointed under sub-rule (1) shall submit a certificate that-

- (a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 (23 of 1959) and the rules or regulations made thereunder;
- (b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Act; and
- (d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Provided that the cost auditor appointed under these rules may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.

Provided further that the Form CRA-2 to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect:

Provided also that nothing contained in this sub-rule shall prejudice the right of the cost auditor to resign from such office of the company.

(3A) Any causal vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointments of cost auditor.

(3B) The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorised by the Board, for submission to the cost auditor to report thereon.

(4) Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in **form CRA-3**.

(5) Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.

(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 alongwith fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(7) The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply *mutatis mutandis* to a cost auditor during performance of his functions under section 148 of the Act and these rules.

### LESSON ROUND-UP

- Proper books of accounts shall be deemed to have been kept by a company if such books exhibit and explain the transactions and financial position of the business of the company, including books containing sufficiently detailed entries of daily cash receipts and payments.
- Every company is required to keep books of account at its registered office in respect of specified transactions. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide.
- As per the Act, books of account and other books and papers should be available for inspection by any director on working days during business hours.
- The expression 'annual accounts' embraces both balance sheet and statement of profit and loss.
- The term 'Balance Sheet' means a statement prepared from the books of a concern showing the debit and credit balances after the trading and profit and loss accounts have been prepared – a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date.
- Profit and loss account is a Statement by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation to its capital, and enables them to judge about the administration and management of the affairs of the company.
- The Act provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- The Act requires that at every annual general meeting of the company, the Board of directors must lay before the shareholders of the company a balance sheet and a profit and loss account for the period as specified therein; and in the case of non-profit companies, an income and expenditure account.

- The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report. The Act gives other provisions also for authentication of annual accounts. The Act also requires the company to file such annual accounts with the Registrar of Companies.
- The Act provides that there shall be attached to every balance sheet laid before a company in general meeting (in practice, the annual general meeting) a report by its Board of directors, with respect to items as specified therein. The Board's Report shall also include a Directors' Responsibility Statement as required under the Act.
- The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. An audit of accounts is conducted with two-fold purpose: (i) detection and prevention of errors; (ii) detection and prevention of fraud.
- The Act provides that every company shall, at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next annual general meeting. The Act also provides for methods of appointment of auditors along with their qualifications and disqualifications.
- The Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India within the limits specified.
- The Act provides that the auditors' report shall be signed only by the person appointed as an auditor of the company.
- The Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs.
- By and large the notes on accounts are self-explanatory. The notes on accounts are intended to clarify and elucidate the financial position of a company as disclosed in its balance sheet and profit and loss account.

### SELF-TEST QUESTIONS

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

1. Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. State the manner of maintenance of books of accounts in electronic form.
2. Write a short note on Indian accounting Standards.
3. Describe the procedure to be followed under Section 143 (12) to report the frauds to the Central Government.
4. What are the matters to be stated under Section 143 (3) in the auditor's report?
5. What are conditions for removal of the auditor appointed under section 139 before the expiry of his term?
6. State the class of companies shall be required to appoint an internal auditor or a firm of internal auditors.
7. List down the functions of CSR Committee.

# Lesson 22

## Divisible Profits and Dividends

### LESSON OUTLINE

- Meaning and Definition of Dividend
- Declaration of Dividend
- Unpaid Dividend Account
- Investor Education and Protection Fund
- Utilisation of Investor Education and Protection Fund
- Right to dividend, right shares and bonus shares to be held in abeyance pending registration of transfer of shares
- Punishment for failure to distribute dividends

### LEARNING OBJECTIVES

Declaration and Payment of Dividend is dealt in Chapter VIII of Companies Act 2013 read with Companies (Declaration and Payment of Dividend) Rules, 2014. It broadly covers transfer of profits to reserves, maximum dividend that can be declared, in case of inadequacy of profits, maintenance of separate bank account for distribution of dividend, transfer of Unpaid Dividend to Unpaid Dividend Account and Investor Protection and enhanced penalty etc.,

After reading this lesson you will be able to understand the legal and procedural aspects relating to distribution of dividend, transfer of unpaid or unclaimed dividend to Unpaid Dividend Account and transfer of unpaid dividend to Investor Education and Protection Fund (IEPF), utilization of IEPF etc.,

*“A stock dividend is something tangible — it’s not an earnings projection; it’s something solid, in hand. A stock dividend is a true return on the investment. Everything else is hope and speculation.”*

*—Richard Russel*

## MEANING AND DEFINITION OF DIVIDEND

A dividend is a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. A share of the after-tax profit of a company, distributed to its shareholders according to the number and class of shares held by them is called dividend. The amount and timing of the dividend is decided by the board of directors, who also determine whether it is paid out of current earnings or the past earnings kept as reserve.

Holders of preference shares receive dividend at a fixed rate and are paid first. However, preference shareholders are not entitled to treat the preference dividend as a debt and sue for its payment. However, if the articles specify that the company's profit shall be applied, by way of payment of the preference dividend, the preference shareholder can sue for it even though it has not been declared [Eving v. Israel & Oppenheimer Ltd. (1918) 1 Ch. 101].

Holders of equity shares are entitled to receive any amount of dividend, based on the level of profit and the company's need for cash for expansion or other purposes.

*Dividend defined under section 2(35) of the Companies Act, 2013, includes any interim dividend.*

The power to pay dividend is inherent in a company and is not derived from the Companies Act, 2013 or the Memorandum or Articles of Association although the Act and the Articles regulate the manner in which dividends are to be declared.

Right to claim dividend will only arise after a dividend is declared by the company in general meeting and until and unless it is so declared, the shareholder has no claim against the company in respect of it. The observation of the Bombay High Court in *Bacha F Guzdar v. CIT* (1952) 22 Com Cases 198 (Bom) was improved upon by the Supreme Court saying that the right to participation in the profits exists independent of any declaration by the company with only difference that the enjoyment of profits is postponed until dividends are declared [*Bacha F Guzdar (Mrs.) v. CIT* (1955) 25 Com Cases 1 at p. 6]

### Final dividend

Dividend is said to be a final dividend if it is declared at the annual general meeting of the company. Final dividend once declared becomes a debt enforceable against the company. Final Dividend can be declared only if it is recommended by the Board of Directors of the Company. In accordance with Section 134(3)(k), Board of directors must state in the Directors' Report the amount of dividend, if any, which it recommends to be paid.

### Interim dividend

Dividend is said to be an interim dividend, if it is declared by the Board of Directors between two annual general meetings of the company. All the provisions relating to the payment of dividend shall be applicable on the interim dividend also.

### Declaration of Dividend (Section 123)

Section 51 of the Act, states that a company may, if so authorized by its articles, pay dividend in proportion to the amount paid up on each share.

**A. Sources of declaration of dividend:** Section 123(1) of Companies Act 2013 provides that no

dividend shall be declared or paid by a company for any financial year except—

- (a) (i) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or
- (ii) out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or
- (iii) out of both; or

For the above purpose, depreciation shall be provided in accordance with the provisions of Schedule II.

- (b) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

**B. Transfer of profits to reserves:** A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

**C. Dividend in case of absence or inadequacy of profits:-** Second proviso to Section 123(1) states that owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf. Rule 3 of Companies (Declaration and Payment of Dividend) Rules, 2014 provides that in the event of adequacy or absence of profits in any year, a company may declare dividend out of surplus subject to the fulfillment of the following conditions, namely:-

- (1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: Provided that this sub rule shall not apply to a company which has not declared any dividend in each of preceding 3 financial years.
- (2) The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
- (3) The amount so drawn shall first be utilized to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
  - (a) The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.
  - (b) No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year. [Fourth Proviso to Section 123(i)] This proviso is not applicable to Government company in which entire paid up share capital is held by the Central Government or by any State Government or Governments or by the Central Government and one or more State Governments.

**D. Dividend to be declared from free reserves only:** Third proviso to Section 123(1) states that that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Free reserves means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend: Provided that—

- (1) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (2) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

- E. Manner of providing depreciation:** According to Section 123(2) for the purpose of declaration of dividend by a company as per Section 123(1)(a), it shall provide depreciation in accordance with Schedule II.
- F. Declaration of interim dividend:** Section 123(3) of the Companies Act, 2013 provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account as well as profit of the financial year in which the interim dividend is sought to be declared. When the company has incurred any loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding the three financial years.
- G. Amount of Dividend to be deposited in Special Account of a Schedule Bank:** Section 123(4) provides that the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend. where if the articles of the company does not authorize so, it has to be amended accordingly. It shall not apply to Government Company in which the entire paid up share capital is held by the Central Government or by any State Government.
- H. Dividend only to registered shareholder:** Section 123(5) explains that no dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash. This sub-section shall apply to Nidhi company subject to the modification that any dividend payable in cash may be paid by crediting the same to the account of the member if the dividend is not claimed within 30 days from the date of declaration of the dividend.
- I. Capitalization of Profits:** Nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.
- J. Mode of payment:** If any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.
- K. No dividend to be declared/paid in case of failure of repayment of deposits:** Section 123(6) provides that a company which fails to comply with the provisions of sections 73(prohibition of acceptance of deposits except in the manner provided) and 74 (Repayment of deposits etc accepted before commencement of Companies Act 2013) shall not, so long as such failure continues, declare any dividend on its equity shares.

#### **UNPAID DIVIDEND ACCOUNT (Section 124)**

Section 124(1) states that when a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.



Section 124(4) states that any person claiming to be entitled to any money transferred under sub-section (1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

**(a) Details of unpaid dividend to be placed at the website:** Section 124 (2) provides that the company shall, within a period of ninety days of making any transfer of an amount under Section 124(1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

**(b) Effect of Non-Transfer of the Dividend:** Section 124(3) provides that if any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent. per annum and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

**(c) Transfer to investor education and protection fund:** Section 124 (5) states that any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under sub-section (1) of section 125 (Investor Education and Protection Fund) and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

**(d) Shares in respect of unpaid dividend also to be transferred to IEPF:** Section 124(6) provides that all shares in respect of which dividend has not been paid or claimed for seven consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed. (As per the Companies Amendment Act, 2015)

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

It is also clarified in the Companies Amendment Act, 2015 that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.

**(e) Offence & penalty:** Section 124(7) provides that if a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

### Investor Education and Protection Fund (Section 125)

The Central Government shall establish a Fund to be called the Investor Education and Protection Fund. Section 125(2) prescribes that the following shall be credited to the Fund—

- (a) the amount given by the Central Government by way of grants after due appropriation made by

Parliament by law in this behalf for being utilised for the purposes of the Fund;

- (b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;
- (c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub section (5) of section 124;
- (d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;
- (e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;
- (f) the interest or other income received out of investments made from the Fund;
- (g) the amount received under sub-section (4) of section 38;
- (h) the application money received by companies for allotment of any securities and due for refund;
- (i) matured deposits with companies other than banking companies;
- (j) matured debentures with companies;
- (k) interest accrued on the amounts referred to in clauses (h) to (j);
- (l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
- (m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and
- (n) such other amount as may be prescribed.

Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

### **UTILISATION OF INVESTOR EDUCATION AND PROTECTION FUND**

Section 125 (3) provides the Fund shall be utilised for—

- (a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
- (b) promotion of investors' education, awareness and protection;
- (c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
- (d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

- (e) any other purpose incidental thereto, in accordance with such rules as may be prescribed:

Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

### **RIGHT TO DIVIDEND, RIGHTS SHARES AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES**

Section 126 provides that when any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provision of this Act,—

- (a) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer; and
- (b) keep in abeyance in relation to such shares, any offer of rights shares under clause (a) of sub-section (1) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (5) of section 123.

### **PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS**

Section 127 of Companies Act 2013 provides that when a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent. per annum during the period for which such default continues.

**Exceptions:** Proviso to section 127 has provided a list where no offence under this section shall be deemed to have been committed:—

- (a) where the dividend could not be paid by reason of the operation of any law;
- (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;
- (c) where there is a dispute regarding the right to receive the dividend;
- (d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

In case of Nidhi company – Section 127 shall apply subject to the modification that where dividend payable to a member is 100 rupees or less, it shall be sufficient compliance of the provisions of the section if the declaration of dividend is announced in the Local Language in one Local Newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhi for at least three months.

### LESSON ROUND- UP

- Under Section 2(35) of the Companies Act, 2013, 'dividend' includes any interim dividend.
- Dividend is the share of the company's profit distributed among the members.
- The Board may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account at any time between two AGM of the company.
- Final Dividend means a Dividend which declared at the Annual General Meeting of the company.
- In case of inadequacy of profits the company can declare the dividend with accordance with the Rule 3 of Companies (Declaration and Payment of Dividend) Rules 2014.
- The amount of dividend shall be deposited in a schedule bank in a separate account within 5 days from the date of declaration.
- Dividend may be paid by cheque or warrant or in any electronic mode to the shareholders entitled to the payment of dividend.
- Where the dividend is not paid or claimed within 30 days, the company shall, within 7 days transfer the amount to Unpaid Dividend Account which shall be opened in a scheduled bank.
- In case of any default in transferring the amount, the company shall be laible to pay interest on the amount as has not been transferred.
- The amount remaining unpaid along with interest accrued thereon for 7 years shall be transferred to Investor Education and Protection Fund.
- In case of non-payment of dividend declared by the company, every party in default be punishable with imprisonment of upto two years and with fine.

### SELF TEST QUESTIONS

- (1) Define the term 'Dividend'. State briefly the provisions related to declaration of dividend under the Companies Act 2013.
- (3) State the procedure for transfer of unpaid or unclaimed dividend to the Investor Education and Protection Fund.
- (4) Explain the law relating to declaration and payment of final dividend.
- (5) Distinguish between 'Interim Dividend' and 'Final Dividend'.
- (6) Write short notes on the following:-
  - (i) Investor Education and Protection Fund (IEPF).
  - (ii) Punishment of failure to distribute dividend

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# Lesson 23

## Board's Report and Disclosures

### LESSON OUTLINE

- Introduction
- Disclosures under Companies Act, 2013
- Disclosure pursuant to rules made under Companies Act, 2013
- Disclosures pursuant to the Listing Regulations of stock exchanges
- Approval of the Board's Report
- Signing of the Board's Report
- Filing of the Board's Report
- Right of members to copies of Balance sheet, Board's Report etc.
- Liability of mis-statement

### LEARNING OBJECTIVES

Disclosure and transparency are of utmost importance in a fiduciary relationship between the directors and shareholders. Boards' Report or Directors' Report is an important tool for the stakeholders to judge or analyse the performance and corporate governance measures adopted by the company.

Company Secretary guides the directors in preparation of this report; they are expected to be well versed with the related provisions.

After reading this lesson you will be able to understand the contents of the directors' report whether mandated by law or adopted as a good corporate practice.

*"When you practice reporting for as long as I have, you keep yourself at a distance from True Believers. Either conservatives or liberals or Democrats or Republicans."*

**– Bob Woodward**

## INTRODUCTION

The Board of Directors of a company provides leadership, strategic guidance and objective judgment, and is accountable to all stakeholders and statutory authorities. It is mandatory for the Board of Directors of every company to present financial statement to the shareholders along with its report, known as the “Board’s Report” at every annual general meeting. Apart from giving a complete review of the performance of the company for the year under report, material changes till the date of the report; it also highlights the significance of various national and international developments which can have an impact on the business and indicates the future strategy of the company.

The Board’s Report, thus, is a comprehensive document circumscribing both financial and non-financial information, serving to inform the stakeholders about the performance and prospects of the company, relevant changes in the management, capital structure, major policies, and recommendations as to the distribution of profits, future programmes of expansion, modernization and diversification, capitalization of reserves, further issue of capital, etc.

The Board’s Report enables shareholders, lenders, bankers, government, prospective investors, all the stakeholders and the public to make an appraisal of the company’s performance and reflects the level of corporate governance in the company.

The matters to be included in the Board’s Report have been specified under various sections of the Companies Act, 2013 and rules made thereunder. Further, the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992 and the regulations, rules, directions, guidelines, circulars, etc. issued thereunder, the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, necessitate certain additional disclosures to be made in the Board’s Report as may be applicable.

## Disclosures pursuant to the Companies Act, 2013

Disclosures under Section 134(3)	Issue of Equity Shares with differential rights	Issue of Sweat Equity Shares
Details of Employees Stock Option Scheme – section 62(1)(b)	Restrictions on purchase by company or giving of loans by it for purchase of its shares – Section 67	Disclosures pertaining to Consolidated Financial Statements
Voluntary revision of Financial Statements or Board’s Report – Section 131(1)	Corporate Social Responsibility – Section 135	Re-Appointments of an Independent Director – Section 149(10)

Resignation of Director – Section 168(1)	Composition of Audit Committee – Section 177(8)	Details of Vigil Mechanism – Section 177(10)
Policy relating to the remuneration for the directors, key managerial personnel and other employees – Section 178(4)	Related party transactions – Section 188(2)	Disclosures pertaining to remuneration of directors and employees – Section 197(12)
Remuneration received by MD and WTD from holding or subsidiary companies – Section 197(14)	Secretarial Audit Report – Section 204(1)	Additional Disclosures by Producer Company

### Disclosures under Section 134(3)

In terms of Sub-section (3) of Section 134, the Board's Report shall include:

- (a) The extract of the annual return as provided under sub-section (3) of section 92: The Board's Report of every company shall include an extract of the Annual Return in Form MGT-9 as provided under sub-section (3) of section 92 for the financial year ended.
- (b) Number of meetings of the Board: Board Report should contain total number of Board Meetings held in respective financial year.
- (c) Directors' Responsibility Statement: Section 134(5) of the Act specifically provides that the Directors' Responsibility Statement shall set out the following affirmations:
  - in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
  - the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
  - the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
  - the directors had prepared the annual accounts on a going concern basis; and
  - the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively; and

- the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.
- (ca) **Details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government:** The Board's Report shall contain a disclosure regarding the following details of frauds reported by the auditor to the Audit Committee or the Board involving an amount lesser than Rupees One Crore-
- Nature of Fraud with description;
  - Approximate Amount involved;
  - Parties involved, if remedial action not taken; and
  - Remedial action taken.
- (d) **A statement on declaration given by independent directors under sub-section (6) of section 149:** Every Independent Director shall give a declaration that he meets the criteria of independence laid down in sub-section (6) of section 149, which is to be given by him at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director. The Board's Report should contain a statement to the effect that the independent directors have given such a declaration.
- (e) **Company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178:** The Board' Report of companies which are required to constitute Nomination and Remuneration Committee shall include:
- criteria for determining qualifications,
  - positive attributes and independence of a director, and
  - recommend to the Board a policy relating to the remuneration of directors, Key Managerial Personnel and other employees.

The Board's Report needs to disclose such criteria and also the policy relating to the remuneration.

*This Section 178 is not applicable to a company incorporated under Section 8 of the Companies Act, 2013. Similarly, Section 178(2)/(3)/(4) is not applicable to Government Companies except with regard to appointment of senior management & other employees via Notification No. GSR 463(E), dated 05-06-2015.*

- (f) **Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—**
- **by the auditor in his report; and**
  - **by the Secretarial Auditor in his secretarial audit report;**
  - **Auditor's report under section 143:** Clause (h) of Section 143(3) provides that the auditor's report shall state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
  - **Cost Audit Report under section 148:** Section 148(5) of the Act and Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 provides that the rights, duties and obligations applicable to the Auditor under Chapter X of the Act shall *mutatis mutandis* apply to a cost auditor



appointed under Section 148 of the Act. It also provides that the cost auditor shall submit his report to the Board of Directors of the company. The cost auditor's report shall also state any qualification, reservation or adverse remark relating to the maintenance of cost accounts and other matters connected therewith.

- **Secretarial Audit Report under Section 204(3):** Section 204(3) of the Act provides that the Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his secretarial audit report. Thus, the Board should state detailed explanation in its board's report for all the observations and qualifications given by the Secretarial auditor in his secretarial audit report including the reasons for such material deviations and reasons that led to such deviations.

- (g) **Particulars of loans, guarantees, security and acquisition under section 186:** The particulars of loans given, guarantees provided or investments in securities and acquisition made during the year under section 186 of the Act should be attached to the Board's Report.
- (h) **Particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form:** The Report of the Board shall contain the details of contracts or arrangements entered with Related Parties as referred to in Section 188 (1) in Form AOC-2 pursuant to Rule 8(2) of Companies [Accounts] Rules, 2014.
- (i) **The state of company's affairs:** Information and data which are usually considered pertinent and necessary for the purpose of a proper appreciation of the state of affairs of a company relating to the period for which the financial statements have been prepared must be disclosed in the report. Relevant changes which have occurred, as compared to the position as stated in the previous year's Board's Report which have a material bearing on the performance of the company should be indicated in the Board's Report.

The figures of the previous year relating to achievement of targets of production and sales should also be given in the Board's Report to facilitate comparison and the reasons for any substantial deviation there from should be explained in brief.

- (j) **The amounts, if any, which it proposes to carry to any reserves:** The first proviso to the section 123(1) of the Act provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.
- (k) **The amount, if any, which it recommends should be paid by way of dividend:** The Board's Report shall disclose the amount per share and the percentage which the Board recommends to be paid as dividend under section 123 of the Act.
- (l) **Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report:** The Board's Report should include material changes and commitments, if any, affecting the financial position of the company and occurring between the date of balance sheet and the date of the report. The Directors' Report should, therefore, contain material changes pertaining to post-financial statement events impacting the operations and performance of the Company.
- (m) **The conservation of energy, technology absorption, foreign exchange earnings and outgo, in**

**such manner as may be prescribed:** The Board's Report should contain following information and details as per Rule 8(3) of the Companies (Accounts) Rules, 2014-

**A. Conservation of energy**

- (i) the steps taken or impact on conservation of energy;
- (ii) the steps taken by the company for utilising alternate sources of energy;
- (iii) the capital investment on energy conservation equipment;

**B. Technology absorption**

- (i) the efforts made towards technology absorption;
- (ii) the benefits derived like product improvement, cost reduction, product development or import substitution;
- (iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year) -
  - a. the details of technology imported;
  - b. the year of import;
  - c. whether the technology been fully absorbed;
  - d. if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
- (iv) the expenditure incurred on Research and Development.

**C. Foreign exchange earnings and Outgo:** The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange outgo during the year in terms of actual outflows.

Provided that the requirement of furnishing information and details under this sub-rule shall not apply to a Government company engaged in producing defence equipment.

- (n) **A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company:** The company should provide about the overall risk management framework of the company, whether it has constituted risk management committee, the risk management policy of the company, the possible risks and steps taken to mitigate those risks in this section.
- (o) **Details about the policy developed and implemented by the company on Corporate Social Responsibility initiatives taken during the year:** Section 135(4) of the Act provides that the Board of every company having net worth of Rs. 500 Crores or more or turnover of Rs. 1,000 Crores or more or net profit of Rs. 5 Crores or more during any financial year shall disclose contents of such Policy in its report and also place it on the company's website.
- (p) **Board evaluation:** Every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors (Rule 8(4) of the Companies (Accounts) Rules, 2014). *This clause shall not apply in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government as per its own evaluation methodology- Notification No. GSR 463(E), dated 5-6-2015.*

- (q) **Such other matters as may be prescribed:** Rule 8(5) of the Companies (Accounts) Rules, 2014, prescribes that the Board's Report shall also include following matters -
- (i) the financial summary or highlights;
  - (ii) the change in the nature of business, if any;
  - (iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;
  - (iv) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;
  - (v) the details relating to deposits, covered under Chapter V of the Act,-
    - (a) accepted during the year;
    - (b) remained unpaid or unclaimed as at the end of the year;
    - (c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-
      - at the beginning of the year;
      - maximum during the year;
      - at the end of the year;
  - (iv) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
  - (vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;
  - (viii) the details in respect of adequacy of internal financial controls with reference to the financial statements.

#### REVIEW QUESTIONS

- (i) Whether explanations or comments by Board on *adverse remark* given by the Auditors/Secretarial Auditor are required to be disclosed?

**Ans:** Yes, any explanation or comment given by Board shall be disclosed in the Board's Report

- (ii) Whether policy developed and implemented on *Corporate Social Responsibility* are required to be disclosed in Board's Report?

**Ans:** Yes

- (iii) Which rule is required to be referred in section 134(3)(*disclosure in Board's Report*)

**Ans:** Rule 8 of Companies (Accounts)rules 2013

#### Disclosures pertaining to Issue of Equity Shares with differential rights

Section 43 of the Act provides that a company limited by shares can issue equity shares with differential rights as to dividend, voting or otherwise in accordance with rules prescribed under Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014.

Rule 4(4) of the Companies (Share Capital and Debentures) Rules, 2014, provides that the Board of Directors shall, *inter alia*, disclose in the Board's Report for the financial year in which the issue of equity

shares with differential rights as to dividend, voting or otherwise was completed, the following details, namely:-

- (a) total number of shares allotted with differential rights;
- (b) details of the differential rights relating to voting rights and dividends;
- (c) percentage of shares with differential rights to the total post-issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting rights shall carry to the total voting rights of the aggregate equity share capital;
- (d) price at which such shares have been issued;
- (e) particulars of promoters, directors or key managerial personnel to whom such shares are issued;
- (f) change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;
- (g) diluted Earnings Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;
- (h) pre and post issue shareholding pattern along with voting rights in the format specified under sub-rule (2) of rule 4.

#### **Disclosures pertaining to Issue of Sweat Equity Shares**

Section 54(1)(d) of the Act provides that where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the SEBI and if they are not so listed, the sweat equity shares are issued in accordance with Rule 8 of Companies (Share Capital and Debentures) Rules, 2014.

Further, Rule 8(13) of Companies (Share Capital and Debentures) Rules, 2014 provides that the Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares namely:-

- (a) the class of directors or employees to whom sweat equity shares were issued;
- (b) the class of shares issued as Sweat Equity Shares;
- (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them, if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;
- (d) the reasons or justification for the issue;
- (e) the principal terms and conditions for issue of sweat equity shares, including pricing formula;
- (f) the total number of shares arising as a result of issue of sweat equity shares;
- (g) the percentage of the sweat equity shares of the total post issued and paid up share capital;
- (h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;
- (i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

#### **Disclosures of Details of Employees Stock Option Scheme - Section 62(1)(b)**

Section 62(1)(b) of the Act read with Rule 12(9) of the Companies (Share Capital and Debentures) Rules,

2014 provides that the Board of directors, shall, *inter alia*, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

- (a) options granted;
- (b) options vested;
- (c) options exercised;
- (d) the total number of shares arising as a result of exercise of option;
- (e) options lapsed;
- (f) the exercise price;
- (g) variation of terms of options;
- (h) money realized by exercise of options;
- (i) total number of options in force;
- (j) employee wise details of options granted to;-
  - (i) key managerial personnel;
  - (ii) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year;
  - (iii) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant.

#### **Disclosures pertaining to Restrictions on purchase by company or giving of loans by it for purchase of its shares – Section 67**

Proviso to Section 67(3) read with Rule 16(4) of Companies (Share Capital and Debentures) Rules, 2014 provides that where the voting rights are not exercised directly by the employees in respect of shares to which the scheme for provision of money for purchase of or subscription for shares by employees or by trustees for the benefit of employees relates, the Board of Directors shall, *inter alia*, disclose in the Board's report for the relevant financial year the following details, namely:-

- (a) the names of the employees who have not exercised the voting rights directly;
- (b) the reasons for not voting directly;
- (c) the name of the person who is exercising such voting rights;
- (d) the number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of the company;
- (e) the date of the general meeting in which such voting power was exercised;
- (f) the resolutions on which votes have been cast by persons holding such voting power;
- (g) the percentage of such voting power to the total voting power on each resolution;
- (h) whether the votes were cast in favour of or against the resolution.

#### **Disclosures pertaining to Consolidated Financial Statements**

Rule 8(1) of the Companies (Accounts) Rules, 2014 specifies that the Board's Report

- shall be prepared on the basis of standalone financial statements of the company.

- shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report. (Amended *vide* Companies (Accounts) Amendment Rules, 2016 dated 27th July 2016)

Proviso to Section 129(3) read with Rule 5 of the Companies (Accounts) Rules, 2014 states that the company shall also attach along with its financial statement a separate statement containing the salient features of the financial statements of a company's subsidiary or subsidiaries, associate company or companies and joint venture or ventures in Form AOC-1.

### **Voluntary revision of Financial Statements or Board's Report - Section 131(1)**

Section 131(1) of the Act provides that revised financial statements or a revised report may be prepared in respect of any of the three preceding financial years where it appears to the directors of a company that the financial statements or the report of the Board, do not comply with the provisions of section 129 or section 134 and the detailed reasons for revision of such financial statements or report should be disclosed in the Board's report in the relevant financial year in which such revision is being made.

### **Disclosures pertaining to Corporate Social Responsibility – Section 135**

- The Board's report shall disclose the composition of the Corporate Social Responsibility Committee - Section 135(2).
- Contents of CSR policy as recommended by CSR Committee and approved by the Board - Section 135(4)(a).
- Section 135(5) provides that the Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. If the company fails to spend such amount, the Board shall, in its report, specify the reasons for not spending the amount.
- The Companies (Corporate Social Responsibility Policy) Rules, 2014 requires that the Board's Report shall include an annual report on CSR containing particulars specified in Annexure to the rules.

### **Re-Appointment of an Independent Director - Section 149(10)**

Subject to the provisions of Section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

Thus, if an independent director is appointed by passing a special resolution after completing a term of five years, the Board's report should contain a disclosure of such appointment.

### **Resignation of Director - Section 168(1)**

A director may resign from his office by giving notice in writing to the company and the Board. Section 168(1) requires the Board to place the fact of resignation of a director in report of directors laid in the immediately following general meeting by the Company.

### **Composition of Audit Committee - Section 177(8)**

The Board's report shall disclose the following –

- Composition of an Audit Committee

- Where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in the report along with the reasons therefor.

#### **Details of Vigil Mechanism - Section 177(10)**

Section 177(9) read with Rule 7 of the Companies (Meeting of Board and its Powers) Rules, 2014 provides that every listed company and the following class or classes of companies shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances-

- (a) Companies which accept deposits from the public;
- (b) Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

#### **Policy relating to the remuneration for the directors, key managerial personnel and other employees – Section 178(4)**

Section 178(3) and (4) provides that the Nomination and Remuneration Committee shall formulate and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. Such policy shall ensure that—

- (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
- (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
- (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

The policy so formulated shall be disclosed in the Board's report.

*Section 178(2)/(3)/(4) is not applicable to Section 8 companies and Government Companies except with regard to appointment of senior management & other employees via Notification No. GSR 463(E), dated 05-06-2015.*

#### **Related party transactions – Section 188(2)**

Every contract or arrangement entered into under Section 188(1) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement in the prescribed form i.e., Form no. AOC-2 (*pursuant to Section 134(3)(h) and Section 188(2)*).

#### **Disclosures pertaining to remuneration of directors and employees –Section 197(12)**

Section 197(12) read with Rule 5 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 and Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2016 provides for following disclosures in the Board's report-

- (1) Every listed company shall disclose in the Board's report-
  - (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
  - (ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;
  - (iii) the percentage increase in the median remuneration of employees in the financial year;

- (iv) the number of permanent employees on the rolls of company;
- (v) del\*;
- (vi) del\*;
- (vii) del\*;
- (viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;
- (ix) del\*;
- (x) del\*;
- (xi) del\*; and
- (xii) affirmation that the remuneration is as per the remuneration policy of the company.

\*Clauses v, vi, vii, ix, x and xi have been deleted *vide* Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2016 notified on 30<sup>th</sup> June 2016.

Explanation.- For the purposes of this rule-

- (i) the expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;
- (ii) if there is an even number of observations, the median shall be the average of the two middle values.

(2) The Board's report shall include a statement showing the names of the top ten employees in terms of remuneration drawn and the name of every employee, who, -

- (i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees;
- (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;
- (iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in sub-rule (2) shall also indicate –

- (i) designation of the employee;
- (ii) remuneration received;
- (iii) nature of employment, whether contractual or otherwise;
- (iv) qualifications and experience of the employee;
- (v) date of commencement of employment;
- (vi) the age of such employee;
- (vii) the last employment held by such employee before joining the company;



- (viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and
- (ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board's report, but such particulars shall be filed with the Registrar of Companies while filing the financial statements and Board's Report:

Provided further that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

### **Remuneration received by MD and WTD from holding or subsidiary companies – Section 197(14)**

Subject to the provisions of Section 197, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

Thus, a company should disclose in its Board's report remuneration or commission from any holding company or subsidiary company received by MD or WTD.

### **Secretarial Audit Report – Section 204 (1)**

Every listed company or every public company having a paid up share capital of fifty crore rupees or more or every public company having a turnover of two hundred fifty crore rupees or more shall annex with its Board's report, a Secretarial Audit report, given by a company secretary in practice. The format of the Secretarial Audit Report should be in Form No. MR-3 of Rule 9 of Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014.

### **Additional Disclosures by Producer Company**

In terms of Section 465(1) of Companies Act, 2013 read with section 581ZA of Companies Act, 1956, a Producer Company should additionally disclose the following in its Board's Report:

- The amounts to be paid as limited return on share capital.
- The amounts, if any, proposed to be disbursed as patronage bonus.

### **Disclosures under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**

#### **(1) Statement of deviation(s) or variation(s) – Regulation 32**

Regulation 32(1) specifies that a listed entity shall submit to the stock exchange the following statement(s)

on a quarterly basis for public issue, rights issue, preferential issue, etc. ,-

- (a) indicating deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;
- (b) indicating category wise variation (capital expenditure, sales and marketing, working capital, etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for general meeting, as applicable and the actual utilisation of funds.

Further Regulation 32(4) provides that the listed entity shall furnish an explanation for the variation specified in sub-regulation (1), in the Directors' report in the annual report.

### **(2) Management discussion and analysis report – Regulation 34(2)(e)**

The annual report of a listed entity shall contain a management discussion and analysis report - either as a part of Director's report or addition thereto. Regulation 18(3) read with Part C of Schedule III provides that the audit committee shall mandatorily review the management discussion and analysis of financial condition and results of operations.

This section shall include discussion on the following matters within the limits set by the listed entity's competitive position:

- Industry structure and developments
- Opportunities and Threats
- Segment-wise or product-wise performance
- Outlook
- Risks and concerns
- Internal control systems and their adequacy
- Discussion on financial performance with respect to operational performance
- Material developments in Human Resources / Industrial Relations front, including number of people employed.

### **(3) Compliance certificate - Schedule V**

Corporate Governance Report under Schedule V provides that Compliance Certificate from either the auditors or company secretaries in practice regarding compliance of conditions of corporate governance shall be annexed with the directors' report.

### **Disclosures under SEBI (Share Based Employee Benefits) Regulations, 2014**

Regulation 14 of the Regulations provides that in addition to the information that a company is required to disclose, in relation to employee benefits under the Companies Act, 2013, the Board of directors of such a company shall also disclose the details of the scheme(s) being implemented, as specified by SEBI in this regard.

SEBI vide circular dated 16th June, 2015 has provided for following disclosure requirements in the Board's Report.

- The Board of directors in their report shall disclose any material change in the scheme(s) and whether the scheme(s) is / are in compliance with the regulations.
- Further, SEBI has prescribed specific details which shall be disclosed on the company's website and a web-link thereto shall be provided in the report of board of directors.

**Disclosure Requirements under the Sexual Harassment of Women at Workplace (Prevention, Prohibition & Redressal) Act, 2013**

- The Act mandates that all companies having more than 10 women employees shall disclose in annual report following details as per section 22 and 28 of the Act.
- Rule 14 of Sexual Harassment of Women at Workplace (Prevention, Prohibition & Redressal) Rules, 2013 provides that the annual report which the Complaints Committee shall prepare shall contain following information-
  - (a) Number of complaints of sexual harassment received in the year;
  - (b) Number of complaints disposed off during the year;
  - (c) Number of cases pending for more than ninety days;
  - (d) Number of workshops or awareness programme against sexual harassment carried out;
  - (e) Nature of action taken by the employer or District Officer.

**APPROVAL OF THE BOARD'S REPORT**

The Board's Report should be considered, approved and signed at a meeting of the Board, convened in accordance with the provisions of the Act and shall not be dealt with in any meeting held through video conferencing or other audio visual means (Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014).

**Signing of Board's Report [Section 134(6)].**

If authorised by the Board- Chairperson of the Company	If not authorised by the Board- At least two directors, one of whom shall be a Managing Director	Further, as a good practice, the companies should get the annexure to the Board's report also separately signed by the Chairman. The Annual Report on CSR may be signed by the Chairman of the CSR Committee.
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**Circulation of the Board's Report**

Along with a signed copy of every financial statement, including consolidated financial statement if any, the Board's Report shall be issued, circulated or published. [Section 134(7)]

**RIGHT OF MEMBERS TO RECEIVE COPIES OF FINANCIAL STATEMENTS, BOARD'S REPORT, ETC.**

Section 136 of the Act provides that, without prejudice to the provisions of Section 101, a copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to

- every member of the company,
- every trustee for the debenture holder of any debentures issued by the company, and
- all persons other than such member or trustee, being the person so entitled,

not less than 21 clear days before the date of the meeting.

Provided that in the case of a listed company, the provisions of this sub-section shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during working hours for a period of 21 days\* before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than 21 days\* before the date of the meeting unless the shareholders ask for full financial statements.

Provided also that a listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

\* Fourteen Days in case of a company registered under section 8 of the Companies Act, 2013

### FILING OF THE BOARD'S REPORT

Section 137(1) of the Act provides that copies of financial statement along with all documents required to be annexed should be filed with the Registrar of Companies within 30 days along with the prescribed fees, after the financial statements, including consolidated financial statements have been adopted at the annual general meeting. The Board's Report has to be attached to the financial statements.

Further that pursuant to the provisions of section 117/ 179 of the Companies Act, and the Rules made thereunder the resolution for approving the Board's Report is also required to be filed to the Registrar within 30 days from the approval by the Board.

Third Proviso of Section 137(1) of the Act also provides that a One Person Company should file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within one hundred eighty days from the closure of the financial year.

### PENALTY FOR NON-COMPLIANCE OF SECTION 134

For Company- Fine which shall not be less than ₹50,000 rupees but which may extend to ₹25,00,000 rupees	For every officer of the company who is in default- Punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹50,000 but which may extend to ₹5,00,000, or both.
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### LET US REMEMBER

(i) What are the punishments for not complying with section 134 of the Act?

**Ans:** (i) For company:- Fine

(a) Minimum - ₹50,000; and

(b) Maximum - ₹25,00,000.

(ii) For employees, who is in default:

(a) Imprisonment for maximum upto 3 years; or

(b) Fine Minimum ₹50,000 and Maximum upto ₹5,00,000

## LIABILITY FOR MIS-STATEMENT

The Board shall be collectively responsible for any statement in its Report which is false in any material particular, or for any omission of a material fact, knowing it to be material. Section 448 of the Act provides that if in any return, report, certificate, financial statement, prospectus, statement or other document required by the Act or the rules made thereunder, any person makes a statement,—

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

then he shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and should also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

## LESSON ROUND-UP

- Attaching Board's report to every balance sheet is mandatory. Apart from giving a complete review of performance of company for the year under report, it highlights various disclosures having impact on business. It also highlights the future strategy of the company.
- The matters to be included in Board's Report should be under the provisions of Companies Act, Listing Agreements, SEBI Guidelines and RBI directions.
- Under Companies Act the matters to be included should be with respect to state of company's affairs, the amount which it proposes to carry to any reserves, recommendation of amount of dividend, material changes, conservation of energy, technology absorption, foreign exchange earning and outgo, particulars in respect of certain employees, director's responsibility statement.
- As per listing regulations, Management Discussion and Analysis Report, Report on Corporate Governance, fact of delisting, suspension of securities are the matters to be included in the Board's Report.
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 provides for disclosures as regards to ESOS and ESOP.
- As per RBI's directions, certain disclosures are required to be made by non-banking companies receiving deposits.
- Board's report should be signed by the Chairman of the Board, if so authorized and if not so authorized then by not less than two directors of the company, one of whom shall be managing director, where there is one.
- The Board shall be collectively responsible for any statement in its Report which is false in any material particular or for any omission of a material fact.
- If a company secretary in practice gives a false statement relating to materially relevant fact or omits a material fact in the compliance certificate, etc.; penal provisions of section 448 of the Companies Act, 2013 will be attracted. He shall be punishable with imprisonment for a term which may extend to ten years and shall also be liable to fine.

## GLOSSARY

### E-filing

The process of using a computer program to transmit information electronically to another party. This allows the user to complete and submit the information in a timely fashion. The electronic filing system prevents the user from making small mistakes by alerting them if something does not register correctly.



# Lesson 24

## Registers, Forms and Returns

### LESSON OUTLINE

- Statutory Books/Registers
- Various statutory Books and Registers to be maintained
- Forms and Returns under the Act
- Annual Return

### LEARNING OBJECTIVES

Every company has to maintain certain registers and records for statutory, statistical, disclosure, and information management/MIS purposes. They also have to file returns with the regulatory authorities to intimate them as to material changes as prescribed. The objective behind such returns is not only statutory requirement, but these are also helpful for the smooth functioning of the company. These records make the company's working more systematic. The company is required to keep these records within the vicinity of the place prescribed for it by the laws.

After reading this lesson you will be able to understand the maintenance, authentication, preservation and inspection of statutory book/registers prescribed under various provisions of the Company Law, non-statutory books; various forms/returns required to be filed with the Registrar of Companies and the provisions relating to Annual Return.

*"Life is like a cash register, in that every account, every thought, every deed, like every sale, is registered and recorded."*

– **Fulton J. Sheen**

## 1. STATUTORY BOOKS/REGISTERS

The Companies Act 2013, lays down that every company must maintain and keep books, registers and copies of returns, documents etc. at its registered office. These books are known as Statutory Books. Some of the statutory registers are required to be kept open by the company for inspection by directors, members, creditors of the company and by other persons. The company is also required to allow extracts to be taken from certain documents, registers, returns etc. and furnish copies of certain documents on demand by a member or by any other person on payment of specified fees.

Every company incorporated under the Act is required to keep at its registered office, *inter alia*, the following statutory books and registers –

- Register of securities bought back. [Section 68(9) and Rule 17(12) of companies (Share Capital and Debenture) Rules, 2014]
- Register of deposits. [Section 73 and Rule 14 Companies (Acceptance of Deposits) Rules, 2014]
- Register of charges. [Section 85 and Rule 7 of Companies (Registration of Charges) Rules 2014]
- Register of members. [Section 88(1)(a) and Rule 3 of Companies(Management and Administration) Rules, 2014]
- Register of debenture holders. [Section 88(1)(b) & (c) and Rule 4 of Companies (Management and Administration) Rules, 2014]
- Foreign register. [Section 88 (4) and Rule 7 of Companies (Management and Administration) Rules, 2014].
- Register of Renewed and Duplicate Share Certificates. [Rule 6 of the Companies (Share Capital and Debentures) Rules, 2014]
- Register of sweat equity shares. [Section 54 and Rule 8(14) of Companies (Share Capital and Debenture ) Rules, 2014]
- Register of Postal Ballot. [Section 110 and Rule 22 of the Companies (Management and Administration) Rules, 2014]
- Books containing minutes of General Meeting and of Board and of Committees of Directors. [Section 118]
- Books of account. [Section 128]
- Register of Directors/ Key Managerial Personnel. [Section 170(1)]
- Register of investments in securities not held in company's name. [Section 18 and Rule 14 of Companies (Meetings of Board and its Powers) Rules, 2014]
- Register of loans, guarantees given and security provided or making acquisition of securities (Section 186(9) and Rule 12 Companies (Meetings of Boards and its Powers) Rules 2014]
- Register of contracts with companies/firms in which directors are interested. [Section 189(5) and Rule 16 of Companies (Meetings of Boards and its Powers) Rules, 2014]



### Register of Securities bought back

[Section 68 (9) and Rule 17 (12) of Companies (Share Capital and Debentures) Rules, 2014]

Where a company buys back its shares or other specified securities under Section 68, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities.

The company shall maintain a register of shares or other securities which have been bought-back in Form No. SH-10.

The register of shares or securities bought-back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf.

The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose

### Register of Deposits

[Rule 14 of Companies (Acceptance of Deposits) Rules, 2014]

Every company other than a banking company which accepts any deposits should, from the date of such acceptance, maintain year-wise one or more separate registers for deposits accepted/renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

- (a) Name, address and PAN of the depositor/s;
- (b) Particulars of guardian, in case of a minor;
- (c) Particulars of the nominee;
- (d) Deposit receipt number;
- (e) Date and amount of each deposit;
- (f) Duration of the deposit and the date on which each deposit is repayable;
- (g) Rate of interest or such deposits to be payable to the depositor;
- (h) Due date(s) for payment of interest;
- (i) Mandate and instructions for payment of interest and for non-deduction of tax at source, if any;
- (j) Date or dates on which payment of interest will be made;
- (k) Details of deposit insurance including extent of deposit insurance;
- (l) Particulars of security or charge created for repayment of deposits;
- (m) Any other relevant particulars;

The register should be maintained deposit receipt number-wise. Entries in the register should be made forthwith from the date of issuance of the deposit receipt.

Entries in the register shall be made within seven days from the date of issuance of the deposit receipt and such entries shall be authenticated by a director or secretary of the company or by any other officer authorized by the Board for this purpose.

The register or registers referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

**The register is not open for inspection.**

## Register of Charges

[Section 85; Rule 10 of Companies (Registration of Charges) Rules, 2014]

Section 85(1) read with Rule 10 of Companies (Registration of Charges) Rules, 2014 provides that every company shall keep at its registered office a register of charges in **Form No. CHG-7** and enter therein particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

- The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.
- Entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.
- The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company. Provided that a copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.
- The register of charges and instrument of charges, shall be open for inspection during business hours—
  - (a) by any member or creditor without any payment of fees; or
  - (b) by any other person on payment of prescribed fees, subject to such reasonable restrictions as the company may, by its articles, impose.

## Register of Members

[Section 88(1)(a) and Rule 3 of Companies (Management and Administration) Rules, 2014]

(1) Every company limited by shares shall, from the date of its registration, maintain a register of its members indicating separately for each class of equity and preference shares held by each member residing in or outside India in **Form No. MGT-1**:

“Provided that in the case of a company existing on the commencement of the Act, the particulars as available in the register of members maintained under the Companies Act, 1956 shall be transferred to the new register of members in Form No.MGT-1 and in case additional information, required as per provisions of the Act and these rules, is provided by the members, such information may also be added in the register as and when provided.”

(2) In the case of a company not having share capital, the register of members shall contain the following particulars, in respect of each member, namely:-

- (a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/Mother's/Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;
- (b) date of becoming member;
- (c) date of cessation;
- (d) amount of guarantee, if any;
- (e) any other interest, if any; and

(+) instructions, if any, given by the member with regard to sending of notices, etc:

Provided that in the case of a company existing on the date of commencement of the Act, the particulars as available in the register of members maintained under the Companies Act, 1956 shall be transferred to the new register of members in Form No.MGT-1 and in case additional information, required as per provisions of the Act and these rules, is provided by the members, such information may also be added in the register as and when provided.

**Register of Debenture Holders and any other Security Holders  
[Section 88(1)(b)&(c) and Rule 4 of Companies (Management and Administration) Rules, 2014]**

Every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders, as the case may be, for each type of debentures or other securities in Form No.MGT-2.

The register should contain information relating to name, father's /husband's name; address and occupation, if any, of each debenture holder; date of allotment; date of registration with the Registrar of Companies; the debentures held by each holder distinguishing each debenture by its number except where such debentures are held with a depository; distinctive number and certificate number of debentures; the amount paid or agreed to be considered as paid on those debentures; date of payment; date on which the name of each person was entered in the register as a debenture holder; date on which any person ceased to be a debenture holder; date of transfer of debentures; serial number of instrument of transfer; transferor's name and folio number; transferee's name and folio number, transfer number, number of debentures transferred and their distinctive numbers; date of transfer; and instructions, if any, for payment of interest.

In the case of debentures held in dematerialised mode, the name and particulars of the depository should be entered in the register as registered owner. The names of beneficial owners on whose behalf such debentures are held in dematerialized form should not be entered.

The register of beneficial owners maintained by a depository is deemed to be part of the register of debenture holders.

If any change occurs in the status of debenture holders whether due to death, insolvency etc., or a change of name or in joint holding, entries thereof should be made in the register.

In the case of joint holding, the particulars of each joint holder should be recorded in the register.

If a declaration of beneficial interest is received from any person who holds beneficial interest in a debenture or class of debentures of the company, specifying the nature of his interest, particulars of the person in whose name the debentures stand registered, other relevant particulars and a note of such declaration should be entered in the register. Such a note should also be made in the register if there is a change in the beneficial interest or a declaration is received from a person whose name is entered in the register as a debenture holder, specifying the name and other particulars of the person who holds the beneficial interest in such debentures.

Entries in the register should be made simultaneously with the allotment or transfer of debentures and entries in the index should be made forthwith.

The register and index should be maintained at the registered office of the company unless in a general meeting a special resolution is passed authorizing the keeping of the register at any other place within the same city, town or village in which the registered office is situated and an advance copy of the proposed special resolution is given to the Registrar of Companies.

### Foreign Register [Section 88(4) and Rule 7 of Companies (Management and Administration) Rules, 2014]

- In terms of sub-section (4) of Section 88, a company, if authorized by its Articles of Association, can also keep any part of the Register in any other country. Hence, in all such countries, where the Company has large number of shareholders, a Register of Members containing information about the members from that particular country may be kept. To be called “foreign register”, this Register should contain the names and particulars of the members, debenture holders, other security holders or beneficial owners residing in that country.
- The Rules provides as under with regard to the foreign register, the company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office in **Form No.MGT-3** along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice in **Form No.MGT-3** with the Registrar of such change or discontinuance. [Rule 7(2)]
- A foreign register shall be deemed to be part of the company’s register of members or of debenture holders or of any other security holders or beneficial owners, as the case may be. The foreign register shall be maintained in the same format as the Principal Register. [Rule 7(3) and 7(4)]
- A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, mutatis mutandis, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept. [Rule 7(5)]
- Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be. [Rule 7(7)]
- The company shall—
  - (a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and
  - (b) keep at such office a duplicate register of every foreign register duly entered up from time to time. [Rule 7(8)]

If a foreign register is maintained, a duplicate thereof should be maintained at the registered office of the company or at such other place where the register of members or debenture holders is kept. Every such duplicate register is deemed to be part of the principal register. The office where the foreign register is maintained should forthwith from the date of making any entry, transmit to the registered office of the company in India a copy of every entry made in any foreign register.

- If a foreign register is kept by a company in any country outside India, the decision of the Tribunal in regard to the rectification of the register shall be binding. [Rule 7(6)]
- The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company in the same part of the world or to the principal register. [Rule 7(11)]

The register should be kept in the custody of the person in charge of the office in the foreign country. The foreign register of members should be preserved until discontinued. On discontinuance, all entries should be incorporated in another foreign register or in the principal register.

The foreign register of debenture holders should be preserved for a period of 15 years from the date of redemption of debentures. On discontinuance, all entries should be incorporated in another foreign register or in the principal register.

### Register of Renewed and Duplicate Share Certificates

[Rule 6(3) of the Companies (Share Capital and Debentures) Rules, 2014]

Every company with a share capital should, from the date of its registration, maintain a register of renewed and duplicate certificates.

The word 'renewed' includes consolidation and sub-division of shares and issue of certificate in lieu thereof.

Particulars of every share certificate issued shall be recorded in a Register of Renewed and Duplicate Share Certificates. Such register shall be maintained in **Form No. SH-2** indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column. Such register shall be kept at the registered office of the company or at such other place where the Register of Members is kept. The register shall be preserved permanently and shall be kept in the custody of the Company Secretary of the company or any other person authorized by the Board for the purpose. All entries made in the Register of Renewed and Duplicate Share Certificates shall be authenticated by the company secretary or such other person as may be authorized by the Board for purposes of sealing and signing the share certificate. The register is not open for inspection.

### Register of Sweat Equity Shares

[Section 54 and Rule 8(14) of Companies (Share Capital and Debentures) Rules, 2014]

Every company which issues sweat equity shares should maintain a register of sweat equity shares and enter therein particulars of sweat equity shares issued. A Register of Sweat Equity Shares shall be maintained by the company in **Form No. SH-3** and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54. The register should contain the particulars of date of the special resolution authorizing the issue of sweat equity shares; date of Board resolution for allotment; name of the allottee; status of the allottee, i.e. whether director or employee; folio number/certificate number; reference to entry in register of members; date of issue of such shares, number of shares issued, face value of the share, price at which the shares are issued, consideration paid, if any, by the employee/director, particulars of consideration other than cash, the lock-in period of these shares and the date of expiry thereof. The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide. Entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection. Members can inspect the register without payment of any fee. Copies of the register can be demanded by any person who inspects the register.

### Register of Postal Ballot

[Section 110 and Rule 22(10) of the Companies (Management and Administration) Rules, 2014]

Every company which is required to or which proposes to get any resolution passed through postal ballot

should maintain a separate register for each postal ballot to record the assent or dissent received through postal ballot.

The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.

Entries in the register should be made immediately after the opening of postal ballots. Separate folios should be maintained for each resolution passed through postal ballot. The register should be kept at the registered office of the company after the Scrutinizer has submitted his report.

The register, postal ballot forms and all other related records are not available for inspection.

All postal ballot forms should be authenticated by the Scrutinizer. Entries in the register should be authenticated by the Scrutinizer.

The register, postal ballot forms and all other related records should be kept in the safe custody of the Scrutinizer till the Chairman signs the Minutes Book in which the result of the voting by postal ballot is recorded.

The secretary of the company, managing director or whole-time director or the director so authorised and the Scrutinizer should make adequate arrangements for safe custody of the register and proof of dispatch of Notices and all envelopes received by post or by hand, until the Scrutinizer submits his report to the Chairman.

The Scrutinizer should return the postal ballot forms and any related documents or records to the designated person of the company for safekeeping until the resolution has been implemented.

The Scrutinizer's report and office copies of the notices should be preserved in good order until the resolution has been implemented or for a period of 10 years, whichever is later.

**Books containing Minutes of proceedings of General Meeting, meeting of Board of Directors and other meeting and resolution passed by postal ballot [Section 118]**

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned.

In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The Chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting.

*As per section 118(10) every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved as such by the Central Government.*

Rule 25 contains provisions with regards to minutes of meetings. A distinct minute book shall be maintained

for each type of meeting namely:

- (i) general meetings of the members;
- (ii) meetings of the creditors;
- (iii) meetings of the Board; and
- (iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution. Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the Chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the Chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that Chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the Chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minute books of general meetings shall be kept at the registered office of the company. Minutes of the Board and committee meetings shall be kept at the registered Office or at such other place as may be approved by the Board.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act. This section shall not apply to Section 8 company as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.

## **Books of Account [Section 128]**

### **Requirement of keeping Books of Account (Section 128)**

Maintenance of books of account would mean records maintained by the company to record the specified financial transaction. It has been specifically provided that every company shall keep proper books of account. This section specifies the main features of proper books of account as under –

- The company must keep the books of account with respect to items specified in clauses (i) to (iv) of Section 2(13) of the Companies Act, 2013, which defines “books of account”.

- The books of account must show all money received and expended, sales and purchases of goods and the assets and liabilities of the company.
- The books of account must be kept on accrual basis and according to the double entry system of accounting.
- The books of account must give a true and fair view of the state of the affairs of the company or its branches.
 

“Books of account” as defined in Section 2(13) includes records maintained in respect of—

  - (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
  - (ii) all sales and purchases of goods and services by the company;
  - (iii) the assets and liabilities of the company; and
  - (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.
- All or any of the books of account may be kept at such other place in India as the Board of directors may decide. When the Board so decides to keep books and other papers at any other place in India, a notice to this effect shall be given to the Registrar in Form AOC-5 giving full address of that other place within seven days of Board's decision.
- The maintenance of books of account and other books and papers in electronic mode is permitted and is optional. Such books of accounts or other relevant books or papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent use. Detail are provided under Rule 3 of the Companies (Accounts) Rules, 2014.
- The books of account, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year. In case of a company incorporated less than eight years before the financial year, the books of account for the entire period preceding the financial year together with the vouchers shall be so preserved. The provisions of Income-tax Act shall also be complied with in this regard. As per proviso to sub-section 5, where an investigation has been ordered in respect of a company under Chapter XIV of the Act related to inspection, inquiry or investigation, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.
- The person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of account etc. shall be: [Section 128(6)]
  - (i) Managing Director,
  - (ii) Whole-Time Director in charge of finance,
  - (iii) Chief Financial Officer, or
  - (iv) Any other person of a company charged by the Board with the duty of complying with provisions of section 128.

**Register of Directors and Key Managerial Personnel  
[Section 170(1) & Rule 17 of Companies (Appointment and Qualification of Directors) Rules, 2014]**

Every company shall keep at its registered office a register of its directors and key managerial personnel



containing the following particulars:-

- (a) Director Identification Number (Optional for KMP);
- (b) present name and surname in full;
- (c) any former name or surname in full;
- (d) father's name, mother's name and spouse's name(if married) and surnames in full;
- (e) date of birth;
- (f) residential address (present as well as permanent);
- (g) nationality (including the nationality of origin, if different);
- (h) occupation;
- (i) date of the board resolution in which the appointment was made;
- (j) date of appointment and reappointment in the company;
- (k) date of cessation of office and reasons therefor;
- (l) office of director or key managerial personnel held or relinquished in any other body corporate;
- (m) membership number of the Institute of Company Secretaries of India in case of Company Secretary;
- (n) PAN mandatory for KMP who is not having DIN.

Entries should be made in the register chronologically with a separate folio maintained in respect of each such person. The register should be maintained at the registered office of the company.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection. Members can inspect the register without payment of any fee and any other person can inspect the register on payment of the requisite fee. No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

In addition to the details of the directors or key managerial personnel, the company shall also include in the aforesaid Register the details of securities held by them in the company, its holding company, subsidiaries, subsidiaries of the company's holding company and associate companies relating to:

- (a) the number, description and nominal value of securities;
- (b) the date of acquisition and the price or other consideration paid;
- (c) date of disposal and price and other consideration received;
- (d) cumulative balance and number of securities held after each transaction;
- (e) mode of acquisition of securities;
- (f) mode of holding – physical or in dematerialized form; and
- (g) whether securities have been pledged or any encumbrance has been created on the securities.

Members or debenture holders can inspect the register without payment of any fee. A member or debenture holder inspecting the register can make extracts from the register during the course of inspection. However, no person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose. This section shall not apply to Government company in which entire share capital is held by central Government, or by any State Government or Governors or by the Central Government or by one or more state Governments.

### Register of Investments in Securities not held in Company's Name

[Section 187 and Rule 14 of Companies (Meetings of Board and its Powers) Rules 2014 ]

- (1) Every company shall, from the date of its registration, maintain a register in **Form No. MBP-3** and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.
- (2) Further, the company shall also record whether such investments are held in a third party's name for the time being or otherwise.
- (3) The register shall be maintained at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.
- (4) Entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

The said register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

### Register of loans, guarantees given and security provided or making acquisition of securities

(Section 186 (9) and Rule 12 Companies (Meetings of Boards and its Powers) Rules, 2014)

- (1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in **Form No. MBP-2** and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.
- (2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.
- (3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.
- (4) The entries in the register (either manual or electronic) shall be authenticated by the company

secretary of the company or by any other person authorized by the Board for the purpose.

- (5) A register can be maintained either manually or in electronic mode.
- (6) The extract from the register may be furnished to any member of the company on payment of fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

*In case of Government Company* - Section 186 shall not apply to :-

- (a) a Government company engaged in defence production;
- (b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

### **Register of contracts with companies/firms in which directors are interested**

[Section 189(5) and Rule 16 of Companies (Meetings of Boards and its Powers) Rules, 2014]

(1) Every company is required to keep one or more registers in Form MBP 4 giving separately the particulars of all contracts or arrangements and shall enter therein the particulars of -

- (a) company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest as mentioned in sub-section (1) of section 184. But the particulars of the company or companies or bodies corporate in which a director himself together with any other director holds two percent or less of the paid-up share capital would not be required to be entered in the register.
- (b) contracts or arrangements with a body corporate or firm or other entity as mentioned under sub-section (2) of section 184, in which any director is, directly or indirectly, concerned or interested; and
- (c) contracts or arrangements with a related party with respect to transactions to which section 188 applies.

(2) The entries in the register shall be made at once, whenever there is a cause to make entry, in chronological order and shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose. (Rule 16(2)).

(3) Such register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 16(3)).

(4) The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding ten rupees per page.

Such register or registers are required to be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Every director within thirty days of his appointment or relinquishment is required to disclose his concern or interest in other associations, which are required to be included in the register. The register be kept at the registered office of the company and also open for inspection during business hours.

In case of Section 8 Company - Section 189 shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

### Forms and Returns under the Companies Act, 2013

The Companies Act, 2013 have prescribed various forms and returns for the purpose of the provisions of Act and Rules made thereunder. These forms are either in the physical form or the e-form. A list of the forms or returns prescribed in the various rules made till date is furnished hereunder-

Chapter of Companies Act, 2013	Form No.	Particulars (Purpose of Form)
Chapter II - Incorporation of the company and matters incidental thereto	INC-1	Application for reservation of name
	INC - 2	Omitted
	INC - 3	Consent of nominee of OPC
	INC - 4	Change in member / nominee of OPC
	INC - 5	Intimation of exceeding threshold of OPC i.e., ceased being an OPC
	INC – 6	Application for Conversion of Private company into OPC
	INC - 7	Application for Incorporation of Company (Part I Company and Company with more than seven subscribers)
	INC-8	Declaration from the professional, during incorporation, as to compliance with the Companies Act, 2013 and related Rules
	INC – 9	Affidavit from subscribers, during incorporation, stating he is not convicted of any offence in connection with formation of company and has not been guilty of any fraud before, under the law
	INC - 10	Form for verification of signature of subscribers by witness (while filing particulars of subscriber with the RoC)
	INC - 11	Certificate of Incorporation
	INC – 12	Application to obtain License under section 8 for companies with charitable objects
	INC – 13	Memorandum of Association
	INC – 14	Declaration by professionals regarding Section 8 Company, as to compliance with Act and Rules
	INC – 15	Declaration by each of the persons making the application
	INC – 16	License under Section 8(1) of the Act
	INC – 17	License under Section 8(5)

	INC – 18	Application to Regional Director for conversion of Section 8 company into any other kind of company
	INC – 19	Notice by applicant under Section 8 inviting objections, if any
	INC - 20	Intimation to RoC of revocation or surrender of license issued under Section 8
	INC - 21	Declaration prior to commencement of business
	INC – 22	Notice of situation or change of situation of registered office and verification
	INC - 23	Application to Regional Director for approval to shift the registered office from one state to another state or from jurisdiction of one RoC to another within the same state
	INC – 24	Application for approval of Central Government for change of name of company
	INC – 25	Certificate of incorporation pursuant to change of name
	INC - 26	Advertisement to be published in newspaper for licence under Section 8 for existing companies
	INC – 27	Conversion of public company into private company or vice versa
	INC – 28	Notice of order of the Court or other authority
	INC-32	SPICe
Chapter III - Prospectus and allotment of securities	PAS - 1	Advertisement giving the details of special resolution varying the terms of contract referred in the prospectus
	PAS – 2	Information Memorandum
	PAS – 3	Return of allotment
	PAS - 4	Private Placement Offer Letter
	PAS - 5	Record of Private Placement Offer
Chapter IV- Share capital and debentures	SH - 1	Share Certificate
	SH – 2	Register of renewed or duplicate share certificates

	SH – 3	Register of Sweat equity shares
	SH – 4	Securities transfer form
	SH – 5	Notice for transfer of partly paid-up shares
	SH – 6	Register of Employee Stock Option
	SH – 7	Notice to RoC for alteration of share capital
	SH – 8	Letter of offer (buy back)
	SH – 9	Declaration of solvency to be filed along with letter of offer during buy back
	SH – 10	Register of Securities bought back
	SH – 11	Return in respect of buy back of securities
	SH – 12	Debenture Trust Deed
	SH – 13	Nomination form
	SH - 14	Cancellation or variation of nomination
	SH - 15	Certificate of compliance in respect of buy back of securities
Chapter V- Acceptance of deposits by companies	DPT -1	Circular in the form of advertisement inviting deposits
	DPT -2	Deposit Trust deed
	DPT -3	Return of Deposits
	DPT -4	Statement regarding deposits existing on the commencement of the Act

Chapter VI - Registration of charges	CHG - 1	Application for registration of creation, modification of charge (other than those related to debentures) including particulars of modification of charge by Asset Reconstruction Company in terms of SARFAESI Act, 2002
	CHG – 2	Certificate of Registration of charge
	CHG – 3	Certificate of registration of Modification of Charge
	CHG – 4	Particulars of satisfaction of charge
	CHG – 5	Memorandum of satisfaction of charge
	CHG - 6	Notice of appointment or cessation of receiver or manager
	CHG - 7	Register of charges
	CHG – 8	Application to Central Government for condonation of delay in filing of charges
	CHG – 9	Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures
Chapter VII - Management and administration	MGT - 1	Register of Members
	MGT – 2	Register of debenture holders /other security holders
	MGT – 3	Notice regarding place of keeping the registers
	MGT – 4	Declaration of beneficial interest (by registered owners)
	MGT – 5	Declaration of beneficial interest by persons holding beneficial interest
	MGT – 6	Return to RoC regarding beneficial interest
	MGT - 7	Annual Return
	MGT – 8	Certification of Annual Return by Company Secretary in Practice in class of companies
	MGT – 9	Extract of Annual Return

	MGT – 10	Changes in the shareholding position of promoters and top ten shareholders
	MGT – 11	Proxy form
	MGT - 12	Polling Paper
	MGT – 13	Report of the Scrutinizer
	MGT – 14	Filing of Resolutions and agreements with the RoC
	MGT – 15	Form for filing the Report on AGM
Chapter VIII - Declaration and payment of dividend	IEPF-1	Statement of amounts credited to Investor Education and Protection Fund
	IEPF-2	Statement of unclaimed and unpaid amounts
	IEPF-3	Statement of shares and unclaimed or unpaid dividend not transferred to the Investor Education and Protection Fund
	IEPF-4	Statement of shares transferred to the Investor Education and Protection Fund
	IEPF-5	Application to the Authority for claiming unpaid amounts and shares out of Investor Education and Protection Fund (IEPF)
	IEPF-6	Statement of unclaimed or unpaid amounts to be transferred to the Investor Education and Protection Fund
Chapter IX - Accounts of companies	AOC - 1	Statement containing salient features of the financial statements of subsidiaries/associate companies/joint ventures
	AOC – 2	Related party disclosure
	AOC – 3	Statement containing salient features of Balance Sheet and Profit and Loss Account
	AOC – 4	Form for filing financial statements and other documents with the RoC
	AOC – 4 CFS	Consolidated financial statements



	AOC-5	Notice of address at which books of account are maintained
Chapter X - Audit and auditors	ADT - 1	Notice of appointment of Auditors
	ADT – 2	Application for removal of auditors before the expiry of term
	ADT – 3	Notice of Resignation of Auditors
	CRA-1	Maintain cost records
	CRA-2	Form of intimation of appointment of cost auditor by the company to Central Government
	CRA-3	Cost Audit Report
	CRA-4	Form for filing Cost Audit Report with the Central Government
	ADT – 4	Report to Central Government, suspecting offence involving fraud
	Chapter IX – Appointment and Qualifications of Directors	DIR – 2
DIR – 3		Application for allotment of Director Identification Number
DIR - 3A		Declaration in case the name of person applying for DIN does not contain a surname
DIR – 3B		Intimation of allotment of DIN to the Company by Director
DIR – 3C		Intimation of DIN by company to RoC
DIR – 5		Application for surrender of DIN
DIR - 6		Intimation of change in particulars of Director to be given to the Central Government
DIR – 8		Intimation by director about other directorships / disqualifications, if any etc.
DIR – 9		Report by a company to RoC furnishing names and addresses of then directors of company in case company fails to file financial statements, annual returns or fails to repay any deposit, interest, dividend
DIR – 10		Application for removal of disqualification

	DIR - 11	Notice of Resignation of Director to the RoC
	DIR – 12	Particulars of appointment of Directors, KMP and changes amongst them
Chapter XII - Meetings of the Board and its powers	MBP - 1	Notice of concern or interest in any company(ies) or bodies corporate (including shareholding interest), firms or other association of individuals
	MBP – 2	Register of loans, investments, etc.
	MBP – 3	Register of investments of company not held in its own name
	MBP - 4	Register of contracts or arrangements in which directors are interested
Chapter XIII- Appointment and remuneration of managerial personnel	MR - 1	Return of appointment of managing director or whole time director or manager
	MR – 2	Form of application to the Central Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration
	MR – 3	Secretarial Audit Report
Chapter XV – Compromises and arrangements	CAA-1	Creditor's responsibility statement
	CAA-2	Advertisement of the notice of the meeting
	CAA-4	Result of the meeting by chairperson
	CAA-5	Notice
	CAA-6	Order on petition
	CAA-7	Order
	CAA-8	Statement to be filed with Registrar of Companies

	CAA-9	Notice of the scheme inviting objections or suggestions
	CAA-10	Declaration of solvency
	CAA-11	Notice of approval of the scheme of merger
	CAA-12	Confirmation order of scheme of merger or amalgamation
	CAA-13	Application by the Central Government to the Tribunal
	CAA-14	Notice to dissenting shareholders
	CAA-15	Information to be furnished along with circular in relation to any scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company
Chapter XVII - Registered valuers	17.1	Application for registration as valuer by individuals and firms
	17.2	Application for registration as valuer by others
	17.3	Report of valuation by a registered valuer
Chapter XVIII - Removal of names of companies from register of companies	STK-1	The Registrar shall give a notice
	STK-2	Application for removal of name of the company
	STK-3	Manner of filing of application
	STK-4	Form to be certified by CA/CS/CWA in practice
	STK-5	Manner of publication of notice
	STK-5A	Public Notice in the Newspaper

	STK-6	Manner of notarisation, apostilisation or consularisation of indemnity bond and declaration in case of Foreign nationals or non-resident Indians
	STK-7	Notice of striking off and dissolution of company by the Registrar in Form STK- 7
	STK-8	Application or forms pending before Central Government shall be disposed in accordance with rules made under the Companies Act, 2013
Chapter XXI - Companies authorized to register under this Act	URC – 1	Application by a company for registration under Section 366
	URC - 2	Advertisement giving notice about registration under Part I of Chapter XXI
Chapter XXII - Companies incorporated outside India	FC-1	Information to be filed by foreign company
	FC-2	Return of alteration in the documents filed for registration by foreign company
	FC-3	Annual accounts along with the list of all principal places of business in India established by foreign company
	FC-4	Annual Return of a Foreign company
	FC-5	Nomination by IDR holder
Chapter XXIV - Registration	GNL – 1	Form for filing an application with RoC for which no specific form is prescribed under the Act
	GNL – 2	Form for submission of documents with RoC
	GNL - 3	Particulars of person(s) or director(s) or charged or specified for the purpose of Section 2(60)
Chapter XXVI - Nidhis	NDH – 1	Return of statutory compliances by Nidhi company
	NDH - 2	Application to Regional Director for extension of time in case of non-compliance of statutory requirements by Nidhi company
	NDH - 3	Half yearly return of Nidhi company

Chapter XXVII - National Company Law Tribunal and National Company Law Appellate Tribunal	NCLT-1	Filing of original application/Reply/Rejoinder/Interlocutory Application or filing of Additional Documents under direction of the Bench
	NCLT-2	Notice of admission
	NCLT-3	Notice of Motion
	NCLT-3A	Advertisement detailing petition
	NCLT-3B	Individual notice of petition/application to creditors, members etc.
	NCLT-4	General Heading for proceedings
	NCLT-5	General Heading for proceedings
	NCLT-6	General Affidavit verifying petition
	NCLT-7	Affidavit by way of Evidence
	NCLT-8	General Heading for proceedings
	NCLT-9	General Heading for proceedings
	NCLT-10	Application for Registration of a Intent of authorized Representative under the Rules
	NCLT-11	Application by Depositor or by Debenture holder or Debenture Trustee
	NCLT-12	Memorandum of Appearance
	NCLT-13	Public notice of Petition under Section 245
	NCLT-14	Before the National Company Law Tribunal
NCLT-15	Before the National Company Law Tribunal	

	NCLT-16	Before the National Company Law Tribunal
	NCLT-17	Certificate of Discharge
	NCLT-18	Before the National Company Law Tribunal
NCLAT	NCLAT-1	Memorandum of Appeal preferred under Section 421 of the Companies Act, 2013
	NCLAT-2	Interlocutory Application in the National Company Law Appellate Tribunal
	NCLAT-3	Pending/disposed off in the National Company Laww Appellate, New Delhi
	NCLAT-4	Affidavit
	NCLAT-5	Certification when deponent is unacquainted with the language of the Affidavit or is blind or illiterate
	NCLAT-7	Deposition of PwRw
	NCLAT-8	Certificate of Discharge
	Chapter XXIX - Miscellaneous	ADJ
MSC – 1		Application to ROC for obtaining the status of dormant company
MSC – 2		Certificate of status of a Dormant Company

MSC – 3	Return of dormant companies
MSC – 4	Application for seeking status of active company
MSC - 5	Certificate of status of an Active Company
RD-1	Applications made to Regional Director

### Annual Return

As per section 92 of the Act, every company shall prepare a return in E-form MGT 7 containing the required particulars as they stood on the close of the financial year and signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice. Where as annual return in relation to One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.

The Annual Return shall contain the following particulars:

- (a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;
- (b) its shares, debentures and other securities and shareholding pattern;
- (c) its indebtedness;
- (d) its members and debenture-holders along with changes therein since the close of the previous financial year;
- (e) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;
- (f) meetings of members or a class thereof, Board and its various committees along with attendance details;
- (g) remuneration of directors and key managerial personnel;
- (h) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;
- (i) matters relating to certification of compliances, disclosures as may be prescribed;
- (j) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and
- (k) such other matters as may be prescribed,

The annual return, filed by a listed company or, by a company having paid-up capital of ten crore rupees or more or turnover of fifty crore rupees or more, shall be certified by a company secretary in practice, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of this Act.

### **An extract of the annual return in Form MGT-9 shall be attached to the Director's Report**

The copy of Annual Return to be filed with the Registrar, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified, under section 403.

If a company fails to file its annual return before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

- Copies of the registers maintained under section 88 or entries therein and annual return filed under section 92 may be furnished to any member, debenture-holder, other security holder or beneficial owner of the company or any other person on payment of such fee as may be prescribed in the Articles of Association of the company but not exceeding rupees ten for each page.
- Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the Registrar.

## **LESSON ROUND-UP**

- The Companies Act, 2013 lays down that every company incorporated under this Act must maintain and keep at its registered office certain books, registers and copies of certain returns, documents etc. and to give certain notices, file certain returns, forms, reports, documents etc. with the Registrar of Companies within certain specified time limits and with the prescribed filing fees. These books are known as Statutory Books.
- Every company incorporated under the Act is required to keep at its registered office, *inter alia*, the following statutory books and registers –
  - Register of securities bought back. [Section 68 and Rule 17(12) of Companies (Share Capital and Debenture) Rules, 2014]
  - Register of deposits. [Section 73 and Rule 14 Companies (Acceptance of Deposits) Rules, 2014]
  - Register of charges. [Section 81 and Rule 7 of Companies Registration of Charges Rules, 2014]
  - Register of members [Section 88(1) and Rule 3(1) of Companies(Management and Administration) Rules, 2014]
  - Register of debenture holders [Section 88 (1)]
  - “Foreign register” containing the names and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India.[ Section 88(4)]
  - Register of Renewed and Duplicate Share Certificates. [Rule 6 of the Companies (Share Capital and Debentures) Rules, 2014]



- Register of sweat equity shares. [Section 54 and Rule 8(14) of Companies (Share Capital and Debentures) Rules, 2014]
- Register of Postal Ballot. [Section 110 and Rule 22 of the Companies (Management and Administration) Rules, 2014]
- Books containing minutes of general meeting and of Board and of committees of Directors. [Section 118]
- Books of account. [Section 128]
- Register of Directors/ key managerial personnel. [Section 170 (1)]
- Register of investments in securities not held in company's name. [Section 187 and Rule 14 of Companies (Meetings and its Board Powers) Rules, 2014 ]
- Register of loans, guarantees given and security provided or making acquisition of securities [Section 186(9) and (Rule 12 Companies Meetings of Boards and its Powers) Rules 2014]
- Register of contracts with companies/firms in which directors are interested. [Section 189(5) and Rule 16 of Companies (Meetings of Boards and its Powers) Rules, 2014]

### SELF-TEST QUESTIONS

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

1. Write the provisions of maintenance, preservation and signing of the following registers:
  - (a) Register of Directors
  - (b) Minute Book
2. What are the particulars to be entered in the
  - (i) Register of Securities bought back
  - (ii) Register of Fixed Deposits
  - (iii) Register of Charges
  - (iv) Register of Postal Ballot.
3. Briefly explain the provisions pertaining to preparation and filing of Annual Return.

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# Lesson 25

## Inspection and Investigation

### LESSON OUTLINE

- Inspection – introduction
- Powers of Registrar
- Duties of directors and other employees
- Conduct of inspection
- Punishment for non- compliance
- Report on inspection
- Investigation and its types
- Scope of investigation
- Powers of inspectors
- Punishment of contravention
- Inspectors report on investigation
- Investigation of foreign companies

### LEARNING OBJECTIVES

A check on the performance and compliance of various applicable laws are generally exercised by the scrutiny of any document filed by the company with the Registrar of Companies or any other regulatory authority, who is empowered to call for information and explanation with respect to any matter to which such documents or any information purports to relate. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate the level of efficiency in the conduct of the companies.

The Companies Act, 2013 empowers the registrar of Companies to call for information, to order an enquiry, to enter and search the place or places where the books are kept. Further the act also empowers central government to order an investigation into the affairs of the company. The act also mandates constitution of Serious Fraud Investigation Office (SFIO) and assigns certain offenses to be investigated by SFIO, which has power to arrest in respect of certain offences. After reading this lesson you will be able to understand the provisions relating to inspection, investigation, powers of regulatory authorities including registrars, central government, SFIO etc relating to inspection and investigation into the affairs of the company.

*“Truth is confirmed by inspection and delay; falsehood by haste and uncertainty.”*

**-Tacitu**

## Introduction

Chapter XIV (Section 206 – 229) of the Companies Act 2013 deals with the aspects of inspection, inquiry and investigation. The broad regulatory framework covers various aspects such as powers of registrar/central government to call for information, to inspect books and papers etc. and to conduct enquiry, procedure for inspection, powers of registrar in the course of inspection and the duties of officers in providing the information in the course of inspection, search/seizure, powers the central government to order an investigation into the affairs of the company, constitution of Serious Fraud Investigation Office (SFIO), investigation into the affairs of the company by SFIO and other operational aspects.

## INSPECTION

Section 206 of the Companies Act 2013 deals with power to call information, inspection of documents, books and papers of any company and conduct inquiries. The section empowers the Registrar or Inspectors appointed by Central Government to conduct inspection in order to ascertain that all the transactions have been validly entered into and recorded in appropriate books and those all applicable laws, rules and procedures have been complied by the company. The section provides some penal provisions for the every defaulting officer of the company if it is clear from the inspection that the affairs of the company is being or has been carried on for a fraudulent or unlawful purpose.

### Purpose of conducting Inspection

Section 206 does not specify the circumstances or pre conditions which must be satisfied to invoke these provisions. Some of the objectives of conducting such inspections may be thus:

1. To detect concealment of income by falsification of accounts.
2. To secure knowledge about the mismanagement of the business of a company and transactions entered into with an intent to defraud creditors, shareholders or otherwise for fraudulent or unlawful purposes.
3. To ascertain whether the statutory auditors have discharged their functions and duties in certifying the true and fair view of a company's accounts and their proper maintenance.
4. To enable the Government to ascertain the quantum of profits accrued but not adequately accounted for.
5. To detect misapplication of funds leading a company to a state of perpetual financial crisis.
6. To keep a watch on performance of a company.
7. To detect misuse of fiduciary responsibilities by the company's management for personal aggrandizement.

Inspection is intended to be a routine and not ad hoc or special affair. However, if sufficient evidence suggests that the company's affairs are being mismanaged and/or managed in fraudulent way manner, then inspection can lead to orders for investigation into the affairs of the company.

Meaning of "The affairs of Company":- The expression "the affairs of the company" as occurring in section 213 (b) of the Companies Act, 2013 is wide enough to include contravention of any law for the time being in force. [ Jiyajeerao Cotton Mills Ltd. v. Company Law Board (1969) 39 Comp. Cas. 856 (MP). ]

### **Powers of registrar to call for information**

As per section 206 of the Companies Act, 2013, if on the scrutiny of any document filed by a company or any information received by him, the Registrar is of the opinion that any further information or explanation or any further document relating to the company is necessary, he may call such other information by a written notice and require the company

- (a) to furnish the information or explanation in writing; or
- (b) to produce such document,

within the reasonable time as may be specified in notice.

### **Company's duty to furnish required information**

In accordance with section 206(2) of the Act, it is the duty of the company and of its officer concerned to furnish such information or explanation to the best of their knowledge and power to produce the documents as required by the registrar within the specified time mentioned in the notice under section 206(1) or the time extended by the Registrar.

### **Past employees to furnish information**

Proviso to section 206(2) states that if such information or explanation is related to any past period then the officers who had been in the employment of the company for such period are also required to furnish such information or explanation to the best of their knowledge when the notice, in writing, has been served by the Registrar to such past employees.

### **Further notice by the registrar, if no information is provided or information provided is inadequate.**

Section 206(3) provides that

- where no information or explanation is furnished to the Registrar within the time specified under section 206(1) or if the Registrar on inspection of documents furnished finds that the information furnished is inadequate

OR

- If on scrutiny the Registrar is of opinion that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required,

he may, by another written notice, call on the company to produce for his inspection such further books of account, books, papers, and explanations as he may require at such place and at such time as he may specify in the notice.

The Proviso to section 206(3) states that before sending any such notice as mentioned in sub section 3, the Registrar shall record his reasons in writing for issuing such notice.

### **Powers of Registrar to call for information/explanation after informing the company of the allegations made against it**

According to Section 206(4) the registrar, on the basis of information available or furnished to him or on a representation made to him by any person, is of the opinion that

- the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act or

- if the grievances of investors are not being addressed, the Registrar may after informing the company of the allegations made against it by a written order,
  - (1) call on the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein and
  - (2) carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard.

### **Powers of Central Government to direct the registrar/inspector to order an enquiry.**

The first proviso to section 206(4) provides that the Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it for the purpose to carry out the inquiry.

When business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447.

### **Meaning of Fraud**

Explanation (i) to Section 447 has defined fraud in relation to affairs of a company or any body corporate to include, any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. 'Wrongful gain' in terms of Explanation (ii), means "the gain by unlawful means of property to which the person gaining is not entitled".

On the other hand, explanation (iii) to section 447 has defined "wrongful loss" to mean the loss by unlawful means of any property to which the person losing is legally entitled".

### **Powers of Central Government to direct for an inspection**

Sections 206(5) and 206(6) empowers the role of Central Government to direct for inspection of any company, by appointing an inspector or by directing a statutory authority.

Section 206(5) provides that the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for the purpose. The power to appoint Inspectors for inspection of books and papers of a company under sub-section 206(5) as order by Central Government has been delegated to the Regional Directors.

Section 206(6) states that the Central Government may, having regard to the circumstances by general or special order authorise any statutory authority to carry out the inspection of books of account of the companies.

### **Punishment for non-compliance of section 206**

Section 206(7) states that if any company fails to furnish any information or explanation or produce any document required under Section 206, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to one lakh rupees and in the case of a continuing failure, with an additional fine which may extend to five hundred rupees for every day after the first day during which the failure continues.

### **Conduct of inspection and inquiry**

Section 207 of the Companies Act lays down the procedure to be adopted for inspection, powers of inspectors during the course of inspection, duties of directors, officers and other employees etc.,

#### ***Duty of every director and officer of the company to render***

According to section 207(1) where the Registrar or inspector calls for the books of accounts and other books and papers under section 206, of a company-

- (i) It shall be the duty of every director, officer or other employee of the company to produce all such documents to the registrar or inspector and
- (ii) To furnish him with such statements, information or explanations in such form as the Registrar or inspector may require and
- (iii) To render all assistance to the registrar or inspector in connection with such inspection.

#### ***Right of Registrar or Inspector to take copies of books of account***

Section 207(2) provides that the Registrar or inspector, making an inspection or inquiry under section 206 may, during the course of such inspection or inquiry, as the case may be,—

- (a) make or cause to be made copies of books of account and other books and papers; or
- (b) place or cause to be placed any marks of identification in such books in token of the inspection having been made.

#### ***Registrar or Inspector to have the powers of civil court***

Section 207(3) states that notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the Registrar or inspector making an inspection or inquiry shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely:—

- (a) The discovery and production of books of account and other documents, at such place and time as may be specified by Registrar or inspector making the inspection or inquiry;
- (b) Summoning and enforcing the attendance of persons and examining them on oath; and
- (c) Inspection of any books, registers and other documents of the company at any place.

### **Punishment for the disobedience**

Section 207(4)(i) states that if any director or officer of the company disobeys the direction issued by the Registrar or the inspector, such director or officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees.

#### **Director or officer to vacate office if convicted**

Section 207(4)(ii) states that when a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall,

- (i) on and from the date on which he is so convicted, be deemed to have vacated his office as such; and
- (ii) on such vacation of office, shall be disqualified from holding an office in any company.

### **Submission of report of inspection to Central Government**

Section 208 of the Companies Act 2013 provides that the Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

### **Search and seizure by the registrar or inspector**

The section 209(1) provides for search and seizure of documents by the Registrar with the permission of special court. The section provides that, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers,—

- (a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and
- (b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

The Registrar or inspector shall return the books and papers seized under section 209(1), as soon as may be, and in any case not later than 180<sup>th</sup> day after such seizure, to the company from whose custody or power such books or papers were seized. [Section 209(2)]

The first proviso to section 209(2) states that the books and papers may be called for by the Registrar or inspector for a further period of one hundred and eighty days by an order in writing if they are needed again:

Second proviso to section 209(2) holds that the Registrar or inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

### **Provisions related to code of criminal procedure, to apply for seizure under section 209.**

Section 209(3) states that the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, mutatis mutandis, to every search and seizure made under this section.

## **INVESTIGATIONS**

### **MEANING AND OBJECT**

Shareholders have been vested with various rights including the right to elect directors under the Companies Act, 2013. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Sections 210 to 229 of the Companies Act, 2013, contain provisions relating to investigation of the affairs of company.



Investigation is a fact finding exercise. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken. The said expression also includes investigation of all its business affairs—profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too [*R. v. Board of Trade, Ex parte St. Martin Preserving Co. Ltd.*, (1964) 2 All. E.R. 561 (Q.B.D.)].



## KINDS OF INVESTIGATION

The Companies Act, 2013 provides for carrying out the following kinds of investigation:

1. Investigation of the affairs of the company if it is necessary to investigate into the affairs of the company in public interest (Section 210);
2. Investigation of the affairs of related companies (Section 219);
3. Investigation about the ownership of a Company (Section 216)
4. Investigation of foreign companies (Section 228)
5. Investigation by Serious Fraud Investigation Office directed by Central government under (section 212)
6. Investigation on the order of Tribunal. (Section 213)

### When the Central government may order for investigations into the affairs of the company?

Section 210 of the companies Act provides that

1. When the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—
  - on the receipt of a report of the Registrar or inspector under section 208;
  - on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
  - in public interest,

it may order an investigation into the affairs of the company.

2. When an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

For the purposes of this section, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct. [Section 210(3)]

## **ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE BY CENTRAL GOVERNMENT**

Section 211(1) seeks to provide that the Central Government shall establish Serious Fraud Investigation Office (SFIO). The SFIO will be headed by a director and will consist of experts from various disciplines. The Central Government shall also appoint a Director in the SFIO not below the rank of Joint Secretary and may also appoint such experts and other officers as it considers necessary for the efficient discharge of functions. Until an SFIO is established under Section 211(1), the SFIO set up earlier vide Government of India resolution No.45011/16/2003-Adm-I dated 2<sup>nd</sup> July 2003 shall be deemed to be the Serious Fraud Investigation Office for the purpose of this section.

### **Investigation by Serious Fraud Investigation Office (SFIO)**

#### ***Basis of ordering investigation by the Central Government***

Section 212(1) provides that without prejudice to the provisions of section 210 (i.e., powers of Central Government to issue order to investigate into the affairs of the company) when the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company by the Serious Fraud Investigation Office—

- (a) on receipt of a report of the Registrar or inspector under section 208;
- (b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;
- (c) in the public interest; or
- (d) on request from any Department of the Central Government or a State Government,

the Central Government may, by order, assign the investigation into the affairs of the said company to the Serious Fraud Investigation Office and The Director of SFIO may designate such number of inspectors, as he may consider necessary for the purpose of such investigation.

#### ***Restrictions on other investigating agencies***

Section 212(2) provides that where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to the SFIO.

#### ***Manner of investigation and submission of report***

Section 212(3) states where the investigation into the affairs of a company has been assigned by the Central Government to SFIO, it shall

- conduct the investigation in the manner and follow the procedure provided in this Chapter; and

- submit its report to the Central Government within such period as may be specified in the order.

### ***Investigating officer to exercise powers of Inspector***

Section 212 (4) provides that the Director, SFIO shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the power of the inspector under section 217(procedures, powers, etc., of inspectors).

### ***Responsibility of company and its officers to provide information to the Investigating Officer***

Sub section(5) of section 212 states that the company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation.

### ***Limitations on grant of Bail for offences liable is punishment for fraud under Cr. PC, 1973***

Section 212(6) states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the offences covered under the following sections of the Companies Act 2013 which attract the punishment of fraud in section 447 of the 2013 Act shall be **cognizable**:-

Sl No.	Section Number	Subject Matter
1	Section 7(5)	Default on furnishing false and incorrect particulars to registrar in relation to incorporation of the company
2	Section 7(6)	Punishment for incorporating a company on the basis of false information.
3	Section 34 -	Criminal liability for mis-statement in prospectus.
4	Section 36 -	Punishment for fraudulently inducing persons to invest money.
5	Section 38(1)	Punishment for personation for acquisition of securities.
6	Section 46(5)	Fraudulent issue of duplicate certificate of shares.
7	Section 66(10) -	Punishment for concealing the name of a creditor.
8	Section 140(5) -	Power of Tribunal to change the Auditor of the company on the grounds of fraudulent conduct.
9	Section 206 (4) -	Power of Registrar to call for inquiry or furnishing of any document by the company.
10	Section 213 -	Investigation into the affairs of the company by Tribunal.
11	Section 229 -	Penalty for furnishing false statement, mutilation, destruction of document.
12	Section 251(1) -	Fraudulent application for removal of name .

13	Section 339(3) -	Punishment for fraudulent conduct of business in course of winding up of business.
14	Section 448 -	Punishment for false statement

No person accused of any such offence under the above mentioned sections shall be released on bail or on his own bond unless—

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

### **Release on bail of certain specified persons**

First proviso to section 212(6) provides that a person, who, is under the age of 16 years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

### **Special court not to take cognizance of any offence except under specified circumstances**

The second proviso to the same section provides further that the Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by—

- (i) the Director, SFIO; or
- (ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

### **Limitation on Grant of Bail - Section 212(7)**

The limitation on granting of bail specified in section 212(6) is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail.

### **Arrest of suspected persons**

If the Director, Additional Director or Assistant Director of Serious Fraud Investigation Office authorised in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in sub-section (6), he may arrest such person and such person shall soon be informed of the grounds of such arrest. [Section 210(8)]

### **Copy of order to SFIO**

Section 212(9) states that the Director, Additional Director or Assistant Director of Serious Fraud Investigation Office shall, immediately after arrest of such person under sub-section (8), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Serious Fraud Investigation Office in a sealed envelope, in such manner as may be prescribed and the Serious Fraud Investigation Office shall keep such order and material for such periods may be prescribed.

### **Arrested person to be produced before a judicial magistrate**

By virtue of section 212(10) every person arrested under section 212(8) shall within 24 hours, be taken to a Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction:

However the period of 24 hours shall exclude the time necessary for the journey from the place of arrest to the Magistrate's court. (Proviso to section 212(10))

If directed by the Central Government, the Serious Fraud Investigation Office shall submit an interim report to the Central Government. [Section 212(11)]

On completion of the investigation, the Serious Fraud Investigation Office shall submit the investigation report to the Central Government. [Section 212(12)]

### Copy of investigation report

Section 212(13) provides that notwithstanding anything contained in this Act or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

### Directions by Central Government after receiving report section 212(14)

On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the Serious Fraud Investigation Office to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company.

Where sub section 15 of section 212 provides that notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973.

#### POINT TO REMEMBER

Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.

### Proceedings to be continued under the Companies Act, 1956

Any investigation or other action taken or initiated by Serious Frauds Investigation Office under the provisions of Companies Act 1956 shall continue to be proceeded with under the same Act.

### TRIBUNAL'S ORDER FOR INVESTIGATION

#### [Section 213]

The Tribunal may

(a) *On an application made by:*

- (i) not less than one hundred members or members holding not less than one-tenth of the total voting power in the case of a company having share capital; or
- (ii) not less than one-fifth of the persons on the company's register of members in case the company has no share capital.

and supported by such evidence as may be necessary to show that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company

Or

*(b) on an application made to it by other persons or otherwise*

If it is satisfied that there are circumstances suggesting that:

- (i) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose.
- (ii) Persons engaged in the formation of company or management of its affairs have been guilty of fraud, misfeasance or other misconduct towards the company or any of its members; or
- (iii) The members of the company have not been given all the information with respect to its affairs which they might reasonably expect including information relating to calculation of commission payable to a managing or other director or manager of the company,

order, after giving reasonable opportunity of being heard to the parties concerned that the affairs of the company ought to be investigated by inspector appointed by the Central Government.

In case such an order is passed, the Central Government shall appoint inspectors to investigate into the affairs of the company.

And to report thereupon in such manner as the Central Government may direct.

### **Security under the Act and the Rules**

Where an investigation is ordered by the Central Government under section 210(1) or pursuant to Tribunal's order under section 213, then before appointing an Inspector 213(3) Clause (b) of the Central Government may require the applicants to give a security not exceeding Rs.25,000 towards the costs and expenses of investigations as per the following criteria

<i>S. No.</i>	<i>Turnover as per previous year balance sheet (Rs.)</i>	<i>Amount of security (Rs.)</i>
1	Turnover upto Rs.50 crore	Rs.10,000
2	Turnover more than Rs. 50 crore and up to Rs.200 crore	Rs.15,000
3	Turnover more than Rs.200 crore	Rs.25,000

(2) The security shall be refunded to the applicant if the investigation results in prosecution.

### **Punishment**

If after investigation it is proved that:

- (i) the business of the company is being conducted with intent to defraud creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or that the company was formed for any fraudulent or unlawful purpose; or
- (ii) any person connected with formation or management of company has been guilty of fraud.

Then every officer of the company who is in default or persons concerned in its formation or management shall be punishable for fraud under Section 447.

**WHO SHALL NOT BE APPOINTED AS INSPECTOR?**

No firm, body corporate or other association shall be appointed as an inspector. **[SECTION 215]**

**Investigation of ownership of company [Section 216]**

The Central Government may if it has reason to believe or shall upon the direction of the Tribunal that the affairs of the company ought to be investigated as regards membership of company, appoint one or more inspectors to investigate and report on matters relating to the company and its membership for determining the true persons:

- (a) who are or have been financially interested in the success or failure whether real or apparent of the company; or
- (b) who are or have been able to control or materially able to influence the policy of the company

Sub-section (2) provides that the Central Government shall appoint one or more inspectors if the Tribunal, in the course of any proceedings before it, directs by an order that the affairs of the company ought to be investigated.

While appointing an inspector, the Central Government may define the scope, the matters and the period of investigation and in particular limit the investigation to matters connected with particular shares or debentures. The inspector's powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding is considered relevant for the purpose of investigation.

**Procedures and powers of inspectors [Section 217(1)]**

It shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219(Power of inspector to investigate the affairs of related companies ), of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person—

- (a) to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and
- (b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

**Inspector may direct any body corporate to furnish any information**

Section 217(2) of the Companies Act 2013 provides that the inspector may require any body corporate, other than a body corporate referred to in above section 217(1),

- to furnish such information to, or
- to produce such books and papers before him or
- any person authorised by him in this behalf as he may consider necessary,

if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation.

#### **TIME LIMIT FOR KEEPING UP OF BOOKS AND PAPERS BY THE INSPECTORS**

Section 217(3) provides that the Inspector shall not keep in his custody any books and papers produced under section 217(1) and section 217 (2) for more than 180 days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.

However the books and papers may be called for by the inspector if they are needed again for a further period of 180 days by an order in writing (*proviso to section 217(2)*).

#### **Examination on oath [section 217(4)]**

An inspector may examine on oath—

- (a) any of the persons referred to in section 217 (1); and
- (b) with the prior approval of the Central Government, any other person,

in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally.

Provided that in case of an investigation under section 212, the prior approval of Director, Serious Fraud Investigation Office shall be sufficient under clause (b).

#### **Powers of inspectors [section 217(5)]**

Notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the inspector, being an officer of the Central Government, making an investigation under this Chapter shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely:—

- (a) the discovery and production of books of account and other documents, at such place and time as may be specified by such person;
- (b) summoning and enforcing the attendance of persons and examining them on oath; and
- (c) inspection of any books, registers and other documents of the company at any place.

#### **Punishment for disobedience of directions issued by the inspector**

Section 217(6) (i) of this Act provides that if any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to 1 year and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees.

#### **Vacation of office by the convicted director or officer and disqualification**

Now section 217(6)(ii) holds that if a director or an officer of the company has been convicted of an offence under section 217, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office.

He shall be disqualified from holding an office in any company.



**Notes to be used as evidence section 217(7)**

The notes of any examination under section 217(4) shall be taken down in writing and the same shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

**Failure to comply with section 217**

Section 217(8) contains the provisions on punishment if the requirements under section 217 have not been complied with.

It states-

If any person fails without reasonable cause or refuses—

- (a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under section 217(1) or section 217(2) to produce;
- (b) to furnish any information which is his duty under section 217 (2) to furnish;
- (c) to appear before the inspector personally when required to do so under section 217(4) or to answer any question which is put to him by the inspector in pursuance of that sub-section; or
- (d) to sign the notes of any examination referred to in section 217(7),

he shall be punishable with imprisonment for a term which may extend to 6 months and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees, and also with a further fine which may extend to 2000 rupees for every day after the first day during which the failure or refusal continues.

**Assistance to the inspector**

Section 217(9) states that the officers of the Central Government, State Government, police or statutory authority shall provide assistance to the inspector for the purpose of inspection, inquiry or investigation, which the inspector may, with the prior approval of the Central Government, require.

***Reciprocal arrangements with foreign governments for inspection, inquiry and investigation***

In terms of Section 217(10), the Central Government may make reciprocal arrangements, with a foreign state to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that state. For this purpose, the Central Government may by notification apply this Chapter subject to modifications, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that state.

Under Section 217(11), if in the course of investigation into the affairs of a company, an application is made to the competent court in India by the inspector stating that the evidence is, or may be, available in a country or place outside India, such a court may issue a letter of request to the court or authority in such country or place.

As per the rules made under Chapter XIV the Letter of Request shall be transmitted in such manner as specified by the Ministry of Corporate Affairs.

The Court or authority in foreign country may be requested

- (a) to examine orally or otherwise any person supposed to be acquainted with the facts and circumstances of the case;

- (b) to record his statement made in the course of such examination and
- (c) to require such person to produce any document or thing which may be in his possession relating to the case, and
- (d) to forward all the evidence taken or collected or authenticated copies thereof to the court in India which had issued the letter of request. Every statement recorded or a document received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

Similarly, under Section 217(12), upon receipt of a request from a court or authority outside India, the Central Government may forward the same to the court concerned which shall thereupon summon the person before it and record his statement, or cause any document or thing to be produced, or send the letter to any inspector for investigation. The inspector shall investigate into the affairs of company in same manner as investigation is done under this Act. The inspector shall send the report to the court within 30 days or such extended time as the court may allow.

The evidence collected or its authenticated copies shall be forwarded by the court to the Central Government for transmission to the court or authority in a country outside India which had issued the letter of request.

### ***Obligation of the company etc. to take Tribunals approval for any action against employee(s)***

Notwithstanding anything contained in any other law for the time being in force, if—

(a) during the course of any investigation of the affairs and other matters of or relating to a company, other body corporate or person under section 210, section 212, section 213 or section 219 or of the membership and other matters of or relating to a company, or the ownership of shares in or debentures of a company or body corporate, or the affairs and other matters of or relating to a company, other body corporate or person, under section 216; or

- (a) during the pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company under Chapter XVI, such company, other body corporate or person proposes—
  - (i) to discharge or suspend any employee; or
  - (ii) to punish him, whether by dismissal, removal, reduction in rank or otherwise; or
  - (iii) to change the terms of employment to his disadvantage,

the company, other body corporate or person, as the case may be, shall obtain approval of the Tribunal of the action proposed against the employee and if the Tribunal has any objection to the action proposed, it shall send by post notice thereof in writing to the company, other body corporate or person concerned.

### **Action against employees, if does not receive approval within 30 days**

Section 218(2) of this Act states if the company, other body corporate or person concerned does not receive within 30 days of making of application under section 218(1), the approval of the Tribunal, then and only then, the company, other body corporate or person concerned may proceed to take against the employee, the action proposed.

### **Appeal to Appellate Tribunal [section 218(3)]**

If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of 30 days of the receipt of the notice of the objection, prefer an appeal to the

Appellate Tribunal in such manner and on payment of such fees as may be prescribed.

### **Decision of Appellate Tribunal [section 218(4)]**

The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

### **PREPARATION BY A COMPANY SECRETARY TO FACE INVESTIGATION**

Before an inspector commences investigation into the affairs of a company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence. The aspects which should be considered by the secretary include:

1. *Basic information about the company*—Name of the company; date of incorporation; location of the registered office, branches, factories and other offices; status of the company—public or private; objects of the company—capital structure; voting rights attached to the shares; shareholding pattern of the company.
2. *Business activities*—Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so the names of other companies falling within the same group.
3. Debentures, bank finance and deposits.
4. Foreign collaboration agreements.
5. *Management*—Brief history of past management set up; existing management set up; composition of Board of Directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to an office or place of profit.
6. Whether all the statutory registers including minute's books are being maintained up-to-date?
7. Whether the internal checks and internal control system is being properly followed?
8. *Working results and financial position*—General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
9. Compliance by the company and its officers with the provisions of the Companies Act, 1956/2013.
10. Compliance with the provisions of other Acts applicable to the company.
11. Whether the loans taken and loans advanced to Directors, the firms in which they are partners or companies in which they are Directors are in accordance with the provisions of the Act.
12. The investments made by the company.
13. Sole selling agency agreement.
14. Instance of mismanagement and other irregularities.
15. Acquisition/disposal of substantial assets.
16. A scrutiny of abnormal/heavy expenditure items.

17. Complaints, if any, against the company and its management and steps taken to redress them.
18. Brief particulars of the litigations against the company and the reasons thereof.
19. Management's relations with the employees and labour.
20. Shareholders—Instance of oppression of minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc. and steps taken to redress Investors, complaints.
21. *Auditors*—Name and address of Statutory auditors, Secretarial Auditor and Cost Auditor, compliance as per the provisions of Companies Act, 2013.

### **Inspector's power to investigate the affairs of company**

By virtue of section 219 if an inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, to investigate also the affairs of—

- (a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;
- (b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;
- (c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or
- (d) any person who is or has at any relevant time been the company's managing director or manager or employee,

he shall, subject to the prior approval of the Central Government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

### **Seizure of documents [section 220(1)]**

If in the course of an investigation under this Chapter (CHAPTER XIV), the inspector has reasonable grounds to believe that the books and papers of, or relating to, any company or other body corporate or managing director or manager of such company are likely to be destroyed, mutilated, altered, falsified or secreted, the inspector may—

- (a) enter, with such assistance as may be required, the place or places where such books and papers are kept in such manner as may be required; and
- (b) seize books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books and papers at its cost for the purposes of his investigation.

### **Inspector to return books and papers seized**

Section 220(2) The inspector shall keep in his custody the books and papers seized under this section for such a period not later than the conclusion of the investigation as he considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person from whose custody or power they were seized:

### Inspector may keep copies or extracts of books

Proviso to section 220(2) states that the inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such manner as he considers necessary.

#### **NOTE THAT !!**

The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply *mutatis mutandis* to every search or seizure made under this section.

SECTION  
220(3)

### Freezing of assets of a company (Section 221)

Where it appears to the Tribunal,-

- (i) on a reference made to it by the Central Government or
- (ii) in connection with any inquiry or investigation into the affairs of a company under this Chapter or
- (iii) on any complaint made by such number of members as specified under Section 244(1) or
- (iv) a creditor having 1,00,000 rupees amount outstanding against the company or
- (v) any other person having a reasonable ground to believe that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest,

it may by order direct that such transfer, removal or disposal shall not take place during such period not exceeding three years as may be specified in the order or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under section 221(1),

- the company shall be punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 25,00,000 rupees; and
- every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than 50,000 rupees but which may extend to 5,00,000 rupees, or with both.

### Restriction on securities [section 222(1)]

Section 222(1) provides that where it appears to the Tribunal, in connection with any investigation under section 216 or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed, the Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding 3 years as may be specified in the order.

Section 222(2) provides that if a company issues and transfers any securities or acted upon the contravention of the order of the Tribunal, under section 222

- (i) the company shall be punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 25,00,000 rupees.

- (ii) and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than 25,000 rupees but which may extend to 500,000 rupees, or with both.

### **Interim and final reports by inspector [section 223(1)]**

An inspector appointed under this Chapter (Chapter XIV) may, and if so directed by the Central Government shall, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government.

Section 223(2) provides that every report made under section 223(1) shall be in writing or printed as the Central Government may direct.

A copy of the report made under section 223(1) may be obtained by making an application in this regard to the Central Government.

The report of any inspector appointed under this Chapter shall be authenticated either—

- (a) by the seal, if any, of the company whose affairs have been investigated; or
- (b) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872,

and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

Nothing in this section shall apply to the report referred to in section 212.

### **Action pursuant to inspector's report [section 224(1)]**

If, from an inspector's report, made under section 223, it appears to the Central Government that any person has,

- (i) in relation to the company or
- (ii) in relation to any other body corporate or other person whose affairs have been investigated under this Chapter been guilty of any offence for which he is criminally liable,

the Central Government may prosecute such person for the offence and it shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution.

### **Petition to tribunal for winding up or for prevention of oppression and mismanagement [section 224(2)]**

If any company or other body corporate is liable to be wound up under this Act or under the Insolvency and Bankruptcy Code, 2016 and it appears to the Central Government from any such report made under section 223 that it is expedient so to do by reason of any such circumstances as are referred to in section 213, the Central Government may, unless the company or body corporate is already being wound up by the Tribunal, cause to be presented to the Tribunal by any person authorised by the Central Government in this behalf—

- (a) a petition for the winding up of the company or body corporate on the ground that it is just and equitable that it should be wound up;
- (b) an application under section 241; or
- (c) both.

**Winding up proceedings [section 224(3)]**

If from any such report as aforesaid, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated under this Chapter—

- (a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate; or
- (b) for the recovery of any property of such company or body corporate which has been misapplied or wrongfully retained,

the Central Government may itself bring proceedings for winding up in the name of such company or body corporate.

**Disgorgement of assets [section 224(5)]**

If the inspectors report states that that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, as the case may be, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

**Reimbursement of expenses incurred by the Central Government**

Section 225(1) states that the expenses of, and incidental to, an investigation by an inspector appointed by the Central Government under this Chapter (CHAPTER XIV) other than expenses of inspection under section 214 shall be defrayed in the first instance by the Central Government, but shall be reimbursed by the following persons to the extent mentioned below, namely:—

- (a) any person who is convicted on a prosecution instituted, or who is ordered to pay damages or restore any property in proceedings brought, under section 224, to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person, or ordering him to pay such damages or restore such property, as the case may be;
- (b) any company or body corporate in whose name proceedings are brought as aforesaid, to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings;
- (c) unless, as a result of the investigation, a prosecution is instituted under section 224,—
  - (i) any company, body corporate, managing director or manager dealt with by the report of the inspector; and
  - (ii) the applicants for the investigation, where the inspector was appointed under section 213,

to such extent as the Central Government may direct.

Section 225(2) provides that any amount for which a company or body corporate is liable under section 225(1)(b) shall be a first charge on the sums or property mentioned in that clause.

**Voluntary winding-up of company not to stop investigation [Section 226]**

An investigation under this Chapter (CHAPTER XIV) may be initiated notwithstanding, and no such

investigation shall be stopped or suspended by reason only of, the fact that—

- (a) an application has been made under section 241;
- (b) the company has passed a special resolution for voluntary winding up; or
- (c) any other proceeding for the winding up of the company is pending before the Tribunal:

The first proviso to section 226(1) states that where a winding up order is passed by the Tribunal in a proceeding referred to in section 226(c), the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit:

The second proviso to section 226(1) provides further that nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

### **Legal advisors and bankers not to disclose facts**

Section 227 of this Act provides that nothing in this Chapter shall require the disclosure to the Tribunal or to the Central Government or to the Registrar or to an inspector appointed by the Central Government—

- (a) by a legal adviser, of any privileged communication made to him in that capacity, except as respects the name and address of his client; or
- (b) by the bankers of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person.

The provisions of this Chapter shall apply *mutatis mutandis* to inspection, inquiry or investigation in relation to foreign companies.

INVESTIGATION OF FOREIGN  
COMPANIES  
[SECTION 228]

### **Penalty for furnishing false statements [Section 229]**

Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation,—

- (a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;
- (b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or
- (c) provides an explanation which is false or which he knows to be false,

he shall be punishable for fraud in the manner as provided in section 447.



## LESSON ROUND-UP

- The Act provides exhaustive powers to the Registrar or inspectors or Serious Fraud Investigation Officer authorized by the Central Government or as the case may be, to conduct inspection in order to ascertain that all transactions have been validly entered into and recorded in appropriate books and that applicable laws, rules and procedures have been complied with by the company.
- Also, the books of account and other books and papers shall be open to inspection by any director during business hours. The Companies Act does not give any statutory right of inspection of books of account to a shareholder. However, articles of a company may give such a right to the shareholders.
- The Act empowers the person making the inspection to make or cause to be made copies of books of account and other books and papers or place or cause to be placed any marks of identification thereon in token of inspection having been made.
- The person making an inspection is required to make a report to the Central Government after inspection of books of account and other books and papers of the company.
- If a default is made in complying with the provisions of inspection, every officer of the company, who is in default, shall be punishable with fine and imprisonment.
- In respect of inspection, the Company Secretary should take all possible steps to comply with the provisions of the Act and other laws. When inspection of books (by the Registrar or an officer of the Central Government or SFIO) is anticipated, he/she should make sure that the prescribed statutory registers and records are being maintained up to date by the company.
- Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and see if any illegal acts or offences are disclosed and then decide the action to be taken.
- The Companies Act provides for carrying out investigation of the affairs of the company whose business is being conducted in fraudulent or unlawful manner or in a manner oppressive of any member or of the affairs of related companies or of ownership of the company for the purpose of determining the true persons who are or have been able to control or materially influence the policy of the company or who are or have been financially interested in the success or failure, whether real or apparent of the company.
- The Central Government has been empowered to conduct investigation into the affairs of the company in circumstances specified under the Act.
- Only an individual or individuals may be appointed as Inspector(s) to conduct the investigation into the affairs of the company and to report thereon in the prescribed manner. Inspectors have been given wide powers under the Companies Act.
- The inspector may, and if so directed by the Central Government, shall make interim reports to that Government and on the conclusion of the investigation, shall make a final report to the Central Government.
- On receipt of the report of the Inspector appointed to investigate the affairs of the Company, the Central Government may undertake prosecution for criminal offence, winding up of company or relief by the court, recovery of damages or property.
- Before an inspector commences investigation into the affairs of the company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged.
- In the public interest it may become necessary for the Central Government to know the persons who are financially



# Lesson 26

## Majority Rule and Minority Rights

### LESSON OUTLINE

- Introduction
- The Principle of Non-interference (Rule in Foss v. Harbottle)
- Justification and Advantages of the Rule in Foss v. Harbottle
- Exceptions to the Rule in Foss v. Harbottle
- Majority Rule and Minority Rights under Companies Act
- Meaning of Oppression
- Application to Tribunal for Relief in cases of Oppression, etc.
- Right to members to apply
- Entitlement to members to make an application
- Powers of Tribunal
- Filing of copy of order of Tribunal
- Interim order
- Alteration through order of the Tribunal
- Certified copy of altered order shall be filed with the Registrar
- Punishment in case of contravention
- Consequence of termination or modification of certain agreements
- Class Action Suits

### LEARNING OBJECTIVES

Democracy is always a better governance structure as compared to any other set up. It preserves the rights of everyone whether majority or minority. Most of the set ups are always preserving the rights of the section to whom it is presenting.

The greed for money is the reason as to why the companies are mismanaged for personal gains. This greed lies with the majority holders. The best set up for a company is that in which the minority rights are protected and also in which mismanagement is avoided.

After reading this lesson you will be able to understand the Principle of Non-interference, Majority Rule and Minority Rights under Companies Act, 2013 and provisions for prevention of Oppression and Mismanagement including Class Action Suits.

The oppression of minority is a normal thing everywhere either in economics or politics or in the companies. However, the subjection of minorities to oppression has been witnessed in all spheres of human activity, be it economics, politics or even corporate.

*"In a democracy the poor will have more power than the rich, because there are more of them, and the will of the majority is supreme."*

**– Aristotle**

## INTRODUCTION

A company being an artificial person with no physical existence, functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that *prima facie* a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs. According to Section 47 of the Companies Act, 2013, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. A special resolution, for instance, requires a majority of 3/4ths of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough [*Edwards v. Halliwell*, (1950) 2 All. E.R. 1064]. The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company [*North-West Transportation Co. v. Beatty* (1887) L.R. 12 A.C. 589].

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the majority of members is subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which being outside the ambit of the memorandum, is *ultra vires* of the company [*Ashbury Rly. Carriage and Iron Co. v. Riche*, (1875) L.R. 7 H.L. 653]. Also, where the articles authorise the directors to deal with any matters except those which are outside the scope of the authority of the directors; or with which the directors, having power, are unable or unwilling to deal. Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

### The Principle of Non-interference (Rule in *Foss v. Harbottle*)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the Board of directors for carrying out their object at the cost of minority of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

### CASE LAW

In *Foss v. Harbottle*, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action. The wrong done to the company was not which could be ratified by the majority of members. The company (i.e. the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide whether to commence proceedings against the directors. The reasons for rule were nicely stated by Melish L.J. in *MacDougall v. Gardiner*, (1875) 1 Ch. D. 13 (C.A.) at p. 25 in the following words:

“If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.”

In *Rajahmundry Electric Supply Co. v. Nageshwara Rao* AIR 1956 SC 213, the Supreme Court observed that:

“The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it.”

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

In *Pavrides v. Jensen* (1956) Ch. 565, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, “It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company's mine at an undervalue, proceedings should not be taken against the directors”.

In *Edwards v. Halliwell* (1950) 2 All. E.R. 1064, Jenkins, L.J. restated the rule in the following terms: “The rule in *Foss v. Harbottle* comes to no more than this. First, the proper plaintiff in respect of wrong alleged to be done to company is prima facie the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then cadit quaestio... (cannot be questioned). If on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company itself should not sue”.

### Justification and Advantages of the Rule in *Foss v. Harbottle*

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On

becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray v. Lewis*, (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in *Foss v. Harbottle* are of a purely practical nature and are as follows:

1. **Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.
2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. **Litigation at suit of a minority futile if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall v. Gardiner*, (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of *Foss v. Harbottle* Rule in Indian context — The Delhi High Court in *ICICI v. Parasrampuriah Synthetic Ltd.* SSL, July 5, 1998 has held that an automatic application of *Foss v. Harbottle* Rule to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding atleast 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss v. Harbottle* Rule would be unjust and unfair.

#### **EXCEPTIONS TO THE RULE IN FOSS V. HARBOTTLE**

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 1956.

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases:

### **(1) Ultra Vires Acts**

Where the directors representing the majority of shareholders perform an illegal or *ultra vires* act for the company, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or *ultra vires* transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an *ultra vires* act.

In *Bharat Insurance Ltd. v. Kanhya Lal*, A.I.R. 1935 Lah. 792, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was : “To advance money at interest on the security of land, houses, machinery and other property situated in India...” The plaintiff complained that “several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments”. The Court observed:

“In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting *ultra vires* in the application of the funds of the company, a single member can maintain a suit”.

It means that the rule in *Foss v. Harbottle* will operate in full force only when the majority of shareholders through their chosen directors act within the extent of the powers of the company.

### **(2) Fraud on Minority**

Where an act done by the majority amounts to a fraud on the minority; an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in *Foss v. Harbottle* in a number of cases. In *Menier v. Hooper's Telegraph Works*, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

Though there is no clear definition of the expression “fraud on the minority”, but the court decides a particular case according to the surrounding facts. The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is “bona fide for benefit of the company as a whole” [*Allen v. Gold Reefs of West Africa*, (1900) 1 Ch. 656]. As regards the meaning of the expression “bona fide for the benefit of the company as a whole” Evershed M.R. in *Greenhalgh Ardeme Cinemas Ltd.* (1950) 2 All E.R. 1120 has observed thus : “It mean that the shareholder must proceed on what, in his honest opinion, is for the benefit, of the company as a whole. Secondly, the phrase ‘the company as a whole’ does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body.” In other words, it can be said that the court ought not to interfere with decision of the majority in a general meeting if that decision is arrived at fairly and honestly [In *Re. Transval Gold Exploration and Land Co. Ltd.* (1885) 1 T.L.R. 604]. and is not an act of fraud on the minority.

### **(3) Wrongdoers in Control**

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [*Cf. Birch v. Sullivan*, (1957) 1 W.L.R. 1274]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par Jenkins L.J. in *Edwards v. Halliwell*, (1950) 2 All E.R. 1064, 1067].

In *Glass v. Atkin* (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: "While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action."

### **(4) Resolution requiring Special Majority but is passed by a simple majority**

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid, formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [*Baillie v. Oriental Telephone and Electric Co. Ltd.*, (1915) 1 Ch. 503 (C.A.); refer also *Nagappa Chettiar v. Madras Race Club*, 1 M.L.J. 662].

### **(5) Personal Actions**

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [*Salmon v. Quin and Azens*, (1909) A.C. 442]. In *Nagappa Chettiar v. Madras Race Club*, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [*Joseph v. Jos*, (1964) 1 Comp LJ 105].

### **(6) Breach of Duty**

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In *Daniels v. Daniels*, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court.

Held, by the Chancery Division, Templeman, J, the application of director should be dismissed. The exception to the rule in *Foss v. Harbottle* enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no



fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit to the directors; accordingly, on the facts alleged, the minority shareholders had a cause of action.

### **(7) Prevention of Oppression and Mismanagement**

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

In *Bennet Coleman & Co. and Ors. v. Union of India & Ors.*, (1977) 47 Com Cases 92 (Bom), the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non-corporate management which may take the form of appointing an administrator or a special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

The exceptions to the rule in *Foss v. Harbottle* are not limited to those covered above. Further exceptions may be admitted where the rules of justice require that an exception to the rule should be made.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [*Panipat Woollen & General Mills Co.Ltd. v. R.L. Kaushik*, (1969) 39 Com Cases 249 (Punj & Har)].

### **“Majority Rule and Minority Rights” under Companies Act**

In India, the Companies Act attempts to maintain a balance between the rights of majority and minority shareholders by admitting in the rule of the majority but limiting it at the same time by a number of well-defined minority rights, and thus protecting the minority shareholders.

Companies Act, 1956 provided for protection of the minority shareholders from oppression and mismanagement by the majority under Section 397 (Application to Company Law Board for relief in cases of oppression) and 398 (Application to Company Law Board for relief in cases of mismanagement).

Oppression as per Section 397(1) of Companies Act, 1956 was defined as 'when affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members' while the term mismanagement was defined under Section 398(1) as 'conducting the affairs of the company in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company or there has been a material change in the management and control of the company, and by reason of such change it is likely that affairs of the company will be conducted in a manner prejudicial to public interest or interest of the company'.

Right to apply to the Company Law Board in case of oppression and/or mismanagement was provided under Section 399 to the minority shareholders meeting the ten percent shareholding or hundred members or one-fifth members limit, as the case may be. However, the Central Government was also provided with the discretionary power to allow any number of shareholders and/or members to apply for relief under Section 397 and 398 in case the limit provided under Section 399 was not met.

Chapter XVI of the Companies Act, 2013 deals with the provisions relating to prevention of oppression and mismanagement of a company. Oppression and mismanagement of a company mean that the affairs of the

company are being conducted in a manner that is oppressive and biased against the minority shareholders or any member or members of the company. To prevent the same, there are provisions for the prevention and mismanagement of a company.

The Ministry of Corporate Affairs *vide* its Notification S.O.1934 (E) dated 1st June 2016 notified section 241 to 245 of the Companies Act, 2013. Section 246 was notified *vide* Notification S.O.2912 (E) dated 9th September, 2016. These provisions are discussed in detail hereunder.

### Meaning of Oppression

The words “oppression” and “mismanagement” are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term “oppression” as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Western Ltd.*, (1952) Scottish Cases 49, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in *Shanti Prasad v. Kalinga Tubes*, (1965) 1 Comp. L.J. 193 at 204 is as under :

“The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely.”

### CASE LAW

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in *Re. Hindustan Co-operative Insurance Society Ltd.*, AIR. 1961 Cal. 443 wherein the life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilise the compensation money for the new objects. This was held to be an “Oppression”. The court observed: “The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards”.

A similar relief was allowed by the House of Lord in *Scottish Co-operative Wholesale Society v. Mayer* (1959) AC 324. In this case, the society created a subsidiary company to enable it to enter in the rayon industry. Subsequently when the need for the subsidiary ceased to exist, the society adopted a policy of running down its business which depressed the value of its shares. The two petitioners who were managing directors and minority shareholders in the company successfully pleaded “oppression”. The court ordered the society to purchase the minority shares at the value at which they stood before the oppressive policy started [This decision has also been followed in *Re. H.R. Harmer Ltd.*, (1959) 1 WLR 62].

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi v. Indian Motor Co.* A.I.R. 1962 Cal 127, the petitioner alleged that the Board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers travelling without ticket on the company’s buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company had been disposed of at low price, that dividends were being declared at too low

a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor [In Re. *Bellador Silk Ltd.*, (1965) 1 All ER 667].

The legal representatives of a deceased member whose name is still on the register of members are entitled to file a petition under Sections 397 and 398 of the Companies Act, 1956, for relief against oppression or mismanagement, *Worldwide Agencies Pvt. Ltd. and Another v. Mrs. Margaret T. Desor and Others*, Com Cases Vol. 67 (1990), 807 (S.C.).

The legal heirs to be registered on probate or will are also entitled to apply. [*K.S. Mothilal v. K.S. Kasimaris Ceranique (P) Ltd.*, (2007) 135 Com Cases 609 CLB].

A shareholder dies and his heirs apply for transmission of shares while their application for succession certificate was pending before the Civil Court. The legal heirs alleged illegal allotment of shares by respondent to themselves, reducing the legal heirs to minority. It has held that the legal heirs are entitled to file a petition alleging oppression and mismanagement. [*Rajkumar Devraj & Aur. v. Jai Mahal Hotels Pvt. Ltd. & Others* (CLB) CA. No. 133 of 2006 in C.P. No. 30 of 2006.

In Re *Five Minute Car Wash Service Ltd.* (1966) 1 All ER 242, a petition founded on the ground that the managing director has been unwise, inefficient and careless in the performance of his duties could not succeed.

It should not, however, be supposed that these special remedies against oppression or mismanagement are available only to minorities. "In an appropriate case, if the court is satisfied about the act of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. "Accordingly, a relief under the section was allowed to a majority group by Mitra, J., of the Calcutta High Court in In Re. *Sindhri Iron Foundry (P) Ltd.* (1963) 68 CWN 118. His Lordship observed that "if the court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival Boards are holding meetings, that the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors there is no reason why the court should not make appropriate order to put an end to such matters.

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, his Lordship said:

"The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a Board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty-five ... There would be complete chaos and confusion ... " (Ibid., p. 335).

"This ingenious remedy has not only permitted redressal of many abuses, but its mere availability has had a deterrent effect upon management." [George H. Hornstein: *The Future of Corporate Control*, (1950) 63 HLR 476].

It was held in the case of *Ajit Singh Ahuja v. Sapphire (India) (P) Ltd.* [(2009) 1 Comp LJ 313 (CLB)] that in a case of oppression, a member has to specifically plead on five facts – (a) what is the alleged act of oppression; (b) who committed the act of oppression; (c) how it is oppressive; (d) whether it is in the affairs of the company; and (e) whether the company is party to the commission of the act of oppression.

Oppression must be a continuous process. This is suggested by the words, 'are being conducted in a manner...' used in Section 397. Hence isolated acts of oppression or mismanagement will not give rise to an action under Section 397 of the Act. In *Shanti Pd. Jain's Case*, the court said:... "events have to be considered not in isolation but as a part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing up-to-date of petition".

However in *Tea Brokers P. Ltd. v. Hemendra Prosad Barooah* (1998) 5 Comp LJ 963 (Cal.) the Division Bench of Calcutta High Court observed that:

'This is undoubtedly, a right and privilege which a member enjoys in his capacity as a member of the company... such an act may be even a single act done on one particular occasion if the effect of such an act will be of a continuing nature and the member concerned is deprived of his rights and privilege for all time to come in future'.

In *Ramshankar Prasad v. Sindu Iron Foundry (P) Ltd.*, AIR 1966 Cal 512, it was held that a petition under Section 397, would be maintainable even if the oppression was of a short duration and of a singular conduct if its effects persisted indefinitely [followed in *Maharashtra Power Development Corporation. Ltd. v. Dabhol Power Co. Ltd.* (2003) 56 CLA 263 (Bom.)].

In *Bhagirath Agarwala v. Tara Properties P. Ltd.* (2003) 51 CLA 57 (Cal.), also the removal of a director and allotment of shares were set aside as they were done at a meeting which was covered without complying with the requirements of Section 286 and also reflected an oppressive policy. The allotment was made only to one member without simultaneous offer to others on pro rata basis. A single act of issue of additional shares can have a continuous effect. It can constitute oppression. A relief can be had against it. There is no bar of limitation in such a case. [*Ashok Kumar Oswal v. Panchsher Textile Mfg. & Trading Co. Ltd.* (2002) 110 Com Cases 800 (CLB-PB)].

Past acts of oppression will not entitle a plaintiff to seek the remedy under Section 397. The purpose of this section is not so much to take up the past as to redeem the future. A catalogue of charges of the past alleged misdeeds will not attract the section [*Thakur Prem Singh v. Thakur Hotel (Simla) Co. (P) Ltd.*, AIR 1963 Punj. 63; *Raghunath Swarup Mathur v. Har Swarup Mathur*, (1970) 40 Com Cases 282 (All)].

### **Application to Tribunal for Relief in Cases of Oppression, etc.**

(1) Application by member: According to section 241(1), any member of the company may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter, if he who complains that

- (a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or
- (b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.

(2) Central Government *suo moto* to apply to the Tribunal: Section 241(2) provides that the Central

Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter.

### **Right to members to apply**

Section 244(1) provides that the following members of a company shall have the right to apply under section 241, namely:—

- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;
- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241.

Explanation.— For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

### **Entitlement to members to make an application**

Section 244(2) provides that where any members of a company are entitled to make an application under sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

### **Powers of Tribunal**

Section 242(1) provides that on any application made under section 241, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, if it is of the opinion—

- (a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

Section 242(2) provides that without prejudice to the generality of the powers under sub-section (1) an order under that sub-section may provide for—

- (a) the regulation of conduct of affairs of the company in future;
- (b) the purchase of shares or interests of any members of the company by other members thereof or by the company;
- (c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;
- (d) restrictions on the transfer or allotment of the shares of the company;
- (e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the

company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

- (f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

No such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

- (g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;
- (h) removal of the managing director, manager or any of the directors of the company;
- (i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;
- (j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);
- (k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;
- (l) imposition of costs as may be deemed fit by the Tribunal;
- (m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

### **Filing of copy of order of Tribunal**

Section 242(3) provides that a certified copy of the order of the Tribunal under Section 242(1) shall be filed by the company with the Registrar within thirty days of the order of the Tribunal.

### **Interim order**

According to Section 242(4), the Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

### **Alteration through order of the Tribunal**

According to Section 242(5) and (6), where an order of the Tribunal under Section 242(1) makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles. The alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered.

### **Certified copy of altered order shall be filed with the Registrar**

Section 242(7) provides that a certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within thirty days after the making thereof, be filed by the company with the Registrar who shall register the same.

### **Punishment in case of contravention**

Section 242(8) provides that if a company contravenes the provisions of sub-section (5), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

### **Consequence of termination or modification of certain agreements**

Section 243(1) states that where an order made under section 242 terminates, sets aside or modifies an agreement such as is referred to in sub-section (2) of that section,—

- (a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;
- (b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

Further, Section 243(2) provides that any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

### **Class Action Suits**

The initiation of class action suits is one of the major changes introduced by the Companies Act, 2013. The major objective behind the provision of class action suits is to safeguard the interests of the minority shareholders. So, class action suits are expected to play an important role to address numerous prejudicial and abusive acts committed by the Board of Directors and other managerial personnel as it has been statutorily recognized under the Companies Act, 2013.

### **What is a class action suit?**

A class action suit is a lawsuit where a group of people representing a common interest may approach the Tribunal to sue or be sued. It is a procedural instrument that enables one or more plaintiffs to file and prosecute litigation on behalf of a larger group or class having common rights and grievances.

### **Filing of application before the Tribunal on behalf of the members or depositors**

Section 245(1) provides that such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (3) may, if they are of the opinion that the

management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—

- (a) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;
- (b) to restrain the company from committing breach of any provision of the company's memorandum or articles;
- (c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;
- (d) to restrain the company and its directors from acting on such resolution;
- (e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;
- (f) to restrain the company from taking action contrary to any resolution passed by the members;
- (g) to claim damages or compensation or demand any other suitable action from or against—
  - (i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
  - (ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
  - (iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
- (h) to seek any other remedy as the Tribunal may deem fit.

### **Required number of members to apply**

According to Section 245(3)

- (i) The requisite number of members provided in sub-section (1) shall be as under:—
  - (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;
  - (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.
- (ii) The requisite number of depositors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

**Remedy:** Section 245(1) provides that where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the



firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

### **Requirement for consideration of application**

Section 245(4) provides that in considering an application under sub-section (1), the Tribunal shall take into account, in particular—

- (a) whether the member or depositor is acting in good faith in making the application for seeking an order;
- (b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of sub-section (1);
- (c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;
- (d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;
- (e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
  - (i) authorised by the company before it occurs; or
  - (ii) ratified by the company after it occurs;
- (f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

### **In case of admission of application**

Section 245(5) provides that if an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—

- (a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;
- (b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;
- (c) two class action applications for the same cause of action shall not be allowed;
- (d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

**Order shall be binding:** Section 245(6) provides that any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

**Punishment for non-compliance:** According to Section 245(7) any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five

lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Application filed is frivolous/vexatious: Section 245(8) states that where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

Exemption from application of section: According to Section 245(9), nothing contained in this section shall apply to a banking company.

Application may be filed on behalf of affected persons: Section 245(10) provides that subject to the compliance of Section 245, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1) of 245.

### **Application of Certain Provisions to Proceedings under Section 241 or Section 245**

Section 246 provides that the provisions of sections 337, 338, 339, 340 and 341 (both inclusive) related to winding up, shall apply *mutatis mutandis*, in relation to an application made to the Tribunal under section 241 or section 245.

### **LESSON ROUND-UP**

- Under the Companies Act, the powers have been divided between two segments; Board of Directors and the shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their power through Annual General Meetings/Extra-ordinary General Meetings.
- The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority.
- Since the majority of the members are in an advantageous position to run the company according to their command, the minority shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority.
- The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company.
- The supremacy of the majority, however, does not prevail in all situations. There are certain acts which the majority of shareholders cannot approve or affirm. In such cases, any shareholder may sue to enforce obligations owed to the company. He brings the action as representative of the corporate interest.
- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the National Company Law Tribunal by way of petition for relief.
- Relief under the Act will also be available if the affairs of the company are being conducted in a manner prejudicial to public interest. 'Public interest' is a very broad term involving the welfare not only of the individual shareholders but also of the country according to the economic and social policies of the State.
- If the court is so convinced that the affairs of a company are being conducted in a manner prejudicial to the interest





# Lesson 27

## Merger, De-Merger, Amalgamation, Compromise and Arrangements – An Overview

### LESSON OUTLINE

- Regulatory framework for merger/ amalgamation
- Provisions of Companies Act, 2013
- Power to Compromise or make arrangements with members or creditors
- Merger and amalgamation of certain companies
- Merger and amalgamation of a company with a foreign company
- Power to acquire shares of shareholders dissenting from scheme or contract approved by majority
- Purchase of minority shareholding
- Power of Central Government to provide for amalgamation of companies

### LEARNING OBJECTIVES

While implementing the strategic decision of merger/amalgamation, the transferor/transferee company has to comply with a number of regulations viz., the Companies Act, 2013 and rules made there under, Income Tax Act, 1961, SEBI(LODR), Regulations, 2015, The Indian Stamp Act, 1899, the Competition Act, 2002 etc. It involves conducting of various meetings including board/general meetings, creditors' meetings, valuation and calculation of swap ratio, obtaining of various approvals from regulators like Stock Exchanges, National Company Law Tribunal(NCLT), Competition Commission of India, etc., drafting of documents such as preparation of scheme, notices/explanatory statements, filing of various documents including e-forms with ROC, filing of scheme of amalgamation with NCLT, etc.

After reading this lesson you will be able to understand the broad regulatory framework with respect to compromise/arrangement, mergers/ demergers.

## REGULATORY FRAMEWORK FOR MERGER/AMALGAMATION

The Regulatory Framework of Mergers and Amalgamations (M&A) covers

1. The Companies Act, 2013
2. The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 made under Chapter XV of the Companies Act 2013
3. Companies Court Rules, 1959
4. Income Tax Act, 1961
5. SEBI (Listing Obligation & Disclosure Requirements) Regulations, 2015
6. The Indian Stamp Act, 1899
7. Competition Act, 2002

### 1. COMPANIES ACT 2013

Chapter XV of Companies Act, 2013 comprising Section 230 to 240 contains provisions on 'Compromises, Arrangements and Amalgamations'. The scheme of Chapter XV goes as follows.

1. Section 230-231 deals with compromise or arrangements.
2. Section 232 deals with mergers and amalgamation including demergers.
3. Section 233 deals with amalgamation of small companies.
4. Section 234 deals with amalgamation of company with foreign company.
5. Section 235 deals with acquisition of shares of dissenting shareholders.
6. Section 236 deals with purchase of minority shareholding.
7. Section 237 deals with power of Central Government to provide for amalgamation of companies in public interest.
8. Section 238 deals with registration of offer of schemes involving transfer of shares.
9. Section 239 deals with preservation of books and papers of amalgamated companies.
10. Section 240 deals with liability of officers in respect of offences committed prior to merger, amalgamation, etc.

### 2. The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 made under Chapter XV of the Companies Act, 2013

The scope of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 made under Chapter XV of the Companies Act, 2013 includes detailed procedural aspects relating to substantive law.

### 3. Companies Court Rules 1959

Rules 67-87 contain provisions dealing with the procedure for carrying out a scheme of compromise or arrangement including amalgamation or reconstruction.

### 4. Income Tax Act 1961

The Income Tax Act, 1961 covers aspects such as tax reliefs to amalgamating/amalgamated companies,

carry forward of losses, exemptions from capital gains tax, etc. For example, when a scheme of merger or demerger involves the merger of a loss making company or a hiving off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, *inter alia*, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferee Company.

### **5. SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015**

Regulation 37 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, provides that the listed entity shall not file any scheme of arrangement under sections 391-394 and 101 of the Companies Act, 1956 or under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, with any Court or Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

Generally, stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the Takeover Code or the SEBI (ICDR) Regulations, Stock Exchanges accord their approval.

The listed entity shall place the Observation letter or No-objection letter of the stock exchange(s) before the Court or Tribunal at the time of seeking approval of the scheme of arrangement. The validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Court or Tribunal.

### **6. The Indian Stamp Act 1899**

It is necessary to refer to the Stamp Act to check the stamp duty payable on transfer of undertaking through a merger or demerger.

### **7. Competition Act 2002**

The provisions of Competition Act and the Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 are to be complied with.

## **PROVISIONS OF THE COMPANIES ACT 2013**

### **POWER TO COMPROMISE OR MAKE ARRANGEMENTS WITH MEMBERS OR CREDITORS**

#### **Tribunal to order meeting of members/creditors, etc.**

Section 230(1) states that when a compromise or arrangement is proposed—

- (a) between a company and its creditors or any class of them; or
- (b) between a company and its members or any class of them,

the Tribunal may, on the application of the (i) company, or (ii) any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator, appointed under this Act or under Insolvency and Bankruptcy Code, 2016 order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

For the purposes of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both these methods.

### **Affidavit by the applicant to disclose certain material facts**

Section 230(2) states that the company or any other person, by whom an application is made under sub-section (1), shall disclose to the Tribunal by affidavit—

- (a) all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;
- (b) reduction of share capital of the company, if any, included in the compromise or arrangement;
- (c) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent of the secured creditors in value, including—
  - (i) a creditors' responsibility statement in the prescribed form;
  - (ii) safeguards for the protection of other secured and unsecured creditors;
  - (iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;
  - (iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and
  - (v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

### **Notice of the meeting**

Section 230(3) states that when a meeting is proposed to be called in pursuance of an order of the Tribunal under sub-section (1), a notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by

- a statement disclosing the details of the compromise or arrangement,
- a copy of the valuation report, if any, and
- explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders, and
- the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
- such other matters as may be prescribed:

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed:

When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.



### **Notice to provide for voting by themselves or through proxy or through postal ballot**

Sub-section (4) of section 230 states that a notice under sub-section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice.

### **Who can object to the scheme?**

Any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

### **Notice to be sent to the regulators seeking their representations**

Section 230(5) states that a notice under sub-section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the Income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

### **Approval and sanction of the scheme**

Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be and the contributories of the company.

### **Order of the Tribunal sanctioning the scheme to provide for the following matters [Section 280(7)]**

An order made by the Tribunal under sub-section (6) shall provide for all or any of the following matters, namely:—

- (a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;
- (b) the protection of any class of creditors;
- (c) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;
- (d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;
- (e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement.

**Accounting treatment proposed in the scheme to be in conformity with accounting standards**

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

**Order of Tribunal to be filed with the Registrar**

Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

**Tribunal may dispense with calling of meeting of creditors**

Section 230(9) states that the Tribunal may dispense with calling of a meeting of creditors or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

**Compromise in respect of buy back is to be in compliance with section 68**

As per Section 230(10), no compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

**Compromise includes takeover (This sub-section is not yet notified)**

Section 230(11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

*Do provisions of section 66 apply with respect to reduction of capital effected in pursuance of order of Tribunal under section 230?*

Provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

**POWER OF THE TRIBUNAL TO ENFORCE COMPROMISE OR ARRANGEMENT**

As per section 231(1), when the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

- (a) shall have power to supervise the implementation of the compromise or arrangement; and
- (b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

Sub-section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up the company and such an order shall be deemed to be an order made under section 273.

## MERGER AND AMALGAMATION OF COMPANIES

### Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies

Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal—

- (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and
- (b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies,

the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply *mutatis mutandis*.

### Circulation of documents for members'/creditors' meeting

Section 232(2) states that when an order has been made by the Tribunal under sub-section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:—

- (a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
- (b) confirmation that a copy of the draft scheme has been filed with the Registrar;
- (c) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;
- (d) the report of the expert with regard to valuation, if any;
- (e) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

### Sanctioning of scheme by Tribunal

Section 232(3) states that the Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

- (a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;
- (b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

***No transferee company can hold shares in its own name or under any trust***

A transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished;

- (c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer;
- (d) dissolution, without winding-up, of any transferor company;
- (e) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;
- (f) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;
- (g) the transfer of the employees of the transferor company to the transferee company;
- (h) when the transferor company is a listed company and the transferee company is an unlisted company,—
  - (A) the transferee company shall remain an unlisted company until it becomes a listed company;
  - (B) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal:
 

The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;
- (i) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and
- (j) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out.

**Auditor's certificate as to conformity with accounting standards**

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

**Transfer of property or liabilities**

Sub-section (4) of Section 232 states that an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect.

### **Certified copy of the order to be filed with the Registrar**

Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

### **Effective date of the scheme**

Section 232(6) states that the scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

### **Annual statement certified by CA/CS/CWA to be filed with Registrar every year until the completion of the scheme**

Section 232 (7) states that every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

### **Punishment**

Section 232(8) states that if a transferor company or a transferee company contravenes the provisions of this section, the transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

### **Explanation under Section 232**

For the purpose of the Section, —

- (i) in a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company;
- (ii) references to merging companies are in relation to a merger by absorption, to the transferor and transferee companies, and, in relation to a merger by formation of a new company, to the transferor companies;
- (iii) a scheme involves a division, where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company; and
- (iv) property includes assets, rights and interests of every description and liabilities include debts and obligations of every description.

### **MERGER AND AMALGAMATION OF CERTAIN COMPANIES**

Section 233 prescribes simplified procedure for Merger or amalgamation of —

- two or more small companies, or
- between a holding company and its wholly-owned subsidiary company or
- such other class or classes of companies as may be prescribed.

### **Merger of small companies/holding and subsidiary companies**

Accordingly, sub-section (1) of Section 233 states that notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:—

- (a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;
- (b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent of the total number of shares;
- (c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and
- (d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

### **Transferee company to file a copy of scheme approved**

Section 233(2) states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

### **Central Government to issue confirmation order, where there are no objections or suggestions from Registrar or Official Liquidator**

Section 233(3) states that on the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

### **Objections if any by the Registrar or Official Liquidator to be communicated to the central government**

Section 233(4) provides that if the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

### **Application by Central Government to the Tribunal**

Section 233(5) states that if the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

### **Tribunal's Action to Central Government's application**

Section 233(6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

If the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

### **Registrar having jurisdiction over transferee company has to be communicated**

Section 233(7) states that a copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

### **Effect of registration of the scheme**

Section 233(8) states that registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding-up.

### **Section 233(9) states that the registration of the scheme shall have the following effects, namely:—**

- (a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;
- (b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;
- (c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and
- (d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

### **Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished**

Section 233(10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

### **Transferee Company to file an application with Registrar along with the scheme registered**

Section 233(11) provides that the transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

## MERGER OR AMALGAMATION OF A COMPANY WITH A FOREIGN COMPANY

Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

For the purposes of sub-section (2), the expression “foreign company” means any company or body corporate incorporated outside India whether having a place of business in India or not.

Section 234(1) states that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply *mutatis mutandis* to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

## Power to Acquire Shares of Shareholders Dissenting from Scheme or Contract Approved by Majority

Section 235(1) provides that where a scheme or contract involving the transfer of shares or any class of shares in a company (the transferor company) to another company (the transferee company) has, within four months after making of an offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, other than shares already held at the date of the offer by, or by a nominee of the transferee company or its subsidiary companies, the transferee company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

Section 235(2) provides that where a notice under sub-section (1) is given, the transferee company shall, unless on an application made by the dissenting shareholder to the Tribunal, **within one month from the date on which the notice** was given and the Tribunal thinks fit to order otherwise, be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

Section 235(3) provides that where a notice has been given by the transferee company under sub-section (1) and the Tribunal has not, on an application made by the dissenting shareholder, made an order to the contrary, the transferee company shall, on the expiry of one month from the date on which the notice has been given, or, if an application to the Tribunal by the dissenting shareholder is then pending, after that application has been disposed of, send a copy of the notice to the transferor company together with an instrument of transfer, to be executed on behalf of the shareholder by any person appointed by the transferor company and on its own behalf by the transferee company, and pay or transfer to the transferor company the amount or other consideration representing the price payable by the transferee company for the shares which, by virtue of this section, that company is entitled to acquire, and the transferor company shall—

- (a) thereupon register the transferee company as the holder of those shares; and
- (b) within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration representing the price payable to them by the transferee company.



Section 235(4) states that any sum received by the transferor company under this section shall be paid into a separate bank account, and any such sum and any other consideration so received shall be held by that company in trust for the several persons entitled to the shares in respect of which the said sum or other consideration were respectively received and shall be disbursed to the entitled shareholders within sixty days.

According to Section 235(5), in relation to an offer made by a transferee company to shareholders of a transferor company before the commencement of this Act, this section shall have effect with the following modifications, namely:—

- (a) in sub-section (1), for the words “the shares whose transfer is involved other than shares already held at the date of the offer by, or by a nominee of, the transferee company or its subsidiaries”, the words “the shares affected” shall be substituted; and
- (b) in sub-section (3), the words “together with an instrument of transfer, to be executed on behalf of the shareholder by any person appointed by the transferee company and on its own behalf by the transferor company” shall be omitted.

Explanation.— For the purposes of this section, “dissenting shareholder” includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract.

### **Purchase of Minority Shareholding**

Section 236 of Companies Act 2013, provides following provisions for the purchase of minority shareholding-

- (1) In the event of an acquirer, or a person acting in concert with such acquirer, becoming registered holder of ninety per cent or more of the issued equity share capital of a company, or in the event of any person or group of persons becoming ninety per cent majority or holding ninety per cent of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, shall notify the company of their intention to buy the remaining equity shares.
- (2) The acquirer, person or group of persons under sub-section (1) shall offer to the minority shareholders of the company for buying the equity shares held by such shareholders at a price determined on the basis of valuation by a registered valuer in accordance with such rules as may be prescribed.
- (3) Without prejudice to the provisions of sub-sections (1) and (2), the minority shareholders of the company may offer to the majority shareholders to purchase the minority equity shareholding of the company at the price determined in accordance with such rules as may be prescribed under sub-section (2).
- (4) The majority shareholders shall deposit an amount equal to the value of shares to be acquired by them under sub-section (2) or sub-section (3), as the case may be, in a separate bank account to be operated by the transferor company for at least one year for payment to the minority shareholders and such amount shall be disbursed to the entitled shareholders within sixty days:

Provided that such disbursement shall continue to be made to the entitled shareholders for a period of one year, who for any reason had not been made disbursement within the said period of sixty days or if the disbursement have been made within the aforesaid period of sixty days, fail to receive or claim payment arising out of such disbursement.

- (5) In the event of a purchase under this section, the transferor company shall act as a transfer agent for receiving and paying the price to the minority shareholders and for taking delivery of the shares

and delivering such shares to the majority, as the case may be.

- (6) In the absence of a physical delivery of shares by the shareholders within the time specified by the company, the share certificates shall be deemed to be cancelled, and the transferor company shall be authorised to issue shares in *lieu* of the cancelled shares and complete the transfer in accordance with law and make payment of the price out of deposit made under sub-section (4) by the majority in advance to the minority by despatch of such payment.
- (7) In the event of a majority shareholder or shareholders requiring a full purchase and making payment of price by deposit with the company for any shareholder or shareholders who have died or ceased to exist, or whose heirs, successors, administrators or assignees have not been brought on record by transmission, the right of such shareholders to make an offer for sale of minority equity shareholding shall continue and be available for a period of three years from the date of majority acquisition or majority shareholding.
- (8) Where the shares of minority shareholders have been acquired in pursuance of this section and as on or prior to the date of transfer following such acquisition, the shareholders holding seventy-five per cent or more minority equity shareholding negotiate or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement, the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a *pro rata* basis.

*Explanation.*— For the purposes of this section, the expressions “acquirer” and “person acting in concert” shall have the meanings respectively assigned to them in clause (b) and clause (e) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

- (9) When a shareholder or the majority equity shareholder fails to acquire full purchase of the shares of the minority equity shareholders, then, the provisions of this section shall continue to apply to the residual minority equity shareholders, even though,—
  - (a) the shares of the company of the residual minority equity shareholder had been delisted; and
  - (b) the period of one year or the period specified in the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, had elapsed.

## **POWER OF THE CENTRAL GOVERNMENT TO PROVIDE FOR AMALGAMATION OF COMPANIES IN PUBLIC INTEREST**

### **Power of Central Government to provide for amalgamation of Companies**

Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

### **Continuation of legal proceedings**

Section 237(2) states that the order under sub-section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

### **Interest or rights of members, creditors, debenture holders not to be affected.**

As per Section 237(3), every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

### **Appeal to Tribunal**

As per Section 237(4), any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

### **Conditions for order under Section 237**

As per Section 237(5), no order shall be made under this section unless—

- (a) a copy of the proposed order has been sent in draft to each of the companies concerned;
- (b) the time for preferring an appeal under sub-section (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and
- (c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

### **Copies of order to be laid before each house of Parliament**

As per Section 237(6), the copies of every order made under this section shall, as soon as may be after it has been made, be laid before each House of Parliament.

### **Registration of offer of schemes involving transfer of shares**

Section 238(1) states that in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235,—

- (a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed;
- (b) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available; and
- (c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered: Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

Section 238(2) states that an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under sub-section (1).

Section 238(3) states that the director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

### **Preservation of books and papers of amalgamated company**

As per section 239, the books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

### **Liability of officers in respect of offences committed prior to amalgamation**

As per Section 240, notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

## **LESSON ROUND-UP**

- Section 230(1) states that when a compromise or arrangement is proposed—
  - (a) between a company and its creditors or any class of them; or
  - (b) between a company and its members or any class of them,
- the Tribunal may, on the application of the (i) company, or (ii) of any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.
- Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company.
- Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.
- Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal—
  - (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and
  - (b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred





# Lesson 28

## Producer Companies

### LESSON OUTLINE

- Concept of producer companies
- Objects of producer company
- Formation and registration of producer company
- Membership and voting rights of members
- Benefits to members
- Memorandum of Association, Articles of Association and their content
- Conversion of inter-state co-operative society into Producer Company
- Appointment of directors, vacation of office, liability of directors, their committee
- Powers and functions of the board, meetings of the board and quorum
- Committee of Board
- Chief Executive and his functions
- Secretary of Producer Company
- Annual general meetings.
- Share capital, transferability of shares and surrender, issue of bonus shares
- Amalgamation, merger or division to form new Producer Companies
- Disputes and striking off name

### LEARNING OBJECTIVES

There are different forms of business organizations. The company form of business organization is one of them. A producer company is one of the said company form of business organization. These type of companies work like co-operative societies and are mainly registered in rural areas by the producers. These companies are incorporated to develop the rural economies and bridge the gap between industry and agriculture, rural and urban area and industry and labour, etc. These companies are basically for the promotion of rural economies.

After reading this lesson you will be able to understand the concept of Producer Companies introduced by the Companies (Amendment) Act, 2002. The provisions not only provide an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. You will also understand the provisions which enable the conversion of an existing co-operative society into a company as well as the incorporation of a Producer Company and the provisions relating to membership, management, meetings, share capital etc. of Producer Companies.

Proviso to Section 465(1) of Companies Act 2013, states that provisions of Part IX A of the Companies Act, 1956 shall be applicable *mutatis mutandis* to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies. The 'Act' under this Chapter refers to Companies Act, 1956, unless specifically mentioned.

## 1. GENESIS

The Companies (Amendment) Act, 2002 has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies. Rural producers have been at a potential disadvantage given their generally limited assets, resources, education and access to advanced technology. In the present scenario, there is an emerging need of changing the terms of trade between rural and urban, labour and industry, finance and commerce. Therefore, if cooperative enterprises are to continue to serve rural producers, they require an alternative to the institutional form presently available under law.

This provision, by virtue of Companies (Amendment) Act, 2002 not only provides an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. The conversion to producer companies will enable them to invite greater investments and modernize themselves. They can take advantage of the provisions to reinvent themselves, and function more efficiently. Accordingly, it is specified that a 'producer' shall mean any person engaged in any activity connected with or relatable to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.

The Amendment Act also includes the insertion of the provisions which enables the conversion of an existing co-operative society into a company as well as the incorporation of a Producer Company. This part contains specific provisions relating to incorporation, management, meetings, share capital etc. of Producer Companies.

### COMPANIES ACT, 2013 AND PRODUCER COMPANIES

Proviso to Section 465(1) of Companies Act, 2013 states that provisions of Part IX A of the Companies Act, 1956 shall be applicable *mutatis mutandis* to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies. Accordingly Part IX of companies Act, 1956 would continue for producer companies.

## 2. OBJECTS OF PRODUCER COMPANY

A Producer company means a body corporate, having objects or activities specified in Section 581B and registered as Producer Company. Hence, the objectives for which Producer Companies may be formed are laid down in Section 581B. These include *inter alia*, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery, etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/ consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.

However, in terms of Section 581B of the Companies Act, 1956, the objects of the Producer Company shall relate to all or any of the following matters, namely:

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import of goods or services for their benefit:

Provided that the Producer company may carry on any of the activities specified in this clause either by itself or through other institution;



- (b) processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its Members;
- (c) manufacture, sale or supply of machinery, equipment or consumables mainly to its Members;
- (d) providing education on the mutual assistance principles to its Members and others;
- (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its Members;
- (f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce;
- (g) insurance of producers or their primary produce;
- (h) promoting techniques of mutuality and mutual assistance;
- (i) welfare measures or facilities for the benefit of Members as may be decided by the Board;
- (j) any other activity, ancillary or incidental to any of the activities referred to in Clauses (a) to (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner;
- (k) financing of procurement, processing, marketing or other activities specified in Clauses (a) to (j) which include extending of credit facilities or any other financial services to its Members.

Every Producer Company shall deal primarily with the produce of its active members for carrying out any of its specified objects. This means there is an obligation on the producer company to deal primarily with the active members in conducting its activities. The expression 'active member' has been defined in Clause (a) of Section 581A to mean a member who fulfils the quantum and period of patronage of the producer company as may be required by the articles of the producer company. The patronage means the use of services offered by the Producer Company to its members by participation in its business activities.

## REVIEW QUESTIONS



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

There is an obligation on the Producer Company to deal primarily with the produce of its active members in carrying out its specified objects.

- True
- False

**Correct answer: True**

## 3. FORMATION OF PRODUCER COMPANY AND ITS REGISTRATION

Section 581C of the Act provides that, any ten or more individuals, each of them being a producer or two or more producer institutions or a combination of ten or more individuals and producer institutions, desirous of forming a producer company may form an incorporated company as such having its objects, specified in

Section 581B as producer company under this Act after complying with the requirements and the provisions of the Act in respect of registration. 'Producer institution' means a Producer Company or any other institution having only producer or producers or Producer Company or Producer Companies as its member whether incorporated or not, having any of the objects referred to in Section 581B and which agrees to make use of the services of the Producer Company or Producer Companies as provided in its articles.

The Registrar on being satisfied that all requirements relating to registration and incidental matters have been complied with, shall register the memorandum, articles and other documents and issue a certificate of incorporation within 30 days of the receipt of the documents for registration. On registration, the Producer Company shall be deemed to be a private company limited by shares without any limit on the number of members.

The direct costs associated with the promotion and registration of the company may be reimbursed by the Producer Company.

#### **4. MEMBERSHIP AND VOTING RIGHTS OF MEMBERS OF PRODUCER COMPANY**

Section 581D of the Act provides that unless the membership of the Producer Company consists of a Producer institution only, every member shall have a single vote irrespective of the number of shares held. In case, where the membership consists solely of Producer Institutions, the voting rights of such Producer institutions shall be determined on their previous year's participation in the business of the company. However, during the first year of its regulation, the voting rights in a Producer Company shall be determined on the basis of shareholding by producer institutions.

Where the membership of Producer Company consists of a combination of individuals and Producer Institutions, every member shall exercise a single vote. The Articles may however, authorize the Producer Company to restrict the voting rights to active members only.

No person, who has any business interest which conflicts with the business of Producer Company, shall become a member of that Producer Company and if subsequently a member acquires any business interest which is in conflict with the business of the Producer Company, he shall cease to be a member.

#### **5. BENEFITS TO MEMBERS**

Section 581E states that, initially every member shall receive only such value of the produce or products pooled and supplied as is determined by the Board of Producer Company and the withheld price may be disbursed later in cash or in kind or by allotment of equity shares. Every such member shall be entitled to receive a limited return and may be allotted bonus shares. 'Withheld price' for this purpose means part of the price due and payable for goods supplied by any member to the Producer Company, and as withheld by the Producer Company for payment on a subsequent date.

Patronage bonus may be disbursed proportionately, if any surplus remains after making provision for limited return and reserves. Patronage bonus refers to the payment by Producer Company out of its surplus income to the members in proportion to their respective patronage.

The approval of Board of directors is necessary for disbursing 'withheld price' whereas for disbursing the 'patronage bonus', either in cash or by way of allotment of equity shares or both, the approval of members at the general meeting is required.

#### **6. MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION**

The Memorandum of Association and the Articles of Association of the Producer Company, duly signed by

the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.

The Memorandum and Articles shall contain the disclosures as provided under the provisions of Sections 581F and 581G respectively and are as under:

### **Contents of Memorandum of Producer Company**

In terms of the provisions of Section 581F of the Act, the Memorandum of Association of every Producer Company shall state the following:

- (a) the name of the company with "Producer Company Limited" as the last words of the name of such Company;
- (b) the State in which the registered office of the Producer Company is to situate;
- (c) the main objects of the Producer Company shall be one or more of the objects specified in Section 581B;
- (d) the names and addresses of the persons who have subscribed to the memorandum;
- (e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount;
- (f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with sub-section (2) of Section 581J;
- (g) that the liability of its members is limited;
- (h) opposite to the subscriber's name the number of shares each subscriber takes:  
Provided that no subscriber shall take less than one share;
- (i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

### **Contents of Articles of Association of Producer Company**

As per Section 581G of the Act, the contents of the Articles of a Producer Company shall contain Mutual Assistance Principles and other provisions, which are as under:

#### **Mutual Assistance Principles**

The articles shall contain the following mutual assistance principles, namely:

- (a) the membership shall be voluntary and available to all eligible persons who, can participate or avail of the facilities or services of the Producer Company, and are willing to accept the duties of membership;
- (b) each Member shall, save as otherwise provided in Part IX of the Act, have only a single vote irrespective of the shareholding;
- (c) the Producer Company shall be administered by a Board consisting of persons elected or appointed as directors in the manner consistent with the provisions of this Part and the Board shall be accountable to the Members;
- (d) save as provided in this Part, there shall be limited return on share capital;
- (e) the surplus arising out of the operations of the Producer Company shall be distributed in an

equitable manner by:

- (i) providing for the development of the business of the Producer Company;
  - (ii) providing for common facilities; and
  - (iii) distributing amongst the Members, as may be admissible in proportion to their respective participation in the business;
- (f) provision shall be made for the education of Members, employees and others, on the principles of mutuality and techniques of mutual assistance;
- (g) the Producer Company shall actively co-operate with other Producer Companies (and other organisations following similar principles) at local, national or international level so as to best serve the interest of their Members and the communities it purports to serve.

### **Other Provisions or Contents of Articles of Producer Company**

The Articles shall also contain the following provisions, namely:

- (a) the qualifications for membership, the conditions for continuance or cancellation of membership and the terms, conditions and procedure for transfer of shares;
- (b) the manner of ascertaining the patronage and voting rights based on patronage;
- (c) subject to the provisions contained in sub-section (1) of Section 581N, the manner of constitution of the Board, its powers and duties, the minimum and maximum number of directors, manner of election and appointment of directors and retirement by rotation, qualifications for being elected or continuance as such and the terms of office of the said directors, their powers and duties, conditions for election or co-option of directors, method of removal of directors and the filling up of vacancies on the Board, and the manner and the terms of appointment of the Chief Executive;
- (d) the election of the Chairman, term of office of directors and the Chairman, manner of voting at the general or special meetings of Members, procedure for voting by directors at meetings of the Board, powers of the Chairman and the circumstances under which the Chairman may exercise a casting vote;
- (e) the circumstances under which, and the manner in which, the withheld price is to be determined and distributed;
- (f) the manner of disbursement of patronage bonus in cash or by issue of equity shares, or both;
- (g) the contribution to be shared and related matters referred to in Section 581Z(I)(2);
- (h) the matters relating to issue of bonus shares out of general reserves as set out in Section 581ZJ;
- (i) the basis and manner of allotment of equity shares of the Producer Company in *lieu* of the whole or part of the sale proceeds of produce or products supplied by the Members;
- (j) the amount of reserves, sources from which funds may be raised, limitation on raising of funds, restriction on the use of such funds and the extent of debt that may be contracted and the conditions thereof;
- (k) the credit, loans or advances which may be granted to a Member and the conditions for the grant of the same;
- (l) the right of any Member to obtain information relating to general business of the company;

- (m) the basis and manner of distribution and disposal of funds available after meeting liabilities in the event of dissolution or liquidation of the Producer Company;
- (n) the authorisation for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith;
- (o) laying of the memorandum and articles of the Producer Company before a special general meeting to be held within ninety days of its registration;
- (p) any other provision, which the Members may, by special resolution recommend to be included in articles.

### **Amendment to Memorandum and Articles**

Amendment in the provisions/clauses of the Memorandum can be done by way of passing a Special Resolution as per Section 581H, whereas, the amendment in the Articles is required to be proposed by not less than two-third of the elected directors or by not less than one-third of the members and adopted by passing a Special Resolution in the general meeting under Section 581-I.

A copy of the amended Memorandum or Articles along with a duly certified copy of Special Resolution thereof are to be filed with the Registrar of Companies within thirty days from the date of its adoption at the general meeting.

## **7. OPTION TO INTER-STATE CO-OPERATIVE SOCIETIES TO BECOME PRODUCER COMPANIES**

An 'Inter-State Co-operative Society' means a Multi-State Co-operative Society as defined in Section 3(p) of Multi-State Co-operative Societies Act, 2002 and includes any co-operative society registered under any other law in force and which has after its formation, extended any of its objects to more than one State.

Section 581J of the Act provides that any Inter-State Co-operative Society whose objects are not confined to one state may submit an application together with the prescribed documents to the Registrar for registration as Producer Company. The Registrar on being satisfied, that all the requirements relating to registration have been complied with, shall within 30 days of receipt of the application, issue a certificate of incorporation and the words "Producer Company Limited" shall form part of its name to explain its identity.

Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith following enclosures and documents:

1. a copy of the Special Resolution passed with 2/3rd majority of the members;
2. a statement showing names, addresses and occupation of the directors and the Chief Executive;
3. a list of the members;
4. a statement indicating that the Inter-State Cooperative Society is engaged in any one or more of the objects specified in Section 581-B;
5. a declaration by two or more directors certifying that the particulars given as per Para (1) to (4) above are correct.

Upon registration as a producer company, the ROCs who registers the company shall immediately intimate the Registrar with whom the Inter-State Cooperative Society was earlier registered, for appropriate deletion of the society from its register.

The 'Inter-State Co-operative Society' shall, upon registration stand transformed into a Producer Company, and shall be governed by the provisions of Part IX-A of the Companies Act, 1956.

## **8. VESTING OF UNDERTAKING IN PRODUCER COMPANY**

Section 581L of the Act provides that all properties, assets, movable or immovable, and all rights, debts, liabilities, interests, privileges and obligations of the Inter-State Co-operative Society shall vest in the Producer Company with effect from the transformation/registration date.

Similarly all sums of money due to Inter-State Co-operative Society immediately before the transformation date shall be deemed to be due to the Producer Company. Every organisation managed by the erstwhile co-operative society, shall henceforth, be managed by the so incorporated Producer Company.

Every organisation getting financial, managerial or technical assistance from the Inter-State Co-operative Society before the 'transformation date', may continue to get such assistance by the Producer Company.

Any pending suit, arbitration, appeal or other legal proceeding, of whatever nature, by or against, the Inter-State Co-operative Society on transformation date may be continued, prosecuted and enforced by or against the Producer Company.

## **9. CONCESSION, ETC. TO BE DEEMED TO HAVE BEEN GRANTED TO PRODUCER COMPANY**

All fiscal and other concessions, licences, benefits, privileges and exemptions granted to the Inter-State Co-operative Society in connection with its affairs and business of the Inter-State Cooperative Society under any law for the time being in force shall be deemed to have been granted from transformation date to the Producer Company. [Section 581M]

## **10. PROVISIONS IN RESPECT OF OFFICERS AND OTHER EMPLOYEES OF INTER-STATE CO-OPERATIVE SOCIETY**

As per Section 581N of the Act, all directors in the Inter-State Co-operative Society before its incorporation as Producer Company, shall continue to be in office for a period of one year from the date of transformation.

Every other officer or employee of such a society (other than a director, chairman or managing director) shall continue to hold office in the so formed Producer Company for the same tenure, at the same remuneration, terms and conditions as he would have held in the Inter-State Co-operative Society.

Any officer or employee of the earlier society opting not to remain in the employment of the newly formed Producer Company, shall be deemed to have resigned.

Officers and employees who have been so transferred from their services shall not be provided any compensation. Similarly, no compensation shall be provided to any director, chairman or managing director of the society on account of premature termination of their contract with the society.

Retired officers and employees of the co-operative society shall continue to receive the same benefits, rights or privileges from the Producer Company.

## **11. NUMBER OF DIRECTORS**

Section 581 of the Act provides that, every Producer Company shall have minimum five and not more than fifteen directors. Provided that in the case of an Inter-State Co-operative Society as a Producer Company, such company may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

## 12. APPOINTMENT OF DIRECTORS

The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors consisting of not less than five directors, who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of Section 581P(2). However, such designation shall remain effective for a period of 90 days only.

The election of directors shall be conducted within a period of ninety days of registration of Producer Company. However, in the case of an Inter-State Co-operative Society, which has been registered as a Producer Company, election of directors should be conducted within a period of three hundred and sixty-five days.

A director shall hold office, as such, for not less than one year but not exceeding five years and every director who retires shall be eligible for re-appointment. The tenure of such directors shall not exceed such period as may be specified in the Articles.

## 13. VACATION OF OFFICE BY DIRECTORS

The office of director of a Producer Company shall become vacant under the following circumstances according to Section 581Q of the Act:

- (a) if he is convicted by a court of any offence involving moral turpitude and sentenced in respect thereto with imprisonment for not less than six months;
- (b) if the Producer Company, in which he is a director, has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for ninety days;
- (c) if he has made a default in repayment of any advances or loans taken from the Producer Company in which he is a director;
- (d) if the Producer Company, in which he is a director:
  - (i) has not filed the annual accounts and annual return for any continuous three financial years commencing on or after the 1st day of April, 2002; or
  - (ii) has failed to, repay its deposit or withheld price or patronage bonus or interest thereon on due date, or pay dividend and such failure continues for one year or more;
- (e) if default is made in holding election for the office of director in the Producer company in which he is a director, in accordance with the provisions of the Companies Act and its Articles;
- (f) if the annual general meeting or extraordinary general meeting of the Producer Company, in which he is a director, is not called in accordance with the provisions of the Act except due to natural calamity or such other reasons.

The above provisions of vacation of the office of a director shall also, apply to the director of that Producer Institution, which is a member of such Producer Company.

## 14. POWERS AND FUNCTIONS OF BOARD

The Board of directors of a Producer Company shall exercise all such powers and do all such acts and things, as a Producer Company is authorized so to do. [Section 581R(1)]

However, in terms of the provisions of Section 581R(2), the Board of Directors may exercise the following powers without prejudice to the generality of the foregoing powers:

- (a) determination of the dividend payable;

- (b) determination of the quantum of withheld price and recommend patronage to be approved at general meeting;
- (c) admission of new Members;
- (d) pursue and formulate the organisational policy, objectives, establish specific long-term and annual objectives, and approve corporate strategies and financial plans;
- (e) appointment of a Chief Executive and such other officers of the Producer Company, as may be specified in the Articles;
- (f) exercise superintendence, direction and control over Chief Executive and other officers appointed by it;
- (g) cause proper books of account to be maintained; prepare annual accounts to be placed before the annual general meeting with the auditor's report and the replies on qualifications, if any, made by the auditors;
- (h) acquisition or disposal of property of the Producer Company in its ordinary course of business;
- (i) investment of funds of the Producer Company in the ordinary course of its business;
- (j) sanction any loan or advance, in connection with the business activities of the Producer Company to any Member, not being a director or his relative;
- (k) take such other measures or do such other acts as may be required in the discharge of its functions or exercise of its powers.

All the above powers can be exercised only by means of a resolution passed by the Board at its meeting on behalf of the Producer Company.

## **15. MATTERS TO BE TRANSACTED AT THE GENERAL MEETING**

Section 581S states that the following powers shall be exercised by the Board of directors on behalf of the company only by means of passing of resolutions at the annual general meeting of the company:

- (a) approval of budget and adoption of annual accounts;
- (b) approval of patronage bonus;
- (c) issue of bonus shares;
- (d) declaration of limited return and decision on the distribution of patronage;
- (e) specify the conditions and limits of loans that may be given by the Board to any director; and
- (f) approval of any transaction of the nature as is to be reserved in the Articles for approval by the Members.

## **16. LIABILITY OF DIRECTORS**

Section 581T, provides that anything done by the directors, whether by way of voting on a resolution or approving by any other means, anything, in contravention of the provisions of this Act or any other law for the time being in force, or its Articles, shall make them jointly and severally liable towards the Producer Company to make good the loss or damage suffered by such company.

Where as a result of the above, such director has made any profit, the Producer Company shall have the right to recover an amount equal to said profits from such director.



The liability so imposed shall be in addition to and not in derogation of a liability imposed under this Act or any other law for the time being in force.

## 17. COMMITTEE OF DIRECTORS

Section 581U states that the Board may constitute such number of committees as it may deem fit for the purposes of assisting the Board in efficient discharge of its functions. However, the Board of directors shall not delegate any of its powers or assign the powers of the Chief Executive, to any committee of directors.

The committee of the Board may, with the approval of the Board, co-opt such number of persons, as it deems fit, as the members of the committee. Provided that the Chief Executive appointed under Section 581W or a director of Producer Committee shall be a member of such committee. [Section 581U(2)]

Every such committee shall function under general superintendence, direction and control of the Board as may be specified. Further, the fees and allowances to be paid to the members of the committee and the tenure of the committee shall be such as may be determined by the Board. The minutes of every Committee meeting shall be placed before the next Board meeting.

## 18. MEETINGS OF THE BOARD AND QUORUM

As per Section 581V, the Board meeting of a Producer Company shall be held at least once in every three months and at least four such meetings shall be held in every year. The Chief Executive shall give notice to every director for the time being in India, and at his usual address in India to every other director at least seven days prior to the date of meeting. However, a Board meeting may also be called at a shorter notice after recording reasons thereof in writing.

The quorum for the meeting shall be one-third of the total strength of directors, subject to a minimum of three.

Unless otherwise provided in the Articles, such sitting fees and allowances may be paid to the directors attending the meetings, as decided by the members.

## 19. CHIEF EXECUTIVE AND HIS FUNCTIONS

As per Section 581W, a full time Chief Executive shall be appointed by the Board by whatever name called who, shall not be a member of the company. He shall be the ex-officio director, and shall not retire by rotation. The qualifications, experience and the terms and conditions shall be such as may be determined by the Board. The Chief Executive, who shall be entrusted with substantial powers of the management, shall manage the affairs of the Producer Company but subject to the superintendence, direction and control of the Board and be accountable to the Board for the performance of the Producer Company.

The various functions that may be discharged by a chief executive may *inter alia* include managing the day to day affairs of the company, maintaining proper books of accounts, furnishing members with periodic information, assisting the Board with respect to legal and regulatory matters making appointments and discharge of such other functions as may be delegated by the Board.

## 20. SECRETARY OF PRODUCER COMPANY

Section 581X of the Act provides that every Producer Company having an average annual turnover exceeding five crore rupees in each of three consecutive financial years shall appoint a member of the Institute of Company Secretaries of India as a whole-time Secretary of the company.

If a Producer Company fails to appoint Company Secretary, the company and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during

which the default continues. However, in any proceedings against a person in respect of an offence for failure to appoint a Company Secretary, it shall be a defence to prove that all reasonable efforts were taken to comply with the provisions or that the financial position of the company was such that it was beyond its capacity to appoint a whole-time secretary.

## **21. QUORUM OF THE GENERAL MEETING**

Section 581Y of the Act provides that unless Articles of Association require a larger number, one-fourth of the total membership shall constitute the quorum at a general meeting.

## **22. VOTING RIGHTS**

Section 581Z states that except as provided in Section 581D(1) (regarding voting rights of individual members and Producer Institutions), and 581D(3) (regarding voting rights to active members), every member of the Producer Company shall have one vote irrespective of the number of shares held by him. In the case of equality of votes, the Chairman or the person presiding over the meeting shall have a casting vote, except in the matter of election of the Chairman.

## **23. ANNUAL GENERAL MEETINGS [SECTION 581ZA]**

Every Producer Company shall hold its first Annual General Meeting (AGM) within a period of ninety days from the date of its incorporation.

Not more than fifteen months shall elapse between the date of one AGM of the Producer Company and that of the next AGM. The Registrar may, for any special reason, permit the extension of time for holding of an AGM (not being the first AGM) by a period not exceeding three months. Notice in writing indicating date, time and place of the meeting shall be given at least fourteen days before the meeting and shall also be accompanied by the following documents which shall be sent to every member and auditor of the company:

- (a) agenda of the meeting;
- (b) minutes of the previous annual general meeting or extraordinary general meeting;
- (c) names and qualifications of candidates for election of directors;
- (d) audited balance sheet, profit and loss account and Board's report of the company in respect of specified disclosures and its subsidiaries, if any;
- (e) draft resolution for appointment of auditors;
- (f) draft resolution for proposed amendment, if any, in memorandum or articles.

The Annual General Meeting shall be held during business hours, on a day not being a public holiday at the registered office of the company or at any other place within the city, town or village where the registered office of the company is situated.

Unless the Articles provide for a larger number, the quorum of the general meeting shall be one-fourth of the total number of members.

Within sixty days from the date of the annual general meeting, the company is required to file the proceedings of the meeting, the audited balance sheet, the profit and loss account and the Director's report together with an annual return along with the filing fees with the Registrar.

On the requisition made in writing and duly signed by not less than one-third of the members, the Board of directors shall call an Extraordinary General Meeting (EGM) in accordance with the provisions of Section 169 and Section 186 of Companies Act, 1956. (Corresponding Section 100 of the Companies Act, 2013).

Where a Producer Company is formed by Producer Institutions then such Institutions shall be represented in the general body through the Chairman or the Chief Executive thereof who shall be competent to act on its behalf, except in case of default under Section 581Q(1).

## REVIEW QUESTIONS



### Choose the correct answer

Within how many days from the date of its incorporation should a Producer Company hold its first Annual General Meeting ?

- (a) Sixty
- (b) Eighty
- (c) Ninety
- (d) Thirty

**Correct answer: (c)**

## 24. SHARE CAPITAL

As per Section 581ZB of the Act, a Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company.

However, in terms of Section 581ZC, the Producers who are active members may, if so provided in the articles, have special rights and the Producer Company may issue appropriate instruments to them in respect of such special rights.

### Transferability of shares and attendant rights

A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board under Section 581ZD. Special rights for this purpose means any rights relating to supply of additional produce by the active member or any other rights relating to his produce conferred on him by the Board.

Within three months from the date of his becoming a member, such person shall nominate his nominee, to whom the shares shall vest in the event of his death.

### Surrender of shares

If the Board of a Producer Company is satisfied that any member has ceased to be a primary member, or he has failed to retain his qualifications, necessary to enable him to remain the member of the Producer Company, then Board may direct him to surrender his shares to the company together with Special Rights, if any, attached therewith, at the value determined by the Board. Alternatively, the Board may direct the issuance of a notice to such member. [Section 581ZD(5)]

## 25. BOOKS OF ACCOUNT

Every producer company shall keep at its registered office, proper books of account with respect to matters specified under Section 581ZE of the Act. The balance sheet and profit and loss account of the Producer Company shall be prepared in accordance with Section 211.

The matters specified under Section 581ZD are as under:

1. Sums of money received and expended.

2. Sales and Purchase of goods.
3. Instruments of liability executed by or on behalf of the company.
4. Assets and liabilities.
5. Utilisation of materials or labour or other items of cost.

## **26. INTERNAL AUDIT**

As per Section 581ZF of the Act, every Producer Company shall have internal audit conducted of its accounts at such intervals in such manner as may be specified in its Articles, by a chartered accountant.

## **27. DONATIONS OR SUBSCRIPTION BY PRODUCER COMPANY**

Section 581ZH provides that a Producer Company, by passing a special resolution, may make donation for promoting social and economic welfare and mutual assistance principles in a financial year to the extent of three percent of the net profit of the company in the preceding financial year. However, a Producer Company is strictly prohibited from making donation for political purposes.

## **28. GENERAL AND OTHER RESERVES**

In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by Section 581ZI.

The Department of Company Affairs (Now Ministry of Corporate Affairs) has issued Producer Companies (General Reserve) Rules, 2003 *vide* F.No. 1/1/2003-CL.V dated 7.8.2003, which is applicable to the companies formed and registered under Section 581C of the Companies Act, 1956.

These Rules define a “co-operative society” to mean a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State.

As per the Rules, a Producer Company shall make investments from and out of its general reserves in the following manner, maintained by it in terms of the provisions of Section 581ZI of the Act:

- (a) in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or Cooperative Societies or scheduled bank, or
- (b) in a cooperative bank, State Cooperative Bank, Cooperative land development bank or Central cooperative bank, or
- (c) with any other scheduled bank, or
- (d) in any of the securities specified in Section 20 of the Indian Trust Act, 1882, or
- (e) in the shares or securities of any other multi-state cooperative society or any cooperative society, or
- (f) in the shares, securities or assets of a public financial institutions specified under Section 4A of the Companies Act, 1956.

The Department of Company Affairs has *vide* Notification No. GSR 146(E) dated 9.03.2006 amended the Procedure Companies (General Reserves) Rules, 2003. As per the amended rules investments may be made in any one or in combination of the above.

## **29. ISSUE OF BONUS SHARES**

A Producer company may, after

- the recommendation of the Board, and
- passing of a resolution in General Meeting;

issue bonus shares to its members in proportion to the shares held by them, on the date of the issuance of such shares, by capitalising the amounts from its general reserves. [Section 581ZJ].

### **30. LOAN, ETC. TO MEMBERS [SECTION 581ZK]**

The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members. However, any loan or advance to any director or his relative shall be granted only after the approval of members by a resolution.

### **31. INVESTMENT IN OTHER COMPANIES, FORMATION OF SUBSIDIARIES ETC. [SECTION 581ZL]**

The Producer Company may invest its general reserves in approved securities, fixed deposits, units, bonds issued by the government or a cooperative or scheduled bank or in such other mode as may be prescribed. It may, for the promotion of its objectives also acquire shares of other Producer Companies. However, special resolution is required to be passed for acquisition of shares of any other Producer Company or entering into agreement for the formation of subsidiaries or joint venture.

Investment in shares of any other company other than Producer Company cannot exceed thirty per cent of the aggregate of its paid-up capital and free reserves, except where a special resolution has been passed and the prior approval of the Central Government has been obtained. However, such investments should be consistent with the objects of the Producer Company. For disposal of any of its investments, special resolution shall be passed by the Board. A register containing particulars of all investments as prescribed shall be kept in the registered office and shall be open to the members of the company for inspection and taking extracts therefrom.

### **32. AMALGAMATION, MERGER OR DIVISION, ETC., TO FORM NEW PRODUCER COMPANIES**

Section 581ZN provides comprehensive provisions for the schemes of amalgamation, merger or division, etc. of Producer Company.

A Producer Company may, by a resolution passed at its general meeting:

- (a) transfer its assets and liabilities, wholly or partly, to any other Producer Company, for any of the objectives specified in Section 581B if other Producer Company so agrees by passing a resolution at its general meeting;
- (b) divide itself into two or more Producer Companies;

Also, two or more Producer Companies may, by a resolution passed at any general or special meetings of its members, decide to:

- (a) amalgamate and form a new Producer Company; or
- (b) merge one Producer Company with another Producer Company.

The resolutions referred to above shall be passed by not less than two-thirds of its members present and voting. However, prior to such resolution a copy of proposed resolution shall be forwarded to all the members and creditors for their consent.

Section 581ZN(5) makes provisions to satisfy the claims of dissenting members and creditors of such amalgamating Producer Companies.

### **33. DISPUTES**

As per Section 581ZO, any dispute relating to the formation, management or business of a Producer

Company shall be settled by conciliation or by arbitration as provided under the Arbitration and Conciliation Act, 1996.

#### 34. STRIKING OFF NAME OF PRODUCER COMPANY

Section 581ZP states that the Registrar can after making an inquiry strike-off the name of a company where the company:

- (i) has failed to commence its business within one year of its registration;
- (ii) ceases to transact business;
- (iii) is no longer carrying on its objectives;
- (iv) is not following the mutual assistance principles.

The Registrar shall, before passing the order issue a show cause notice to the company with a copy to the directors and give a reasonable opportunity of being heard. Any member of the Producer Company aggrieved by an order may appeal to CLB within sixty days of passing an order.

#### 35. RE-CONVERSION OF PRODUCER COMPANY TO INTER-STATE CO-OPERATIVE SOCIETY

Any Producer Company may make an application, after a resolution has been passed in the general meeting by not less than two-third of its members present and voting or on request by its creditors representing three-fourth of its value of creditors, to the High Court for its re-conversion to Inter-State Co-operative Society, and follow the procedure as laid down in Section 581ZS of the Act.

#### LESSON ROUND-UP

- Proviso to Section 465(1) states that provisions of Part IX A of the Companies Act, 1956 shall be applicable *mutatis mutandis* to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies:
- The Companies (Amendment) Act, 2002 has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies.
- A 'producer' shall mean any person engaged in any activity connected with or relating to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.
- Objectives for which Producer Companies may be formed include *inter alia*, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery, etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.
- The Act provides that, any ten or more individuals, each of them being a producer or two or more producer institutions or a combination of ten or more individuals and producer institutions, desirous of forming a producer company may form an incorporated company, as such having its objects specified under this Act after complying with the requirements and the provisions of the Act in respect of registration.
- Unless the membership of the Producer Company consists of a Producer institution only, every member shall have a

single vote irrespective of the number of shares held. Further, every such member shall be entitled to receive a limited return and may be allotted bonus shares.

- The Memorandum of Association and Articles of Association of the Producer Company, containing the disclosures as required under the Act and duly signed by the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.
- Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith enclosures and documents as required under the Act.
- The Act gives provisions regarding concessions deemed to have been granted to Producer Company and in respect of officers and other employees.
- The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of the Act. Minimum and maximum number of directors has been given under the Act as also their powers and the circumstances under which the office of director of a Producer Company shall become vacant. Provisions for meeting of the board and quorum are also given therein.
- The Board may constitute such number of committees as it may deem fit for the purpose of assisting the Board in efficient discharge of its functions.
- A full time Chief Executive shall be appointed by the Board by whatever name called who shall not be a member of the company.
- Every Producer Company having an average annual turnover exceeding ₹ Five crores in three consecutive financial years shall appoint a whole-time Secretary of the company. The Whole time Secretary should be member of the Institute of Company Secretaries of India.
- Provisions for conducting an Annual General Meeting along with notice contents have also been provided under the Companies Act.
- A Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company. A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board. The board may direct a member to surrender his shares to the company if he ceases to be a primary member or fails to retain his qualifications essential for being a member.
- Every Producer Company shall keep proper books of account with respect to matters specified in the Act and shall have internal audit of its account as may be specified in its Articles, by a Chartered Accountant.
- In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by the Companies Act. A Producer Company may issue bonus shares to its members by capitalizing the amount from its general reserves. It may also invest in other companies or in formation of subsidiaries in accordance with the Act.
- The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members.
- The Act provides comprehensive provisions for the schemes of amalgamation, merger or division etc. of Producer Company.
- Any dispute relating to the formation, management or business of a Producer Company shall be settled by conciliation or by arbitration. Further, the Registrar can after making an inquiry strike off the name of a company under the circumstances given in the Act.
- Any Producer Company may make an application to the High Court for its re-conversion to Inter-State Co-operative Society, following the procedure laid down in the Act.





# Lesson 29

## Limited Liability Partnerships

### LESSON OUTLINE

- Introduction
- Salient Features
- Important terms as per the Limited Liability Partnership Act, 2008
- The important requirements for formation of a Limited Liability Partnership
- Partners and Designated Partners
- Roles and responsibilities of Designated Partners
- Limited Liability Partnership (LLP) Agreement.
- LLP for the professionals
- Statement of Account and Solvency
- Audit of Limited Liability Partnership
- Filing of Annual Return
- Foreign Limited Liability Partnership
- Electronic filing of documents
- Investigation of the affairs of LLP
- Winding up of LLP

### LEARNING OBJECTIVES

In order to cope with and conform to the rapid changes taking place in the industry and business, a form of business organization combining the vital aspects of a partnership firm and the advantages of a limited liability company was essential. This need gave birth to the new form of organization called “**Limited Liability Partnership**”, which is more popularly known as LLP.

LLP is an alternative business vehicle that gives the benefits of limited liability company and the flexibility of a partnership firm. Since, LLP contains elements of both ‘a corporate structure’ as well as ‘a partnership firm structure’; LLP is many a times termed as a **hybrid** of a company and a partnership. LLP is a separate legal entity which can continue its existence irrespective of changes in its partners.

After reading this lesson you will be able to understand the features of LLP, important requirements for formation, role and responsibility of designated partner and rules regarding winding up of LLP and the difference between LLP and other forms of business.

## 1. INTRODUCTION

Limited Liability Partnership (LLP) is an incorporated partnership formed and registered under the Limited Liability Partnership Act, 2008 ('The Act') with limited liability and perpetual succession. The Act came into force, for most part, on 31st March, 2009 followed by its Rules on 1st April, 2009 and the registration of the first LLP on 2nd April, 2009.

The arrival of the much-desired and long-awaited LLP Act was result of efforts of several expert committees which recommended its introduction starting with the Bhatt Committee of 1972, Naik Committee of 1992, Abid Hussain Committee of 1997, Gupta Committee of 2001, Naresh Chandra Committee of 2003 and the JJ Irani Committee of 2005.

LLP is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its partners the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement.

The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be a suitable vehicle for small and medium enterprises and for investment by venture capitalists.

## REVIEW QUESTIONS



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

The Indian Partnership Act, 1932 shall be applicable to LLPs.

- True
- False

**Correct Answer: False**

## 2. SALIENT FEATURES

The salient features of Limited Liability Partnership are as follows:—

- (i) LLP is a body corporate and a legal entity separate from its partners. Any two or more persons, associated for carrying on a lawful business with a view to profit, may by subscribing their names to an incorporation document and filing the same with the Registrar, form a Limited Liability Partnership. The LLP has a perpetual succession;
- (ii) The mutual rights and duties of partners of an LLP *inter se* and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the proposed legislation. There would be flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the proposed legislation;
- (iii) LLP is a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be tangible or intangible in nature or both tangible and intangible in nature. No partner would be liable on account of the independent or unauthorized acts of other partners or their misconduct;

- (iv) Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India.
- (v) An LLP shall maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government;
- (vi) The Central Government has power to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose;
- (vii) The Indian Partnership Act, 1932 shall not be applicable to LLPs. A partnership firm, a private company and an unlisted public company may convert themselves to LLP in accordance with provisions of the proposed legislation;
- (viii) The Central Government has made rules for carrying out the provisions of the LLP Act.

## REVIEW QUESTIONS



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

The Central Government does not have any powers whatsoever to investigate the affairs of an LLP.

- True
- False

**Correct Answer: False**

The Central Government shall have powers to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose.

## 3. DISTINCTION BETWEEN LLP AND PARTNERSHIP

The principle points of difference between a company and a partnership are as follows:

1. LLP is a separate legal entity and therefore, can be sued or it can sue others without involving the partners. A partnership firm is not distinct from the several persons who compose it.
2. The partners of an LLP would have limited liability i.e., they would not be liable beyond the money contributed by them. Whereas, partners of a firm would have unlimited liability.
3. The retirement or death of a partner would not dissolve the LLP. On the other hand, the death or retirement of a partner would dissolve the partnership firm.
4. In a partnership, the property of the firm is the property of the individuals comprising it. In an LLP, it belongs to the LLP and not to the individuals comprising it.
5. Whereas a partnership can be formed either orally or by a deed of agreement whether registered or not, LLP is formed by an incorporation document and an LLP agreement, thus, giving it a legality.
6. Whereas a registered or unregistered partnership cannot have more than 20 partners, LLP can have more than that number since no upper limit has been laid down by the Act.
7. An LLP has perpetual succession, i.e., the death or insolvency of a shareholder or all of them does not affect the life of the LLP, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

8. Whereas an individual partner would not be able to conduct business transaction with the partnership firm of which he is a partner, a partner of LLP in his separate capacity as a legal person can do business with the LLP since the LLP is a separate legal entity by itself.

#### **4. DISTINCTION BETWEEN LLP AND COMPANY**

1. In case of LLP, the need for defining the objects to be pursued and the other matters which are necessary for furtherance of the objects as well as framing the Share Capital clause in the memorandum for incorporating a company is reduced into a simple procedure of filling of the prescribed information in the Incorporation document and statement in Form No. 2.
2. In case of LLP, a 'limited liability partnership agreement' (LLPA) is prepared which is a variant of the 'articles of association' of a company.
3. Whereas the memorandum of a company is required to name the state in which it is required to be incorporated, there is no such obligation in the case of LLP. Consequently, the detailed procedure involved in changing the registered office from the state of incorporation to another state is not required to be followed in case of a LLP.
4. In the LLP Act, there is no such stipulation for meeting of partners either periodically or compulsorily at the year end as stipulated for directors and shareholders meetings in the Companies Act.
5. There is no separation between management of the company and the ownership as is observed in a company since all the partners, unlike all the directors, can take part in the day to day affairs of the LLP.
6. In case of a company, no individual director can conduct the business of the company but in an LLP, each partner has the authority to do so unless expressly prohibited by the partnership terms.
7. Whereas, the Companies Act contemplates regulating the remuneration payable to directors, there are no corresponding provisions in the LLP Act for remuneration payable to designated partners. The same could be as per the LLP Agreement.
8. In the case of LLP, unlike in the case of companies, there are no restrictions on the borrowing powers.
9. The LLP can choose to maintain the accounts on cash basis/accrual basis whereas under the Companies Act, accrual method is compulsory.
10. Audit of a company is compulsory. Conversely, the audit of LLP is not compulsory if the capital contributed does not exceed ₹25 lakh or if the turnover does not exceed ₹40 lakhs.
11. Cost audit as contemplated in Section 148 of the Companies Act, 2013 has not been prescribed for LLPs.
12. The appointment of Company Secretaries as required under Section 203 of the Companies Act, 2013 is not provided in the LLP Act. However, the annual return of a LLP in Form 11 is to be certified as 'true and correct' by a Company Secretary in practice.

#### **5. COMPARISON OF LLP WITH PRIVATE LIMITED COMPANY**

A comparison of a LLP with a Private Limited Company reveals that such companies have:

- Limited Liability: Similar to LLP.
- Internal flexibility: As opposed to Company Law which requires a formal board structure and decision making at validly constituted meetings, passing of resolutions and maintenance of minutes

of meetings.

- Privacy: Similar to LLP.
- Requirement of an LLP agreement: The Memorandum and Articles of Association are the default standard provisions doing away with the need for a separate agreement similar to a LLP agreement.
- Legal uncertainty: Private Limited companies have long been in existence and being tried and tested vehicles of business entities, there is no legal uncertainty which is not true in case of a LLP.

The LLP structure seems most suited for partnership concerns set up by professionals such as company secretaries in practice and others, by offering them the benefits of limited liability on one hand and the flexibility in internal management that is akin to partnerships on the other. Venture capitalists might also be attracted to the LLP structure owing to the ability of the partners to participate in management without the risk of losing limited liability, the absence of capital maintenance rules and the likely advantageous tax position. The laws of U.S.A., U.K., Singapore and Australia permit formation of LLPs.

## 6. INCORPORATION OF LIMITED LIABILITY PARTNERSHIP

According to section 11 (1) of the Limited Liability Partnership Act, 2008, for a limited liability partnership to be incorporated—

- (a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;
- (b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the registrar of the state in which the registered office of the limited liability partnership is to be situated; and
- (c) a statement in the prescribed form shall be filed along with the incorporation document, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the limited liability partnership and by any one who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

2. The incorporation document shall—

- (a) be in Form 2 as per rule 11.
- (b) state the name of the limited liability partnership;
- (c) state the proposed business of the limited liability partnership;
- (d) state the address of the registered office of the limited liability partnership;
- (e) state the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (f) state the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
- (g) contain such other information concerning the proposed limited liability partnership as may be prescribed.

3. If a person makes a statement under clause (c) of Sub-Section (1) which he—

- (a) knows to be false; or

(b) does not believe to be true,

shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

Subject to prior compliance with the requirements of section 11(1) of the Act, section 12(1) mandates the Registrar to register the incorporation document and issue a certificate of incorporation within 14 days. The certificate of incorporation shall be conclusive evidence that the limited liability partnership is incorporated by the name specified in the incorporation document.

### **Registered Office of LLP**

Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received. [Section 13(1)]

Rule 17 (1) of the Limited Liability Partnership Rules, 2009 provides that the limited liability partnership may change its registered office from one place to another by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide for such procedure, consent of all partners shall be required for changing the place of registered office of limited liability partnership to another place:

Provided that where the change in place of registered office is from one state to another state, the limited liability partnership having secured creditors shall also obtain consent of such secured creditors.

### **Name of LLP**

According to section 15(1), every limited liability partnership shall have either the words "limited liability partnership" or the acronym "LLP" as the last words of its name. Section 15 (2) prohibits registration of an LLP with a name that is either undesirable in the opinion of the Central Government or that is identical with or that which too nearly resembles to the name of any existing partnership firm or an LLP or a body corporate or a trade mark registered or pending registration under the Trade Marks Act, 1999.

Rule 18 (1) of the LLP Rules, 2009 provides that the name of the limited liability partnership shall not be one prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950. Further, Rule 20 (1) provides that the limited liability partnership may change its name by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide such procedure, consent of all partners shall be required for changing the name of the limited liability partnership.

The MCA vide Circular no.2/2014 dated 11<sup>th</sup> February, 2014 clarified that no company should be allowed to be registered with the word "National" as part of its title unless it is a government company and the Central / State government(s) has a stake in it. Similarly, the word 'Bank' may be allowed in the name of an entity only when such entity produces a 'No Objection Certificate' from the RBI in this regard. By the same analogy the word, "Stock Exchange" or "Exchange" should be allowed in name of a company only where No Objection Certificate from SEBI in this regard is produced by the promoters.

## **7. LLP AGREEMENT**

No provision has been made for directors or a board structure on the lines of Company Law. The LLP agreement determines the mutual rights and duties of the partners and their rights and duties in relation to limited liability partnership. This LLP agreement is required to be filed with the Registrar.

It has been provided under Section 23 – Save as otherwise provided by this Act, the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability

partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.

Limited liability partnership agreement should be filed with the Registrar within 30 days of incorporation in Form 3. A person becomes a Partner by virtue of LLP agreement. This means that the LLP agreement is a must and it serves as a basic document and, to a certain extent, takes the place of MOA and AOA applicable in the case of a company registered under the Companies Act, 1956. Any change in the LLP agreement is also required to be notified to the Registrar of Companies. The importance of the said document lies in the fact that it is a public document and it is open to public inspection being on the records of the Registrar.

In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the limited liability partnership and the partners shall be determined by the provisions relating to that matter as are set out in the First Schedule.

## 8. PARTNERS AND DESIGNATED PARTNERS

Any person can be a 'partner' in the limited liability partnership in accordance with the LLP agreement. Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

Section 5 provides that any individual or body corporate may be a partner in limited liability partnership. However, an individual shall not be capable of becoming a partner of a limited liability partnership, if—

- (a) He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- (b) he is an undischarged insolvent; or
- (c) he has applied to be adjudicated as an insolvent and his application is pending.

Section 7 provides that every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India. Provided that in case of a limited liability partnership in which all the partners are body corporates, at least two partners shall nominate their respective individuals who are to act as "designated partners" and one of the nominees shall be a resident of India. Vide Circular No. 2/2016 dated 15<sup>th</sup> January 2016, it has been clarified by Ministry of Corporate Affairs that a HUF or its Karta cannot become partner or designated partner in LLP.

Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply *mutatis mutandis* for the said purpose.

The Central Government, vide Notification No. GSR 506(E) dated 5th July, 2011, notified Limited Liability Partnership (Amendment) Rules, 2011 whereby it has integrated the Director's Identification Number (DIN) issued under Companies Act, 1956 with Designated Partnership Identification Number (DPIN) issued under Limited Liability Partnership (LLP) Act, 2008 with effect from 9.7.2011.

Pursuant to aforesaid notification with effect from 9.7.2011, there was no fresh issuance of DPIN. The same has relevance after notification of Companies Act, 2013. Any person, who desires to become a designated partner in a Limited Liability Partnership, now has to obtain DIN by filing e-form DIR-3. If a person has been allotted DIN, the said DIN shall also be used as DPIN for all purposes under Limited Liability Partnership Act, 2008. If a person has been allotted DPIN, the said DPIN will also be used as DIN for all the purposes under Companies Act, 2013 and the previous Act. If a person has been allotted both DIN and DPIN, his DPIN will stand cancelled and his DIN will be used as DIN as well as DPIN for all purposes under Limited Liability Partnership Act, 2008 and Companies Act, 2013. Every designated partner, shall intimate his consent to

become a designated partner to the limited liability partnership and DPIN in Form 9 and the LLP shall intimate such DPIN to Registrar in Form 4.

The Central Government *vide* General Circular no. 2/2016 dated 15th January 2016 clarified that as per section 5 of LLP Act, 2008 only an individual or body corporate may be a partner in a Limited Liability Partnership. An HUF cannot be treated as a body corporate for the purposes of LLP Act, 2008. Therefore, a HUF or its Karta cannot become partner or designated partner in LLP'.

However, the clarification inadvertently does not mention partner in the last sentence of the paragraph quoted above which has been pointed out by a stakeholder. It is hereby clarified that a HUF or its Karta cannot become partner or designated partner in LLP.

### Disqualification of a designated partner

If he –

- (a) Has at any time within the preceding five years been adjudged insolvent; or
- (b) Suspends, or has at any time within the preceding five years suspended payment to his creditors and has not at any time within the preceding five years made, a composition with them;
- (c) has been convicted by a Court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months; or
- (d) has been convicted by a Court for an offence involving section 30 of the Act.

(Section 30 deals with punishment for carrying out acts by the LLP or its partners with intent to defraud its creditors or for a fraudulent purpose).

### Responsibilities of Designated Partner - Where the LLP has contravened the provisions of LLP Act

The designated partner would be liable to all penalties imposed on the LLP for the contravention of the provisions of the Act and as such the designated partner would be required to pay all the monetary fines imposed on the LLP. There is no provision in the Act providing for the reimbursement of such monetary penalties to him by the LLP. Further in the following instances apart from the LLP, the designated partner would also be imposed monetary penalties under the Act:-

- For non-compliance with the directions of the Central Government for change of name under Section 17 of the Act,
- For non-maintenance of books of accounts, non-filing of accounts, duly audited where such an audit is mandatory under Section 34 of the Act,
- For non-filing of the annual return of the LLP with the Registrar under Section 35 of the Act.

### REVIEW QUESTIONS



#### Choose the correct answer

What is the minimum limit for appointment of designated partners in a limited liability partnership?

- (a) Maximum two designated partners
- (b) At least two designated partners
- (c) Any number of designated partners
- (d) None of the above

**Correct answer: (b)**



## 9. PARTNERS' OBLIGATIONS

All partners, not just the designated partners, are agents of the LLP, but not of other partners. As such, all partners owe the duties of an agent to the LLP. The LLP shall not be bound by anything done by a partner in dealing with a person if that partner has no authority to act for LLP in doing a particular act and the person with whom he is dealing also knows that the partner has no authority for such act and to provide that an obligation of LLP, whether arising out of contract or otherwise will solely be the obligation of LLP. It is also provided that liabilities of LLP are to be met from the property of LLP. Further the LLP shall be liable for a wrongful act or omission by a partner in the course of the business of the LLP or with its authority. The obligation of an LLP shall not affect the personal liability of a partner for his own wrongful act or omission but a partner shall not be personally liable for wrongful act or omission of any other partner. No partner is personally liable directly or indirectly for an obligation of LLP solely by reason of his being a partner of the LLP.

## 10. ADVANTAGES & DISADVANTAGES OF LLP

The advantages of an LLP include:

- **Separate legal entity:** A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- **Perpetual Succession:** A limited liability partnership shall have perpetual succession. In other words, partners may come and partners may go but an LLP will go on till the winding up of its affairs.
- **Limited Liability:** reduced risk to personal wealth from creditors' claims.
- **Internal flexibility:** allows for participation in management and maintenance of ethos of partnership.

The disadvantages include:

- *Lack of privacy:* Disclosure of financial information required under Section 34.
- *Requirement of an LLP agreement:* LLP agreement is a necessity so as to avoid the application of default provisions (First Schedule) and to provide for matters not covered in the default provisions.

## 11. LLP FOR THE PROFESSIONALS

LLPs are eminently suited to the professionals like Company Secretaries and others. They will get the benefit of limited liability and insulate them from third party claims against professional negligence or deficiency. A cross section of the professionals may come together under the banner of LLP to carry on the professional work in their respective field of specialisation, with the respective statutes according sanction for such a dispensation. Such an arrangement will bring the professionals closer and this will benefit the corporate and other clients, as they may be able to get solutions to their problems under one roof. This will also create a strong organisation of professionals and acts as a bulwark against keen competition expected to happen from the professionals abroad, with the opening of legal field under the WTO dispensation.

## 12. VALUATION OF CAPITAL CONTRIBUTION

As per Rule 23(1) of the LLP Rules, 2009, the contribution of each partner shall be accounted for and disclosed in the accounts of the LLP along with nature of contribution and amount. Further, Rule 23 (2) provides that the contribution of a partner consisting of tangible, movable or immovable or intangible property or other benefits brought or contribution by way of an agreement or contract for services shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government.

### **13. MAINTENANCE OF BOOKS OF ACCOUNT (RULE 24 OF LLP RULES)**

(1) Every limited liability partnership shall keep books of account which are sufficient to show and explain the limited liability partnership's transactions and are such as to —

- (a) disclose with reasonable accuracy, at any time, the financial position of the limited liability partnership at that time; and
- (b) enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act. [Rule 24(1)]

(2) The books of account shall contain—

- (a) particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;
- (b) a record of the assets and liabilities of the limited liability partnership;
- (c) statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and
- (d) any other particulars which the partners may decide. [Rule 24(2)]

(3) The books of account which a limited liability partnership is required to keep shall be preserved for eight years from the date on which they are made. [Rule 24(3)]

(4) Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. [Rule 24(4)]

(5) A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners. [Rule 24(6)]

### **14. AUDIT OF LIMITED LIABILITY PARTNERSHIP ACCOUNTS (RULE 24 OF LLP RULES)**

The accounts of every limited liability partnership shall be audited in accordance with these rules:

A limited liability partnership whose turnover does not exceed, in any financial year, forty lakh rupees or whose contribution does not exceed twenty-five lakh rupees is not required to get its accounts audited.

The Accounts of LLP should be audited as per LLP Rules, 2009. Where the partners of LLP do not decide for audit of the accounts of the LLP, such LLP shall include in the Statement of Account and Solvency a statement by the partners to the effect that the partners acknowledge their responsibilities for complying with the requirements of the Act and the Rules with respect to preparation of books of account and a certificate in the form specified in Form 8. [Rule 24(8)]. The audit of LLP may be done by a Chartered Accountant in Practice only.

An auditor or auditors of a limited liability partnership shall be appointed for each financial year of the LLP for auditing its accounts. [Rule 24(10)]

### **15. FILING OF ANNUAL RETURN (RULE 25 OF LLP RULES)**

As per Section 35(1), every limited liability partnership shall file an annual return with the Registrar in Form 11. The annual return of an LLP having turnover upto five crore rupees during the corresponding financial year or contribution upto fifty lakh rupees shall be accompanied with a certificate from a designated partner,

other than the signatory to the annual return, to the effect that annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in practice to the effect that he has verified the particulars from the books and records of the limited liability partnership and found them to be true and correct.

## REVIEW QUESTIONS



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

A partner shall not be personally liable for the wrongful act or omission of any other partner of the Limited Liability Partnership.

- True
- False

**Correct answer: True**

## 16. ELECTRONIC FILING OF DOCUMENTS

Rule 36(1) of LLP Rules provides that every form or application or document or declaration required to be filed or delivered under the Act and rules made there under, shall be filed in computer readable electronic form, in portable document format (pdf) to the Registrar through the portal maintained by the Ministry of Corporate Affairs(MCA) on its website [www.mca.gov.in](http://www.mca.gov.in) or through any other website approved by the Central Government and authenticated by a partner or designated partner of the limited liability partnership for such purpose by the use of a valid digital signature. Earlier MCA had launched a separate portal [www.llp.gov.in](http://www.llp.gov.in) for filling of form/application etc. Now the same is integrated with MCA portal.

### Integrating e-Governance project for Limited Liability Partnership (LLP) under the platform of MCA21

The Ministry of Corporate Affairs has achieved a new milestone by integrating e- Governance project for Limited Liability Partnership (LLP) under the platform of MCA21. With effect from 11-06-2012, all LLP forms, except Forms to be filed by Foreign LLP are being processed and approved by respective Registrar of Companies (ROCs) of concerned state. The forms to be filed by foreign LLPs shall be processed and approved by the ROC, Delhi & Haryana.

## 17. INVESTIGATION OF THE AFFAIRS OF LIMITED LIABILITY PARTNERSHIP (SECTION 43)

As per Section 43, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.

- (a) if not less than one-fifth of the total number of partners of the limited liability partnership make an application along with supporting evidence and security amount as may be prescribed; or
- (b) if the limited liability partnership makes an application that the affairs of the limited liability partnership ought to be investigated; or
- (c) if, in the opinion of the Central Government, there are circumstances suggesting—
  - (i) that the business of the limited liability partnership is being or has been conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the limited liability partnership was formed for any fraudulent or unlawful purpose; or

- (ii) that the affairs of the limited liability partnership are not being conducted in accordance with the provisions of this Act; or
- (iii) that, on receipt of a report of the Registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the limited liability partnership ought to be investigated.

## **18. FOREIGN LIMITED LIABILITY PARTNERSHIP**

As per rule 34(1) of the LLP Rules, a foreign limited liability partnership shall, within thirty days of establishing a place of business in India, file with the Registrar in Form 27 —

- (a) a copy of the certificate of incorporation or registration and other instrument(s) constituting or defining the constitution of the limited liability partnership;
- (b) the full address of the registered or principal office of the limited liability partnership in the country of its incorporation;
- (c) the full address of the office of the limited liability partnership in India which is to be deemed as its principal place of business in India; and
- (d) list of partners and designated partners, if any, and the names and addresses of two or more persons resident in India, authorized to accept on behalf of the limited liability partnership, service of process and any notices or other documents required to be served on the limited liability partnership.

## **19. WINDING UP OF LIMITED LIABILITY PARTNERSHIP**

The winding up of a limited liability partnership may be either voluntary or by the Tribunal. Limited liability partnership, so wound up may be dissolved.(Section 63)

### **Circumstances in which limited liability partnership may be wound up by Tribunal (Section 64)**

A limited liability partnership may be wound up by the Tribunal—

- (a) if the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;
- (b) if, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two;
- (c) if the limited liability partnership is unable to pay its debts;
- (d) if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
- (e) if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or
- (f) if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

### **Limited Liability Partnership (Winding up and Dissolution) Rules, 2012**

The Limited Liability Partnership (Winding up and Dissolution) Rules, 2012 prescribes the detailed provisions relating to winding up. Any LLP may be wound-up voluntarily if the LLP passes a resolution to wind up the

LLP with approval of at least three-fourths of the total number of its partners. Provided that where the LLP has creditors, whether secured or unsecured, the winding up shall not take place unless approval of such creditors takes place. A copy of the resolution shall be filed with the Registrar within thirty days of passing of such resolution in Form No. 1. For details, please visit [www.mca.gov.in/LLP](http://www.mca.gov.in/LLP).

## 20. FOREIGN DIRECT INVESTMENT (FDI) IN LIMITED LIABILITY PARTNERSHIPS (LLPs)

FDI is allowed in LLPs. The Department of Industrial Policy and Promotion vide its press note dated May 20 2011, amending Consolidated FDI Policy allows LLPs to have FDI.

### Salient Features

- FDI in LLPs is allowed through the government route only for LLPs operating in sectors/activities where 100% FDI is allowed through automatic route. There are no FDI linked performance related conditions (Such as 'Non-Banking Finance Companies' or 'Development of townships, housing, built-up infrastructure and Construction-development projects' etc.).
- FDI in LLP is not allowed at all even through government route in those sectors where 100% FDI is not allowed under automatic route.
- LLPs with FDI is not eligible to make any downstream investments.
- An Indian Company having FDI is permitted to make downstream investment in an LLP only if both the company as well as LLP are operating in sectors where 100% FDI is allowed through the automatic route and there are no FDI linked performance related conditions.
- LLP with FDI is not allowed to operate in agricultural/plantation activity, print media or real estate business.
- LLPs cannot avail External Commercial Borrowings.
- Foreign Capital participation in the capital structure of LLPs is allowed only by way of cash consideration, received by inward remittance, through normal banking channels or by debit to NRE/FCNR account of the person concerned, maintained with an authorized dealer/authorized bank.
- Investment in LLPs by Foreign Institutional Investors (FIIs) and Foreign Venture Capital Investors (FVCIs) is not permitted.
- Conversion of a company with FDI, into an LLP, is allowed only if the conditions stipulated for LLP regarding FDI are complied with.
- For LLPs with FDI, the designated partner "resident in India", as defined under the 'Explanation' to Section 7(1) of the LLP Act, 2008, would also have to satisfy the definition of "person resident in India", as prescribed under Section 2(v)(i) of the Foreign Exchange Management Act, 1999.
- In case the LLP with FDI has a body corporate that is a designated partner or nominates an individual to act as a designated partner in accordance with the provisions of Section 7 of the LLP Act, 2008, such a body corporate should only be a company registered in India under the Companies Act, 1956 and not any other body, such as an LLP or a trust.

### LESSON ROUND-UP

- Any two or more persons associated for carrying on a lawful business with a view to earn profit may form a limited liability partnership by subscribing their names to an incorporation document and registration with the Registrar of companies.

- Salient features of the Limited Liability Partnership
- Body corporate with a separate legal entity.
- Mutual rights and duties of partners of an Limited Liability Partnership inter se and those of the Limited Liability Partnership and its partners shall be governed by an agreement between the partners.
- Limited liability of the partners.
- Every Limited Liability Partnership shall have atleast two partners.
- The Indian Partnership Act, 1932 shall not be applicable to LLPs.
- Every Limited Liability Partnership shall have at least two designated partners who are individuals and atleast one of them shall be a resident of India.
- The mutual rights and duties of the partners of limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.
- Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners.
- A limited liability partnership whose turnover exceed forty lakh rupees, in any financial year or whose contribution exceed twenty-five lakh rupees shall be required to get its accounts audited.
- Every limited liability partnership shall file an annual return with the Registrar in Form 11.
- The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.
- The winding up of a limited liability partnership may be either voluntary or by the Tribunal.

## GLOSSARY

<b>LLPA</b>	Limited Liability Partnership Agreement
<b>DPIN</b>	Designated Partner Identification Number

## SELF-TEST QUESTIONS

1. What do you mean by Limited Liability Partnership. State the salient features of Limited Liability Partnerships.
2. Who is a designated partner? Give the relevant provisions of the LLP Act 2008 with regard to designated partners.
3. Write short notes on:
  - (i) LLP Agreement (ii) LLP for the professionals.
4. State the circumstances in which LLP may be wound up by the Tribunal.

# Lesson 30

## Application of Company Law to Different Sectors

### LESSON OUTLINE

- Introduction
- Application of company law to Different Sectors
- Exemptions provided under the Act to specific sectors
- IFSC Companies and exemptions provided

### LEARNING OBJECTIVES

Companies Act 2013 is applicable on other forms of businesses such as Banking Sector, Insurance Sector, Companies engaged in supply of electricity etc., which are also governed by Special Act of parliament, as far as there is no inconsistency.

While, Section 1(4) of the Companies Act deals with the provisions relating to application of Company law to different sectors, the certain aspects relating to financial statement, loans and investments, acceptance of deposits etc., are not applicable to some sectors as they are regulated by the principle legislations governing them.

After reading this lesson you will be able to understand the applicability of Companies Act, 2013 to different sectors and the exemptions provided there under.

## INTRODUCTION

Companies Act 2013 is applicable to other sectors such as Banking companies, insurance companies, electricity companies etc. However, the Act excludes these companies from its purview for some sections which are governed under the special acts under which these companies are formed.

## APPLICATION OF COMPANIES ACT TO INSURANCE, BANKING, ELECTRICITY SUPPLY AND OTHER COMPANIES GOVERNED BY SPECIAL ACTS

Section 1(4) of the Companies Act 2013 states that the provisions of this Act shall apply to—

- (a) companies incorporated under this Act or under any previous company law;
- (b) insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;
- (c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;
- (d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;
- (e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and
- (f) such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification.

## EXCEPTIONS PROVIDED UNDER COMPANIES ACT 2013 TO SPECIFIC SECTORS.

The following are the important sections that exclude certain sectors from the applicability of that particular section in Companies Act 2013.

### 1. Section 67(3)- Financial assistance for purchase of shares

Section 67 (2) states that no public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

Section 67 (3) states that nothing in Section 67 (2) shall apply to the lending of money by a banking company in the ordinary course of its business;

### 2. Proviso to Section 73(1)- Prohibition on Acceptance of Deposits from Public

Section 73(1) states that On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter.

Proviso to Section 73(1) states that nothing in this sub-section shall apply to a banking company and nonbanking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.



### 3. Proviso to Section 129(1)- Financial Statements

Section 129 (1) states that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

The proviso to Section 129(1) states that nothing contained in this 129(1) shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company. Further the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—

- (a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
- (b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
- (c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
- (d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

### 4. Proviso to Section 179(3) & proviso to section 180(1)(c) - Powers of the Board to borrow

Section 179(3) states that the Board of Directors of a company shall exercise certain powers specified in the section on behalf of the company by means of resolutions passed at meetings of the Board. The borrowing powers of the Board is covered under Section 179(3)(d)

The proviso to Section 179(3) states that the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section.

Explanation to Section 179(3) states that nothing in clause (d) shall apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.

### 4. Proviso to Section 179(3) & proviso to section 180(1)(c) - Powers of the Board to borrow

Section 180(1) states that the Board of Directors of a company shall exercise the certain powers only with the consent of the company by a special resolution

Borrowing money, where the money to be borrowed, together with the money already borrowed by the company in excess of aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business, requires special resolution under section 180(1)(c).

Proviso to Section 180(1)(c) states that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

## 5. Section 186- Loan and investment by company

Section 186 prescribes limits upto which a company shall give any loan/guarantee/provide security in connection with a loan to any other body corporate. This section also mandates certain disclosures, maintenance of registers etc.,

Section 186 (11) states that nothing contained in Section 186, except sub-section (1), shall apply—

- (a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;
- (b) to any acquisition made by a banking company or an insurance company or a housing finance company, making acquisition of securities in the ordinary course of its business (inserted vide Removal of Difficulty Order No. S.O. 504(E) dated 13<sup>th</sup> February, 2015).

Section 186(1) states that without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

## 6. Section 189 – Register of Contracts

Section 189 (1) states that every company shall keep one or more registers giving separately the particulars of all contracts or arrangements to which sub-section (2) of section 184 (Contract in which director is interested) or section 188(Related Party transactions) applies, in such manner and containing such particulars as may be prescribed and after entering the particulars, such register or registers shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Section 189(5)(b) states that nothing contained in sub-section (1) shall apply to any contract or arrangement by a banking company for the collection of bills in the ordinary course of its business.

## IFSC Companies and exemptions provided to them

International Financial Service Centre (IFSC) is a hub of financial services within a country, which has laws and regulations different from the rest of the country. Usually these centres have low tax rates and flexible regulations for securities and currency trading, banking and insurance, which makes them attractive for foreign investment. It can be said that these centres deal mainly with the flow of money, financial products and services across borders.

An IFSC caters to customers outside the jurisdiction of the domestic economy. Such centres deal with flows of finance, financial products and services across borders. London, New York and Singapore can be counted as global financial centres. Many emerging IFSCs around the world, such as Shanghai and Dubai, are aspiring to play a global role in the years to come.

India announced in budget 2015 that the first IFSC centre in India shall be set up in Gujarat International Finance Tec-City (GIFT City), near Ahmedabad. It will be set up under Section 18(1) of Special Economic Zones Act, 2005. Establishment of an IFSC in SEZ means that separate regulations shall be formed for an IFSC which shall be different from the rest of India.

## Exemptions to IFSC Companies under Companies Act, 2013

In exercise of powers under Section 462(1) of the Companies Act, 2013 (“the Act”), the MCA has exempted the Companies which are licensed to operate by the RBI or SEBI or IRDA from the International Financial Services Centre (“IFSC”) located in an approved multi-services Special Economic Zone set-up under the

Special Economic Zones Rules, 2006 (“IFSC Public/Private Company”). Further, separate exemptions have been provided for public and private limited companies.

*Specified IFSC private company:* A private company which is licensed to operate by the RBI or the SEBI or the IRDAI from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 are referred to as “Specified IFSC private company”. Following exemptions are provided to the Specified IFSC private company.

Serial Number	Provisions of the Companies Act, 2013 (18 of 2013)	Exceptions/Modifications/Adaptations
(1)	(2)	(3)
1.	Clause (41) of section 2	In clause (41), after the second proviso, the following proviso shall be inserted, namely:- “Provided also that in case of a Specified IFSC private company, which is a subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company and approval of the Tribunal shall not be required.”
2.	Sub-section (2) of section 3	In sub-section (2), the following proviso shall be inserted, namely:- “Provided that a Specified IFSC private company shall be formed only as a company limited by shares.”
3.	Clause (a) of sub-section (1) of section 4	In clause (a) of sub-section (1), after the proviso, the following proviso shall be inserted, namely:- “Provided further that a Specified IFSC private company shall have the suffix “International Financial Service Company” or “IFSC” as part of its name.”
4.	Clause (c) of sub-section (1) of section 4	In clause (c) of sub-section (1) of section 4, the following proviso shall be inserted, namely:- “Provided that a Specified IFSC private company shall state its objects to do financial services activities, as permitted under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006 and any matter considered necessary in furtherance thereof, in accordance with license to operate, from International Financial Services Centre located in an approved multi services Special Economic Zone, granted by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India.”.
5.	Sub-section (1) of section 12	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that a Specified IFSC private company shall have its registered office at the International Financial Services Centre located in the approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006, where it is licensed to operate, at all times.”

6.	Sub-section (2) of section 12	For the words “thirty days” read as “sixty days”.
7.	Sub-section (4) of section 12	For the words “fifteen days” read as “sixty days”.
8.	Sub-section (5) of section 1212	For sub-section (5), the following sub-section shall be substituted, namely:- “(5) Except on the authority of a resolution passed by the Board of Directors, the registered office of the Specified IFSC private company shall not be changed from one place to another within the International Financial Services Centre:  Provided that a Specified IFSC private company shall not change the place of its registered office to any other place outside the International Financial Services Centre.”.
9.	Section 21	For the words “an officer” read as “an officer or any other person”.
10.	Sub-sections (3) and (7) of section 42	Shall not apply.
11.	Sub-section (6) of section 42	For the words “sixty days” read as “ninety days”.
12.	Clause (c) of sub-section (1) of section 54	Shall not apply.
13.	Sub-section (4) of section 56	In sub-section (4), after the proviso, the following proviso shall be inserted, namely:- “Provided further that a Specified IFSC private company shall deliver the certificates of all securities to subscribers after incorporation, allotment, transfer or transmission within a period of sixty days.”.
14.	Sub-section (1) of section 82	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC private company, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed.”.
15.	Sub-section (6) of section 89	For the words “thirty days” read as “sixty days”.

16.	Sub-section (3) of section 92	Shall not apply.
17.	Sub-section (1) of section 100	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC private company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.”.
18.	Sub-section (1) of section 117	For the words “thirty days” read as “sixty days”.
19.	Sub-section (1) of section 118	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC private company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub section (1) at or before the next Board or committee meeting, as the case may be and kept in books kept for that purpose.”.
20.	Sub-section (10) of section 118	Shall not apply.
21.	Sub-section (3) of section 134	In sub-section (3), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC private company, if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors.”.
22.	Section 135	Shall not apply for a period of five years from the commencement of business of a Specified IFSC private company.
23.	Section 138	Shall apply if the articles of the company provides for the same.
24.	Fourth proviso to sub- section (1) of section 139	For the words “fifteen days” read as “thirty days”.
25.	All provisos to sub- section (2) of section 139	Shall not apply.

26.	Sub-section (1) of section 140	In sub-section (1), after the proviso, the following proviso shall be inserted, namely:- "Provided further that in case of a Specified IFSC private company, where, within a period of sixty days from the date of submission of the application to the Central Government under this sub-section, no decision is communicated by the Central Government to the company, it would be deemed that the Central Government has approved the application and the company shall appoint new auditor at a general meeting convened within three months from the date of expiry of sixty days period."
27.	Sub-section (3) of section 149	In sub-section (3), the following proviso shall be inserted, namely:- "Provided that this sub-section shall apply to the Specified IFSC private company in respect of financial years other than the first financial year from the date of its incorporation."
28.	Sub-section (3) of section 161	In sub-section (3), the following proviso shall be inserted, namely:- "Provided that in case of a Specified IFSC private company, the Board may appoint, any person nominated by any institution or company or body corporate as a director in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company."
29.	Proviso to sub-section (1) of section 168	For the word "shall" read as "may".
30.	Sub-section (2) of section 170	For the words "thirty days" at both places read as "sixty days".
31.	Sub-section (1) of section 173	In sub-section (1), after the proviso, the following proviso shall be inserted, namely:- "Provided further that a Specified IFSC private company shall hold the first meeting of the Board of Directors within sixty days of its incorporation and thereafter hold at least one meeting of the Board of Directors in each half of a calendar year."
32.	Sub-section (3) of section 174	Shall apply with the exception that interested director may participate in such meeting provided the disclosure of his interest is made by the concerned director either prior or at the meeting.
33.	Sub-section (3) of section 179	In sub-section (3), after the second proviso, the following proviso shall be inserted, namely:- "Provided also that in case of a Specified IFSC private company, the Board can exercise the powers by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation."

34.	Sub-section(1) of section 185	In the Explanation, for clause (c), the following clause shall be substituted, namely:- “(c) any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect.”
35.	Sub-section (1) of section 186	Shall not apply.
36.	Sub-sections (2) and (3) of section 186	Shall not apply, if a company passes a resolution either at meeting of the Board of Directors or by circulation.
37.	Sub-section (5) of section 186	In sub-section (5), after the proviso, the following proviso shall be inserted, namely:- “Provided further that in case of a Specified IFSC private company, the Board can exercise powers under this sub-section by means of resolutions passed at meetings of the Board of Directors or through resolutions passed by circulation.”
38.	Sub-section (2) of section 384	In sub-section (2), the following proviso shall be inserted, namely:-  “Provided that notwithstanding anything contained in this Act, the exemptions provided under section 92 to companies incorporated under this Act for the purpose of operating from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 (28 of 2005) and the Special Economic Zones Rules, 2006, shall apply <i>mutatis mutandis</i> to a foreign company registered under Chapter XXII of this Act, which has a place of business or which conducts business activity from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 and the Special Economic Zones Rules, 2006.” .
39.	Sub-section (4) of section 384	In sub-section (4), the following proviso shall be inserted, namely:-  “Provided that notwithstanding anything contained in this Act, the exemptions provided under Chapter VI to companies incorporated under this Act for the purpose of operating from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 (28 of 2005) and the Special Economic Zones Rules, 2006, shall apply <i>mutatis mutandis</i> to a foreign company registered under Chapter XXII of this Act, which has a place of business or which conducts business activity from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 and the Special Economic Zones Rules, 2006.”

**Specified IFSC public company:** An unlisted public company which is licensed to operate by the RBI or the SEBI or the IRDAI from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 is Specified IFSC public company. Following Exemption are provided to Specified IFSC public company.

Serial Number	Provisions of the Companies Act, 2013 (18 of 2013)	Exceptions/Modifications/Adaptations
(1)	(2)	(3)
1.	Clause (41) of section 2	In Clause (41), after the second proviso, the following proviso shall be inserted, namely :-  “Provided also that in case of a Specified IFSC public company, which is a subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company and
2.	Sub-clause (viii) of	Shall not apply with respect to section 188.
3.	Sub-section (2) of section 3	In sub-section (2), the following proviso shall be inserted, namely:-  “Provided that a Specified IFSC public company shall be formed only as
4.	Clause (a) of sub-section (1) of section 4	In clause (a) of sub-section (1), after the proviso, the following proviso shall be inserted, namely:-  “Provided further that a Specified IFSC public company shall have the suffix “International Financial Service Company” or “IFSC” as part of its
5.	Clause (c) of sub-section (1) of section 4	In clause (c) of sub-section (1) of section 4, the following proviso shall be inserted, namely:-  “Provided that a Specified IFSC public company shall state its objects to do financial services activities, as permitted under the Special Economic Zones Act, 2005 (28 of 2005) read with the Special Economic Zones Rules, 2006 and any matter considered necessary in furtherance thereof, in accordance with license to operate, from International Financial Services Centre located in an approved multi services Special Economic Zone, granted by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India.”



6.	Sub-section (1) of section 12	In sub-section (1), the following proviso shall be inserted, namely:-  “Provided that a Specified IFSC public company shall have its registered office at the International Financial Services Centre located in the approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006, where it is
7.	Sub-section (2) of section 12	For the words “thirty days” read as “sixty days”.
8.	Sub-section (4) of section 12	For the words “fifteen days” read as “sixty days”.
9.	Sub-section (5) of section 12	For sub-section (5), the following sub-section shall be substituted, namely:-  “(5) Except on the authority of a resolution passed by the Board of Directors, the registered office of the Specified IFSC public company shall not be changed from one place to another within the International Financial Services Centre:  Provided that the Specified IFSC public company shall not change the place of its registered office to any other place outside the said International Financial Services Centre.”
10.	Section 21	For the words “an officer” read as “an officer or any other person”.
11.	Sub-sections (3) and (7) of section 42	Shall not apply.
12.	Sub-section (6) of section 42	For the words “sixty days” read as “ninety days”.
13.	Section 43	Shall not apply to a Specified IFSC public company, where memorandum of association or articles of association of such company provides for it.
14.	Section 47	Shall not apply to a Specified IFSC public company, where memorandum of association or articles of association of such company provides for it.
15.	Clause (c) of sub-section (1) of section 54	Shall not apply.

16.	Sub-section (4) of section 56	In sub-section (4), after the proviso, the following proviso shall be inserted, namely:-  “Provided further that a Specified IFSC public company shall deliver the certificates of all securities to subscribers after incorporation, allotment, transfer or transmission within a period of sixty days.”.
17.	Clause (a) of sub-section (1) of section 62	In clause (a) of sub-section (1), the following proviso shall be inserted, namely:-  “Provided that notwithstanding anything contained in sub-clause (i), in case of a Specified IFSC public company, the periods lesser than those specified in the said sub-clause shall apply if ninety per cent. of the members have given their consent in writing or in electronic mode.”.
18.	Clause (b) of sub-section (1) of section 62	For the words “special resolution” read as “ordinary resolution”.
19.	Section 67	Shall not apply to a Specified IFSC public company-  (a) in whose share capital no other body corporate has invested any money;  (b) if the borrowings of such company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
20.	Clauses (a) to (e) of sub-section (2) of section 73	Shall not apply to a Specified IFSC public company which accepts from its members, monies not exceeding one hundred per cent. of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified.
21.	Sub-section (1) of section 82	In sub-section (1), the following proviso shall be inserted, namely:-  “Provided that in case of a Specified IFSC public company, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed.”
22.	Sub-section (6) of section 89	For the words “thirty days” read as “sixty days”.
23.	Sub-section (3) of section 92	Shall not apply.

24.	Sub-section (1) of section 100	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC public company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.”
25.	Sections 101 to 107 and section 109	Shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company.
26.	Sub-section (1) of section 117	For the words “thirty days” read as “sixty days”.
27.	Clause (g) of sub-section (3) of section 117	Shall not apply.
28.	Sub-section (1) of section 118	In sub-section (1), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC public company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub-section (1) at or before the next Board meeting or committee meeting, as the case may be and kept in the books kept for that purpose.”
29.	Sub-section (10) of section 118	Shall not apply.
30.	Sub-section (3) of section 134	In sub-section (3), following proviso shall be inserted, namely:-  “Provided that in case of a Specified IFSC public company, if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors.”
31.	Section 135	Shall not apply for a period of five years from the commencement of business of a Specified IFSC public company.
32.	Section 138	Shall apply if the articles of the company provides for the same.
33.	Fourth proviso to sub-section (1) of section 139	For the words “fifteen days” read as “thirty days”.
34.	All provisos to sub-section (2) of section 139	Shall not apply.

35.	Sub-section (1) of section 140	In sub-section (1) after the proviso, the following proviso shall be inserted, namely:- “Provided further that in case of a Specified IFSC public company, where, within a period of sixty days from the date of submission of the application to the Central Government under this sub-section, no decision is communicated by the Central Government to the company, it would be deemed that the Central Government has approved the application and the company shall appoint new auditor at a general meeting convened within three months from the date of expiry of sixty days period.”
36.	Second proviso to sub-section (1) of section 149	Shall not apply.
37.	Sub-section (3) of section 149	In sub-section (3), the following proviso shall be inserted, namely:- “Provided that this sub-section shall apply to a Specified IFSC public company in respect of financial years other than the first financial year from the date of its incorporation.”
38.	Sub-sections (4) to (11), clause (i) of sub-section (12) and sub-section (13) of section 49	Shall not apply.
39.	Sub-section (5) of section 152	For the words “thirty days” read as “sixty days”.
40.	Sub-sections (6) and (7)	Shall not apply.
41.	Section 160	Shall apply as per the articles framed by the company.
42.	Sub-section (3) of section 161	In sub-section (3), the following proviso shall be inserted, namely:- “Provided that in case of a Specified IFSC public company, the Board may appoint, any person nominated by any institution or company or body corporate as a director in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.”.
43.	Section 162	Shall not apply.
44.	Proviso to sub-section (1) of section 168	For the word “shall” read as “may”.

45.	Sub-section (2) of section 170	For the words “thirty days” at both places read as “sixty days”.
46.	Sub-section (1) of section 173	In sub-section (1), after the proviso, the following proviso shall be inserted, namely:- “Provided further that a Specified IFSC public company shall hold the first meeting of the Board of Directors within sixty days of its incorporation and thereafter hold atleast one meeting of the Board of Directors in each half of a calendar year.”
47.	Sub-section (3) of section 174	Shall apply with the exception that interested director may participate in such meeting provided the disclosure of his interest is made by the concerned director either prior or at the meeting.
48.	Section 177	Shall not apply.
49.	Section 178	Shall not apply.
50.	Sub-section (3) of section 179	In sub-section (3), after the second proviso, the following proviso shall be inserted, namely:- “Provided also that in case of a Specified IFSC public company, the Board can exercise powers by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation.”.
51.	Section 180	Shall apply in case of a Specified IFSC public company, unless the articles of the company provides otherwise.
52.	Sub-section (2) of section 184	Shall apply with the exception that interested director may participate in such meeting provided the disclosure of his interest is made by the concerned director either prior or at the meeting.
53.	Sub-section (1) of section 185	In the Explanation, for clause (c), the following clause shall be substituted, namely:- “(c) any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect;”.
54.	Sub-section (1) of section 186	Shall not apply.
55.	Sub-sections (2) and (3) of section 186	Shall not apply if a company passes a resolution either at meeting of the Board of Directors or by circulation.

56.	Sub-section (5) of section 186	In sub-section (5), after the proviso, the following proviso shall be inserted, namely:- “Provided further that in case of a Specified IFSC public company, the Board can exercise powers under this sub-section by means of resolutions passed at meetings of the Board of Directors or through resolutions passed by circulation.”.
57.	Second proviso to sub-section (1) of section 188	Shall not apply.
58.	Sub-section (4) of section 196	Shall not apply.
59.	Section 197	Shall not apply.

**LESSON ROUND-UP**

Section 1(4) states that Companies Act is applicable to Banking, Insurance other sectors.

There are exceptions provided under Companies Act 2013 especially to banking sector with respect to

- Financial statements
- Borrowings
- Loans and investments
- Acceptance of deposits etc.

**SELF-TEST QUESTIONS**

1. What is the applicability of Companies Act, 2013 to different sectors?
2. Discuss the applicability of provisions of Companies Act, 2013 on
  - (a) Banking Companies
  - (b) Insurance Companies
  - (c) Electricity Companies

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# Lesson 31

## Offences, Penalties and their Compounding

### LESSON OUTLINE

- Introduction
- Officers in default
- Adjudication of penalties
- Compounding of Offences
- Punishment for fraud
- Appointment of company prosecutors
- Punishment for false statements
- List of offences covered under Section 447 (punishment for fraud)
- List of compoundable offences
  - By Tribunal
  - By Regional Director
  - By Special Courts

### LEARNING OBJECTIVES

The Companies Act, 2013 provides effective penalty mechanism, time bound actions, speedy trials, etc. considering the gravity of offence. Some innovative measures are establishment of special courts for speedy trials, punishment for fraud, enhanced penalties etc. Besides, the penalty mechanism provided under 1956 act has been strengthened with respect to appointment of company prosecutors, compounding of offences etc. The Act states that notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Act. Section 212 deals with investigation into the affairs of the company by Serious Fraud Investigation Office.

After reading this lesson you will be able to understand the broad view of regulatory mechanism with respect to offences, penalties, etc. including provisions relating to special courts, adjudication of penalties, punishment for fraud, etc. This lesson also lists out various offences and penalties under different heads such as compoundable vs. non compoundable, various offences that attract penalties for fraud, etc.

## REGULATORY FRAMEWORK – OFFENCES, PENALTIES AND COMPOUNDING – COMPANIES ACT, 2013

The Companies Act, 2013 provides for stricter enforcement of penalties in time bound manner by establishing necessary mechanism for enforcement of penalties such as establishment of special court, appointment of adjudicating officers, imposition of penalties for various offences including fraud depending on the gravity of an offence, hefty penalties, wider definition of officer in default, etc. Further the Act bifurcates offences into compoundable and non-compoundable offences. Based on the amount of penalty the compoundable offences are compounded either by the Tribunal or the Regional Director as the case may be.

***Broadly Companies Act, 2013 covers the aspects such as offences, penalties, prosecution, remedies, etc.***

Section 2(60) – Officer in default

Section 435-438 – Special Courts

Section 439 – Offences to be non-cognizable

Section 441 – Compounding of certain offences

Section 443- Appointment of Company Prosecutors

Section 447- Punishment for fraud

Section 448- Punishment for false statements

Section 449- Punishment for false evidence

Section 450- Punishment where no specific penalty or punishment is provided

Section 451- Punishment in case of repeated default

Section 452- Punishment for wrongful withholding of property

Section 453 – Punishment for improper use of the words ‘Limited’ or ‘Private Limited’

Section 454- Adjudication of penalties

## OFFENCES UNDER COMPANIES ACT, 2013

### Who is an “Officer who is In Default” [Section 2(60)]

As per Section 2(60), “officer who is in default”, for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:—

- (i) whole-time director;
- (ii) key managerial personnel;
- (iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
- (iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records,



authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

- (v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;
- (vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;
- (vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

### **ESTABLISHMENT OF SPECIAL COURT (SECTIONS 435 TO 438)**

The Central Government may for the purpose of providing speedy trial of offences punishable under this Act with imprisonment of two years or more, by notification establish or designate Special Courts. All other offences shall be tried by a Metropolitan Magistrate or a judicial magistrate of the first class having jurisdiction to try any offence under this Act or under any previous company law. The Special Court may exercise the same power which a Magistrate having jurisdiction to try a case may exercise under Section 167 of the Code of Criminal Procedure, 1973 in relation to an accused person who has been forwarded to him. When a person accused of or suspected of the commission of an offence under the Act is forwarded, a Judicial Magistrate may authorise the detention of that person for fifteen days or an Executive Magistrate for seven days. When the Magistrate considers that the detention of the person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction.

A Special Court may upon perusal of the police report of the facts constituting an offence under this Act or upon a complaint, take cognizance of the offence without the accused being committed to it for trial. When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may under the Code of Criminal Procedure, 1973 be charged in a same trial. The Special Court may try in a summary way any offence under this Act which is punishable with imprisonment for a term not exceeding three years. In case of summary trial, a sentence of imprisonment for a term exceeding one year shall not be passed. Where the Special Court think it is undesirable to try the case summarily, the Special Court shall record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear in regular trial.

All offences under the Companies Act shall be triable only by the Special Court for the area in which the registered office of the company in relation to which the offence is committed. The provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court. The Special Court shall be deemed to be a Court of Session and the person conducting a prosecution before a Special Court be deemed to be a Public Prosecutor.

### **OFFENCES TO BE NON-COGNIZABLE (SECTION 439)**

#### **All offenses are non-cognizable except offences referred to SFIO**

Every offence under this Act except the offences referred to in sub – section (6) of Section 212 (Section 212 deals with investigation of offences by SFIO, which is discussed elsewhere in this lesson) shall be deemed to be non – cognizable within the meaning of the said code.

When can court take cognizance of any offence?

No court shall take cognizance of any offence under this Act except on the complaint of –

- (a) the Registrar in writing,
- (b) a shareholder of the company,
- (c) a person authorised by the Central Government.

The court may take cognizance of offences relating to issue and transfer of securities and non – payment of dividend on complaint in writing by a person authorised by the Securities and Exchange Board of India. When the complainant is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offence shall not be necessary. The court may require personal attendance of these complainants at the trial.

### **COMPOUNDING OF OFFENCES (Section 441)**

Any offence punishable (whether committed by a company or any officer thereof) with fine only and where the maximum amount of fine which may be imposed for such offence does not exceed five lakh rupees, may, be compounded by the Regional Director;

Any offence punishable under this Act (whether committed by a company or any officer thereof) with fine only and where the maximum amount of fine which may be imposed for such offence exceeds five lakh rupees, may, be compounded by the Tribunal;

The offences which are punishable with Fine or with Imprisonment; or with fine or Imprisonment or with both may be compoundable with the permission of Special Court.

Any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

Offences may be compounded by

- Regional Director
- National Company Law Tribunal
- Special court

Compoundable offences: Where the complainant agrees to enter into compromise and drop the charges against accused i.e., the offences which are eligible to compromise are compoundable. The offences are not of serious nature.

List of offences as may be compounded by Special Courts/ Regional Director or National Company Law Tribunal is placed at Annexure I

### **APPOINTMENT OF COMPANY PROSECUTORS (SECTION 443-SECTION 445)**

The Central Government may appoint generally or for any specified class of cases in any local area, one or more persons as Company Prosecutors for the conduct of prosecution arising out of this Act and persons so appointed shall have all the powers and privileges conferred by the Code on Public prosecutors appointed under section 24 of the Code of Criminal procedure, 1973. The Central Government may, in any case arising out of the new Act, direct any Company Prosecutor or authorise any other person to present an appeal from an order, other than High Court, and the appeal presented by such Prosecutor or other person shall be deemed to have been validly presented to the appellate court. The provisions of section 250 of the Code of Criminal Procedure 1973, shall apply, *mutatis mutandis*, to compensation for accusation without reasonable cause before the Special Court or the Court of Sessions. The court imposing any fine may direct that the whole or any part thereof shall be applied in or towards payment of costs of the proceedings or in or towards

payment of reward to the person on whose intimation the proceedings were instituted.

### **PUNISHMENT FOR FRAUD (SECTION 447)**

Explanation to Section 447 defines the term 'Fraud' as –

- (i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;
- (ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;
- (iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

Any person who is found guilty of fraud is punishable with imprisonment for a term of not less than six months but it may extend to ten years. The liability towards fine is not less than the amount involved in the fraud but it may extend to three times the amount. Where the fraud involves public interest, the imprisonment shall not be less than three years. This is without prejudice to the repayment of any debt involved in fraud.

List of offences attracted under Section 447 are placed at Annexure II.

### **PUNISHMENT FOR FALSE STATEMENT (SECTION 448)**

Any person making a statement which is false in any material particulars knowing it to be false or omitting to make material fact knowing it to be material, in relation to any return, report, certificate, financial statement, prospectus, statement or other document required by the provisions of this Act or the rules made thereunder, shall be liable for punishment for the same as is applicable for fraud under Section 447.

### **PUNISHMENT FOR FALSE EVIDENCE (SECTION 449)**

If any person intentionally gives false evidence upon any examination on oath or solemn affirmation authorised under this Act or in any affidavit, deposition or solemn affirmation in or about the winding up of any company, he shall be punishable with imprisonment for a term which shall not be less than three years but it may extend to seven years and with fine which may extend to rupees ten lakh.

### **PUNISHMENT WHERE NO SPECIFIC PENALTY OR PUNISHMENT IS PROVIDED (SECTION 450)**

If a company or any officer of the company or any other person contravenes any of the provisions of Act or the rules thereunder or any condition, limitation, or restriction subject to which any approval is given or granted for which no penalty or punishment is provided elsewhere, then the company and every officer thereof who is in default or such other person is punishable with fine extending to rupees ten thousand and where the contravention is a continuing offence, with a further fine extending to rupees one thousand for every day during which the contravention continues.

### **PUNISHMENT IN CASE OF REPEATED DEFAULT (SECTION 451)**

In the case of repeated default committed for the second or subsequent occasions within a period of three years, then the company and every officer thereof who is in default is punishable with twice the amount of fine for such offence, in addition to any imprisonment for the same.

### **PUNISHMENT FOR WRONGFULLY WITHHOLDING OF PROPERTY (SECTION 452)**

If any officer or employee of a company wrongfully obtains possession of any property including cash or having such property wrongfully withholds it or knowingly applies it for the purpose other than expressed or directed in the articles and authorised by this Act, then he shall, on the complaint of the company or any member or creditor or contributory thereof, be punishable with fine of not less than rupees one lakh but it may extend to rupees five lakh. The court trying an offence may also order restoration of property and in default thereof, the person is punishable with imprisonment for a period of two years.

- The expression 'wrongfully' used in section 452(1)(a) of the Companies Act, 2013 would mean that a person continues to remain in possession or hold the property otherwise than in due course of law. **[B. R. Herman & Mohatta India Ltd. v. Ashok Rai (1948) 55 Comp. Cas. 61 (Delhi)].**
- The expression 'withholding' used in section 452(1)(b) of the Companies Act, 2013 would mean wrongful withholding of property of the company or knowingly applying it for the purpose other than those expressed or directed in the articles and authorised by the Act. The dictionary meaning of the word 'withholding' is to hold back; to keep back; to restrain or decline to grant. The holding back or keeping back is not an isolated act but is a continuous process by which the property is not returned or restored to the company which is deprived of its possession, if the officer or employee of the company does any such act by which the property given to him is wrongfully withheld and is not restored back to the company, it will clearly amount to an offence within the meaning of section 452 of the Companies Act, 2013. [corresponding to section 630 of the 1956 Act.]. The object of this section is that the property of the company is preserved and is not used for purposes other than those expressed or directed in the Articles of the company or as authorised by the Act. **[Lalit Jalan v. Bombay Gas Co. Ltd. ( 2003) 44 SCL 130/114 Comp. Cas. 515 (SC).]**

### **PUNISHMENT FOR IMPROPER USE OF THE WORD "LIMITED" OR "PRIVATE LIMITED"(SECTION 453)**

If any person carries on trade or business under the name or title of which the word "limited" or the words "private limited" or any construction or imitation thereof is or are the last word or words, that person, unless duly incorporated with limited liability or as a private company with limited liability, as the case may be, is punishable with fine of not less than rupees five hundred but it may extend to rupees two thousand for every day during which that name or title has been used.

### **ADJUDICATION OF PENALTIES (SECTION 454)**

The Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of this Act in the manner as may be prescribed. The Central Government shall while appointing adjudicating officers, specify their jurisdiction in the order.

The adjudicating officer may, by an order impose the penalty on the company and the officer who is in default stating any non-compliance or default under the relevant provision of the Act.

The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to such company and the officer who is in default.

Any person aggrieved by an order made by the adjudicating officer may prefer an appeal in Form No. ADJ to the Regional Director having jurisdiction in the matter. Every appeal shall be filed within sixty days from the date on which the copy of the order made by the adjudicating officer is received by the aggrieved person and shall be in such form, manner and be accompanied by such fees as may be prescribed.

The Regional Director may, after giving the parties to the appeal an opportunity of being heard, pass such order as he thinks fit, confirming, modifying or setting aside the order appealed against.

When the company does not pay the penalty imposed by the adjudicating officer or the Regional Director within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees. When an officer of a company who is in default does not pay the penalty within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

### Companies (Adjudication of Penalties) Rules, 2014

- Before adjudging penalty, the adjudicating officer shall issue a written notice.
- A written notice to the company and to every officer of the company who is in default, to show cause, within such period as may be specified in the notice (not being less than fifteen days and more than forty five days from the date of service thereon), why the inquiry should not be held against him. Every notice issued under this sub-rule, shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company and officer in default, as the case may be:
- **Provided** further that the adjudicating officer may, for reasons to be recorded in writing, extend the period referred to above by a further period not exceeding fifteen days, if the company or officer (as applicable) satisfies the said officer that it has sufficient cause for not responding to the notice within the stipulated period.
- While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely:-
  - (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
  - (b) the amount of loss caused to an investor or group of investors or creditors as a result of the default;
  - (c) the repetitive nature of the default.

Every appeal against the order of the adjudicating officer shall be filed in writing with the Regional Director having jurisdiction in the matter within a period of sixty days from the date of receipt of the order of adjudicating officer by the aggrieved party, in Form **ADJ** setting forth the grounds of appeal and shall be accompanied by a certified copy of the order against which the appeal is sought.

The detailed procedural aspects are prescribed in Companies (Adjudication of Penalties) Rules, 2014.

All sums realised by way of penalties under the Act shall be credited to the Consolidated Fund of India.

*Annexure I*

#### List of offences Compoundable in nature (powers vested with Regional Director)

<b>Section</b>	<b>Nature of offence</b>	<b>Fine/ Imprisonment</b>
16(3)	Committing default in complying with the directions issued under	Fine upto ₹1,000 for each day of default on company. Fine not less than ₹5,000 but may be extended to

	sub-section (1) relating to rectification of name of company	₹1 lakh (for officer in default).
26(9)	Contravention of provisions relating to issue of a prospectus	Fine from ₹50,000 to ₹3 lakh on company and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.
53(3)	Violation of provisions relating to issue of shares at discount	Fine not less than ₹1 Lakh but may be extended to ₹5 lakh on company and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.
56(6)	Failure to comply with the provision relating to transfer and transmission of securities under sub-section (1) to (5)	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.
59(5)	Committing default in complying with the order of Tribunal relating to rectification of register of members	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.
64(2)	Failure to file a notice related to alteration, increase or redemption of share capital along with the altered memorandum with the Registrar	Fine upto ₹1,000 for each day of default continues, or five lakh rupees, whichever is less on company and person in default.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty five lakh rupees.
68(11)	If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board of India relating to buy back	Fine not less than ₹1 lakh but may be extended to ₹3 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which

	of securities	may extend to three lakh rupees, or with both.
86	Contravention of any provision of Chapter VI relating to Registration of Charges	Fine not less than ₹1 lakh but may be extended to ₹10 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.
88(5)	Failure to maintain register of members or debenture-holders or other security holders as prescribed	The company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues.
89(5)	Failure to file declaration not holding beneficial interest in any share	Fine upto ₹50,000 and further fine up to ₹1,000 for each day of default in case failure continues.
89(7)	Failure to file return relating to beneficial interest in any share before the expiry of the time specified under the first proviso to sub-section (1) of section 403	Fine not less than ₹500 but may be extended to ₹1,000 on company & every officer who is in default and further fine up to ₹1,000 for each day of default in case failure continues.
92(5)	Failure of company to file Annual Return	Fine on company – shall not be less than ₹50,000 but which may extend to ₹5,00,000 for officers fine shall not be less than ₹50,000 but may extend to ₹5,00,000.
92(6)	If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder	Fine which shall not be less than ₹50,000 but may be extended to ₹5 lakh.
99	Default in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal	Fine upto ₹1 lakh on company & every officer who is in default and further fine up to ₹5,000 for each day of default in case failure continues.
102(5)	Default in complying with the provisions of this section relating to statement to be annexed to notice	Fine upto ₹50,000 or 5 times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.
105(3)	If default is made in complying with	Fine upto ₹5,000 on every officer who is in default.

	sub-section (2) relating to proxies	
105(5)	If invitations to appoint a person as proxy or one of a number of persons specified in the invitations are issued	Every officer of the company who knowingly issue or willfully authorizes or permits their issue shall be punishable with Fine upto ₹1 lakh.
121(3)	Failure to file Report on annual General meeting	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company. Fine not less than ₹25,000 but may be extended to ₹1 lakh (for officer in default)
124(7)	Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124	Fine not be less than ₹1 lakh but may be extended to ₹5 lakh or with both (for every officer in default) and for company from ₹5 lakh to ₹25 lakh [NCLT for above ₹5 lakh].
137(3)	Failure to file financial statements with the Registrar	Fine up to ₹1,000/- for each day of default, but maximum up to ₹10 lakh and from ₹1 lakh to 5 lakh (for officers in default). [NCLT for above ₹5 lakh]
140(3)	Non-compliance by auditor of sub-section (2) relating to filing of resignation information	Fine not less than ₹50,000 but may be extended to ₹5 lakh on auditor/audit firm.
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.
157(2)	Failure to furnish DIN to Registrar	Fine not less than ₹25,000 but may be extended to ₹1 lakh on company and every officer in default.
165(6)	Acting as a director of more than 20 companies	Fine not less than ₹5,000 but may be extended to ₹25,000 for each day of default.
166(7)	Default in complying with the provisions of this section relating to directors duties	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on directors.
172	Contravention of the provisions of Chapter XI relating to appointment and qualifications of directors	Fine not less than ₹50,000 but may be extended to ₹5 lakh.
178(8)	Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination and Remuneration and Stakeholders Relationship	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand



	Committee	rupees but which may extend to one lakh rupees, or with both.
188(5)(i) 188(5)(ii)	Related party transaction in case of other company and listed company	In case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and  In case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.
186(13)	Contravention of the provisions of this section relating to loans and investment	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company for officer in default ₹25,000 to ₹1 lakh
187(4)	Contravention of the provisions of this section relating to investment of company held in its name	Fine not less than ₹25,000 but may be extended to ₹25 lakh on company. For officer ₹25,000 to ₹1 lakh. [above 5 lakh to NCLT]
191(5)	Contravention of the provisions of this section relating to payment to director for loss of office in connection with transfer of property.	Fine not less than ₹25,000 but may be extended to ₹1 lakh on such director.
197(15)	Contravention of the provisions of this section relating to managerial remuneration in case of absence or inadequacy of profits.	Fine not less than ₹1 lakh but may be extended to ₹5 lakh
203(5)	Contravention of the provisions of this section relating to appointment of Key Managerial personnel	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company  Fine up to ₹50,000 on Director or key managerial person who is in default and further fine up to ₹1,000 for each day of default in case the contravention continues.
204(4)	Contravention of the provisions of this section relating to Secretarial Audit for bigger companies.	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on the company, every officer of the company and company secretary in practice.
206(7)	Failure to furnish any information during inspection or inquiry	Fine up to ₹1 lakh and further fine up to ₹500 for each day of default on the company and every officer of the company.
221(2)	Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1)	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but

		which may extend to five lakh rupees, or with both.
222(2)	Securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.
232(8)	Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation	Fine not less than ₹1 lakh but may be extended to ₹ 25 lakh on company and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.
238(3)	Failure to register the offer of Schemes involving transfer of shares.	Fine not less than ₹25,000 but may be extended to ₹5 lakh on director who issue such circular.
242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and ₹25,000 to ₹1 lakh on officers [above 5 lacs to NCLT].
*247(3) Proviso	Contravention of the provisions of this section by the valuer	Valuer shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
249(2)	Filing of application in restricted cases for removal of name	Fine upto ₹1 lakh.
302(4)	Committing default by official liquidator in forwarding a copy of the order of dissolution of company by Tribunal within the period specified in sub-section (3)	Fine upto ₹5,000 for each day of default (on company liquidator).
342(6)	Failure or neglect to give assistance required under sub-section (5)	Fine not less than ₹25,000 but may be extended to ₹1 lakh.
344(2)	Failure to give statement that the company is in liquidation	The company, and every officer of the company, the Company Liquidator and any receiver or manager, who wilfully authorises or permits the non-compliance, shall be punishable with Fine not less than ₹50,000 but may be extended to ₹3 lakh.

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\* Not yet enforced

348(6)	Contravention of the provisions of information as to pending liquidation	Fine upto ₹5,000 for each day of default (for Company liquidator).
356(2)	Failure to file certified copy of the order of Tribunal relating to declaring dissolution of company void with the Registrar	Fine upto ₹10,000 for each day of default continues (for Company liquidator or the person on whose application the order was passed).
392	Contravention of the provisions of Chapter XXII by a foreign company	Fine not less than ₹1 lakh but may be extended to ₹3 lakh and further fine up to ₹50,000 for each day of default for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees, or with both.
405(4)	Failure to furnish information or statistics, etc. by the companies required by the Central Government	Fine upto ₹25,000 on company and every officer of the company who is in default, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to three lakh rupees, or with both.
450	No specific penalty or punishment is provided in the Act	Fine up to ₹10,000 and further fine up to ₹1,000 for each day of default in case of contravention continues.
451	Repeated default within 3 years	Twice the amount of fine for such offence in addition to any imprisonment provided for that offence.
452(1)	Punishment for wrongful withholding of property	Fine not less than ₹1 lakh but may be extend to ₹5 lakh on officer or employee of the company.
453	Improper use of the words "limited" and "private limited"	Fine not less than ₹500 but may be extended to ₹2,000 for each day of default.
454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company

464(3)	Being a member of a company formed exceeding certain numbers	Fine upto ₹1 lakh and liabilities incurred in such business.
469(3)	Contravention of the Rules framed by Central Government	Fine upto ₹5,000 and further fine up to ₹500 for each day of default in case of contravention continues.

**List of offences compoundable in nature (powers vested with the Tribunal)**

<b>Section</b>	<b>Nature of offence</b>	<b>Fine/ imprisonment</b>
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects, etc.	Fine not less than ₹10 lakh but may be extended to ₹1 crore on company and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees, or with both.
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock exchanges	Fine not less than ₹5 lakh but may be extended to ₹50 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.
46(5)	Fraudulently issuing of duplicate share certificates by a company	Fine not less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may extended to 10 times or ₹10 crore whichever is higher on company and every officer of the company who is in default shall be liable for action under section 447.
59(5)	Committing default in complying with the order of Tribunal relating to rectification of register of members	Fine shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.
66(11)	Failure to publish the order of confirmation of the reduction of share capital by the Tribunal	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall

		not be less than one lakh rupees but which may extend to twenty-five lakh rupees. [If less than ₹5 lakh then compoundable by the RD].
71(11)	Committing default in complying with the order of Tribunal relating to redemption of debentures	Imprisonment upto three years or fine not less than ₹2 lakh but may be extended to ₹5 lakh or with both (for officer in default).
74(3)	If a company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal	Fine not less than ₹1 crore but may be extended to ₹10 crore on company and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
117(2)	Failure to file with the Registrar the copy of notice or agreement within stipulated time	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company.  Fine not less than ₹1 lakh but may be extended to ₹5 lakh (for officer in default including liquidator).
124(7)	Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
143(15)	Failure of auditor to intimate to Central Government regarding fraud against the company by officers or employees	Fine not less than ₹1 lakh but may be extended to ₹25 lakh.
185(2)	Contravention of the provisions of sub-section 1 relating to loans, guarantee or security	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company or on other officers in default and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.
245(7)	Committing default in complying with the order of Tribunal under this section	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall

		not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
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**List of offences compoundable in nature (powers vested with Special Court)**

<b>Section</b>	<b>Nature of offence</b>	<b>Fine / Imprisonment</b>
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects, etc.	If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees, or with both:  <b>Provided</b> that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.
26(9)	Contravention of provisions relating to issue of a prospectus	Imprisonment upto three years or fine not less than ₹50,000 but may be extended to ₹3 lakh and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock exchanges	If a default is made in complying with the provisions of this section, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.
48(5)	Committing default in complying with the provisions regarding to variation of shareholders' rights	Every officer of company in default - Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹5 lakh or with both (for officer in default).
53(3)	Violation of provisions relating to issue of shares at discount	One lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

68(11)	If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board relating to buy back of securities	The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.
74(3)	If a company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal	Fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
86	Contravention of any provision of Chapter VI relating to Registration of Charges	Fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.
92(5)	Failure to file annual return before the expiry of the period specified under section 403 with additional fee	Fine not less than ₹50,000 but may be extended to ₹5 lakh on company. Imprisonment upto six months or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for officer in default).
128(6)	Failure to keep proper books of account	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for MD, WTD, CFO etc.)
129(7)	Failure to keep proper financial statement	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors).
134(8)	Default in complying with the provisions regarding financial statement and Board's report	Fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.



137(3)	Failure to file financial statements with the Registrar	The company shall be punishable with fine of one thousand rupees for every day during which the failure continues but which shall not be more than ten lakh rupees, and the managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	Company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.
159	Contravention of the provisions of section 152, 155 and 156	Imprisonment upto six months or fine up to ₹50,000 and further fine up to ₹500 for each day of default in case of contravention continues.
167(2)	Functioning as a director after vacation of office	Imprisonment upto one year or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both.
178(8)	Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination, Remuneration and Stakeholders Relationship Committee	The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.
184(4)	Failure to disclose of director's interest and participation in Board meeting by interested director	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹1 lakh or with both.
185(2)	Contravention of the provisions of sub-section 1 relating to loans, guarantee or security	If any loan is advanced or a guarantee or security is given or provided in contravention of the provisions of sub-section (1), the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be



		punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.
187(4)	Contravention of the provisions of this section relating to investment of company held in its name	The company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.
188(5)(i)	Contravention of this section relating to Related party transaction in case of listed company	Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall,— (i) in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and (ii) In case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.
194(2)	Forward dealing in securities of the company by Key Managerial personnel or director	Imprisonment upto two years or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both (for director or Key Managerial Personnel).
195(2)	Contravention of this section (195) relating to Insider trading of securities by Key Managerial personnel or director	Imprisonment upto five years or fine not less than ₹5 lakh but may be extended to ₹ 25 crore or three times the profit made on insider trading whichever is higher or with both.
221(2)	Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1)	The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.
222(2)	Securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but

		which may extend to five lakh rupees, or with both.
232(8)	Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation	Imprisonment upto one year or fine not less than ₹1 lakh but may be extended to ₹3 lakh or with both (for officer in default).
238(3)	Failure to register the offer of Schemes involving transfer of shares.	The director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.
242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both (for officer in default).
284(2)	Failure to extend full cooperation to the company liquidator	Person shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.
347(4)	contravention of any rule framed or an order made under sub-section (3)	Imprisonment upto six months or fine upto ₹50,000 or with both.
348(7)	Wilful default by company liquidator	Person acts in contravention of any rule framed or an order made under sub-section (3), he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.
392	Contravention of the provisions of Chapter XXII by a foreign company	The foreign company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twentyfive thousand rupees but which may extend to five lakh rupees, or with both.
405(4)	Failure to furnish information or statistics, etc. by the companies required by the Central	The company shall be punishable with fine which may extend to twenty-five thousand rupees and every officer of the company who is in default, shall be punishable with imprisonment for a term which may extend to six months

	Government	or with fine which shall not be less than twenty-five thousand rupees but which may extend to three lakh rupees, or with both.
441(5)	Failure to comply with the order made by Tribunal or Regional Director in relation to Compounding of offences	Imprisonment upto six months or fine upto ₹1 lakh or with both.
454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	Company does not pay the penalty imposed by the adjudicating officer or the Regional Director within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twentyfive thousand rupees but which may extend to five lakh rupees. Where an officer of a company who is in default does not pay the penalty within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

**List of offences non-compoundable in nature**

<b>Section</b>	<b>Nature of offence</b>	<b>Imprisonment and Fine</b>
57	Deceitfully personating as an owner of any shares or interest in a company	Imprisonment minimum of one year but may be extended to three years and with fine not less than ₹1 lakh but may be extended to ₹ 5 lakh.
58(6)	Contravention of an order of the Tribunal regarding the refusal of registration and appeal against refusal.	Company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
118(12)	Tampering with the minutes of the proceedings of meeting	Imprisonment upto two years and fine not less than ₹25,000 but may be extended to ₹1 lakh.

127	Failure to distribute dividend within thirty days	Imprisonment upto two years and fine not less than ₹1,000 for each day of failure (for every director) and 18% interest liability on company
147(2) <i>Proviso</i>	Failure of auditor to comply with the provisions of sections 139, 143, 144 and 145 If knowingly contravenes	The auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees: Provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
182(4)	Political contribution made in contravention of this section	Company shall be punishable with fine which may extend to five times the amount so contributed and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.
186(13)	Contravention of the provisions of this section relating to loans and investment	Company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
207(4)	Disobeys the direction issued by the Registrar or inspector under this section	The director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
217(6)	Disobeys the direction issued by the Registrar or inspector under this section in relation to investigation	The director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
217(8)	Failure to provide information, books or papers, etc. to inspector during investigation	Imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.
245(7)	Committing default in complying with the order of Tribunal under this section	Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the

		company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
*247(3) Proviso	Contravention of the provisions of this section by the valuer	Valuer shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
336(1)	Offences by officers of companies in liquidation	Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.
336(2)	Offences by officers of companies in liquidation covered under sub-Section (viii) of Section (d) of sub-section (1)	Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than three lakh rupees but which may extend to five lakh rupees.
337	Frauds by officers	Person punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.
338(1)	Failure to keep proper books of account before winding up	Imprisonment not less than one year but may be extended to three years and fine not less than ₹1 lakh but may be extended to ₹3 lakh.
447	Punishment for fraud  If the fraud involves public interest	Imprisonment not less than six months but may be extended to 10 years and fine not less than the amount involved in fraud but may be extended to 3 times the amount involved in fraud. Imprisonment not less than 3 years.
449	Intentionally gives false evidence	Imprisonment not less than three years but may be extended to seven years and fine upto ₹10 lakh.
452(2)	Wrongful withholding of property	To deliver up or refund any such property or cash wrongfully obtained; the benefits that have been derived, imprisonment for a term which may extend to two years.

\* not yet enforced

### LESSON ROUND-UP

- Companies Act provides punishment for offences in the form of imprisonment and/or fine in the various sections of the Act.
- All offences under Companies Act shall be triable by special court for the area in which the registered office of the company in relation to which the offence is committed.
- Section 212(6) deals with investigation into the affairs by serious fraud investigation office.



# Lesson 32

## Winding up-Concept and Modes

### LESSON OUTLINE

- Introduction
- Legal provisions for winding up of companies
- Winding up by the tribunal
- Voluntary winding up
- Provisions applicable to every mode of winding up

### LEARNING OBJECTIVES

Corporate Collapse implies business failure of the company, which may occur due to inadequate capital, fraudulent business practices, management inexperience and incompetence, failure to respond to change, recession, obsolescence, excessive gearing etc.

In the words of Prof. L.C.B. Gower, Winding-up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. A liquidator is appointed and he takes control of the company, collects its debts and finally distributes any surplus among the members in accordance with their rights. The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law. The Companies Act, 2013 provides for effective time bound winding up process.

## INTRODUCTION

Winding up of a company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. In words of Professor Gower, "Winding up of a company is the process whereby its life is ended and its Property is administered for the benefit of its members & creditors. 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."

According to Halsbury's Laws of England, "Winding up is a proceeding by means of which the dissolution of a company is brought about & in the course of which its assets are collected and realised; and applied in payment of its debts; and when these are satisfied, the remaining amount is applied for returning to its members the sums which they have contributed to the company in accordance with Articles of the Company." Winding up is a legal process.

Under the process, the life of the company is ended & its property is administered for the benefits of the members & creditors. A liquidator is appointed to realise the assets & properties of the company. After payments of the debts, if any surplus of assets is left out they will be distributed among the members according to their rights. Winding up does not necessarily mean that the company is insolvent. A perfectly solvent company may be wound up by the approval of members in a general meeting.

There are differences between winding up and dissolution. At the end of winding up, the company will have no assets or liabilities. When the affairs of a company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of the companies and its legal personality as a corporation comes to an end.

## Legal provisions for Winding Up of Companies

Section 2(94A) of the Companies Act 2013 provides the following definition of Winding up.

"Winding up" means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable. "Winding up" means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.

The procedures for Winding up of companies are provided under Chapter XX of the Companies Act, 2013 and Insolvency and Bankruptcy Code of India 2016.

The Insolvency and Bankruptcy Code, 2016 is an act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto. The Insolvency and Bankruptcy Code, 2016 (IBC) was passed by the Parliament on 11 May 2016, received Presidential assent on 28 May 2016 and was notified in the official gazette on the same day.

## Winding Up by the Tribunal

Section 270 of the Companies Act, 2013 provides that the provisions of Part I of Chapter XX of the



Companies Act, 2013 shall apply to the winding up of a company by the Tribunal under this Act.

### **Circumstances in Which Company May be Wound Up by Tribunal**

Section 271 of the Companies Act, 2013 provides that a company may, on a petition under section 272, be wound up by the Tribunal under following circumstances-

- (a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (c) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up."

### **Petition for Winding Up**

Section 272(1) of the Companies Act, 2013 provides that subject to the provisions of this section, a petition to the Tribunal for the winding up of a company shall be presented by—

- (a) the company;
- (b) any contributory or contributories;
- (c) all or any of the persons specified in clauses (a) and (b);
- (d) the Registrar;
- (e) any person authorised by the Central Government in that behalf; or
- (f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.

A contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder. [Section 272(2)]

The Registrar shall be entitled to present a petition for winding up under section 271, except on the grounds specified in clause (a) or clause (e) of that sub-section: Provided that the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition:

Provided further that the Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations. [Section 272(3)]

A petition presented by the company for winding up before the Tribunal shall be admitted only if

accompanied by a statement of affairs in such form and in such manner as may be prescribed. [Section 272(4)]

A copy of the petition made under this section shall also be filed with the Registrar and the Registrar shall, without prejudice to any other provisions, submit his views to the Tribunal within sixty days of receipt of such petition. [Section 272(4)]

### **Powers of Tribunal**

Section 273(1) of the Companies Act, 2013 provides the Tribunal may, on receipt of a petition for winding up under section 272 pass any of the following orders, namely:—

- (a) dismiss it, with or without costs;
- (b) make any interim order as it thinks fit;
- (c) appoint a provisional liquidator of the company till the making of a winding up order;
- (d) make an order for the winding up of the company with or without costs; or
- (e) any other order as it thinks fit:

Provided that an order under this sub-section shall be made within ninety days from the date of presentation of the petition:

Provided further that before appointing a provisional liquidator under clause (c), the Tribunal shall give notice to the company and afford a reasonable opportunity to it to make its representations, if any, unless for special reasons to be recorded in writing, the Tribunal thinks fit to dispense with such notice:

Provided also that the Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

Section 273(2) of the Companies Act, 2013 provides where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy.

### **Company Liquidators**

Section 275 (1) and (2) of the Companies Act, 2013 provides that for the purposes of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint a Provisional Liquidator or the Company Liquidator, as the case may, from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016.

### **Voluntary Winding up**

Chapter V of the Insolvency and Bankruptcy Code of India 2016 deals with the Voluntary Liquidation of Corporate Persons.

#### **Section 59**

- (1) A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of this Chapter.
- (2) The voluntary liquidation of a corporate person under sub-section (1) shall meet such conditions (3)

and procedural requirements as may be specified by the Board.

- (3) Without prejudice to sub-section (2), voluntary liquidation proceedings of a corporate person registered as a company shall meet the following conditions, namely:—
- (a) a declaration from majority of the directors of the company verified by an affidavit stating that—
    - (i) they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and
    - (ii) the company is not being liquidated to defraud any person;
  - (b) the declaration under sub-clause (a) shall be accompanied with the following documents, namely:—
    - (i) audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;
    - (ii) a report of the valuation of the assets of the company, if any prepared by a registered valuer;
  - (c) within four weeks of a declaration under sub-clause (a), there shall be—
    - (i) a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or
    - (ii) a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator: Provided that the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within seven days of such resolution.
- (4) The company shall notify the Registrar of Companies and the Board about the resolution under sub-section (3) to liquidate the company within seven days of such resolution or the subsequent approval by the creditors, as the case may be.
- (5) Subject to approval of the creditors under sub-section (3), the voluntary liquidation proceedings in respect of a company shall be deemed to have commenced from the date of passing of the resolution under sub-clause (c) of sub-section (3).
- (6) The provisions of sections 35 to 53 of Chapter III and Chapter VII shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary.
- (7) Where the affairs of the corporate person have been completely wound up, and its assets completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate person.
- (8) The Adjudicating Authority shall on an application filed by the liquidator under sub-section (7), pass an order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly.
- (9) A copy of an order under sub-section (8) shall within fourteen days from the date of such order, be forwarded to the authority with which the corporate person is registered.

### Provisions applicable to every mode of winding up

Part III of Chapter XX of the Companies Act, 2013 provides for following Sections which are applicable to every mode of winding up.

- 324 - Debts of all Descriptions to be Admitted to Prof
- 326 - Overriding Preferential Payments
- 327 - Preferential Payments
- 328 - Fraudulent Preference
- 329 - Transfers Not in Good Faith to be Void
- 330 - Certain Transfers to be Void
- 331 - Liabilities and Rights of Certain Persons Fraudulently Preferred
- 332 - Effect of Floating Charge
- 333 - Disclaimer of Onerous Property
- 334 - Transfers, etc., After Commencement of Winding Up to be Void
- 335 - Certain Attachments, Executions, etc., in Winding Up by Tribunal to be Void
- 336 - Offences by Officers of Companies in Liquidation
- 337 - Penalty for Frauds by Officers
- 338 - Liability Where Proper Accounts not Kept
- 339 - Liability for Fraudulent Conduct of Business
- 340 - Power of Tribunal to Assess Damages Against Delinquent Directors, etc.
- 341 - Liability Under Sections 339 and 340 to Extend to Partners or Directors in Firms or Companies
- 342 - Prosecution of Delinquent Officers and Members of Company
- 343 - Company Liquidator to Exercise Certain Powers Subject to Sanction
- 344 - Statement that Company is in Liquidation
- 345 - Books and Papers of Company to be Evidence
- 346 - Inspection of Books and Papers by Creditors and Contributories
- 347 - Disposal of Books and Papers of Company
- 348 - Information as to Pending liquidations
- 349 - Official Liquidator to Make Payments into Public Account of India
- 350 - Company Liquidator to Deposit Monies into Scheduled Bank
- 351 - Liquidator Not to Deposit Monies into Private Banking Account
- 352 - Company Liquidation Dividend and Undistributed Assets Account
- 353 - Liquidator to Make Returns, etc.
- 354 - Meetings to Ascertain Wishes of Creditors or Contributories

- 355 - Court, Tribunal or Person, etc., Before Whom Affidavit May be Sworn
- 356 - Powers of Tribunal to Declare Dissolution of Company Void
- 357 - Commencement of Winding Up by Tribunal
- 358 - Exclusion of Certain Time in Computing Period of Limitation

### LESSON ROUND-UP

- Winding up of a Company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. An administrator called the liquidator is appointed and he takes control of the company, collects its assets, pays debts and finally distributes any surplus among the members in accordance with their rights. At the end of winding up, the company will have no assets or liabilities. When the affairs of a Company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of companies and its legal personality as a corporation comes to an end.
- *Winding up means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.*
- Winding up is only a process while the dissolution puts an end to the existence of the company.
- Section 271 of the Companies Act, 2013 provides that a company may, on a petition under section 272, be wound up by the Tribunal.
- Section 273(2) of the Companies Act, 2013 provides where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy.

### SELF-TEST QUESTIONS

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

1. What is compulsory winding up? Who are entitled to make a petition to the court?
2. Describe voluntary liquidation process under Insolvency and Bankruptcy Code, 2016.
3. What are the circumstances in which a company may be wound up by Tribunal?
4. What orders can tribunal pass after receiving petition for winding up under Section 272 ?
5. Who are company liquidators?
6. What are the powers of Tribunal under Section 273(1) of the Companies Act, 2013?

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# Lesson 33

## Striking off Name of Companies

### LESSON OUTLINE

- Power of Registrar to Remove Name of Company from Register of Companies
- Removal of name of company from the Register on Suo Motu basis
- Restrictions on Making Application under Section 248 in Certain Situations
- Fraudulent Application for Removal of Names
- Appeal to tribunal for Restoration of the name of Company
- Meaning of Dormant Company
- Power and Role of the Registrar in case of Dormant Company

### LEARNING OBJECTIVES

Section 248 to 252 of the Companies Act, 2013 prescribes the procedure for striking off the name of defunct companies which are not carrying on any business, from the register of companies maintained by the Registrar. This is an alternative to winding up of a company subject to statutory criterion specified under the section. After reading this lesson you will be able to understand the regulatory provisions with regard to striking off names by registrar, procedural aspects involved in striking of names/restoration, etc.

## Power of Registrar to Remove Name of Company from Register of Companies

Section 248 provides that Where the Registrar has reasonable cause to believe that—

- (a) a company has failed to commence its business within one year of its incorporation [or];
- (b) [Omitted].
- (c) a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under .

Nothing shall apply to a company registered under section 8. The Register of Companies shall send a notice to the company and all the directors of the company to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents within a period of thirty days from the date of the notice.

A company may, after extinguishing all its liabilities, by a special resolution file an application in the prescribed manner to the Registrar for removing the name of the company from the register of companies on all or any of the grounds specified above.

The Registrar shall on receipt of application serve a public notice. In the case of a company regulated under a special Act, approval of the regulatory body constituted or established under that Act shall also be obtained and enclosed with the application.

A notice issued shall be published in the prescribed manner and also in the Official Gazette for the information of the general public.

At the expiry of the time mentioned in the notice, the Registrar may, unless cause to the contrary is shown by the company, strike off its name from the register of companies, and shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the company shall stand dissolved.

The Registrar before passing an order shall satisfy himself that sufficient provision has been made for the realisation of all amount due to the company and for the payment or discharge of its liabilities and obligations by the company within a reasonable time and, if necessary, obtain necessary undertakings from the managing director, director or other persons in charge of the management of the company.

Nothing in this section shall affect the power of the Tribunal to wind up a company the name of which has been struck off from the register of companies.

Removal of name of company from the Register on Suo Motu basis

The following categories of companies shall not be removed from the register of companies –

- (i) listed companies;
- (ii) companies that have been delisted due to non-compliance of listing regulations or listing agreement or any other statutory laws;
- (iii) vanishing companies;
- (iv) companies where inspection or investigation is ordered and being carried out or actions on such order are yet to be taken up or were completed but prosecutions arising out of such inspection or investigation are pending in the Court;



- (v) companies where notices under section 234 of the Companies Act, 1956 (1 of 1956) or section 206 or section 207 of the Act have been issued by the Registrar or Inspector and reply thereto is pending or report under section 208 has not yet been submitted or follow up of instructions on report under section 208 is pending or where any prosecution arising out of such inquiry or scrutiny, if any, is pending with the Court;
- (vi) companies against which any prosecution for an offence is pending in any court;
- (vii) companies whose application for compounding is pending before the competent authority for compounding the offences committed by the company or any of its officers in default;
- (viii) companies, which have accepted public deposits which are either outstanding or the company is in default in repayment of the same;
- (ix) companies having charges which are pending for satisfaction; and
- (x) companies registered under section 25 of the Companies Act, 1956 or section 8 of the Act.

Explanation.- For the purposes of clause (iii), the expression “vanishing company” means a company, registered under the Act or previous company law or any other law for the time being in force and listed with Stock Exchange which has failed to file its returns with the Registrar of Companies and Stock Exchange for a consecutive period of two years, and is not maintaining its registered office at the address notified with the Registrar of Companies or Stock Exchange and none of its directors are traceable.

#### **Restrictions on Making Application under Section 248 in Certain Situations**

Section 249 provides that An application shall not be filed on behalf of a Company if, at any time in the previous three months, the company—

- (a) has changed its name or shifted its registered office from one State to another;
- (b) has made a disposal for value of property or rights held by it, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;
- (c) has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application under that section, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;
- (d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or
- (e) is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

An application filed shall be withdrawn by the company or rejected by the Registrar as soon as conditions are brought to his notice.

#### **Fraudulent Application for Removal of Names**

Section 251 provides that Where it is found that an application by a company has been made with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the persons in charge of the management of the company shall, notwithstanding that the company has been notified as dissolved—(a) be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and (b) be punishable for fraud in the manner as provided in section 447.

The Registrar may also recommend prosecution of the persons responsible for the filing of an application.

### Appeal to tribunal for Restoration of the name of Company

Section 252 provides that Any person aggrieved by an order of the Registrar, notifying a company as dissolved may file an appeal to the Tribunal within a period of three years from the date of the order of the Registrar and if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies:

Before passing any order the Tribunal shall give a reasonable opportunity of making representations and of being heard to the Registrar, the company and all the persons concerned :

if the Registrar is satisfied, that the name of the company has been struck off from the register of companies either inadvertently or on the basis of incorrect information furnished by the company or its directors, which requires restoration in the register of companies, he may within a period of three years from the date of passing of the order dissolving the company an application before the Tribunal seeking restoration of name of such company.

A copy of the order passed by the Tribunal shall be filed by the company with the Registrar within thirty days from the date of the order and on receipt of the order, the Registrar shall cause the name of the company to be restored in the register of companies and shall issue a fresh certificate of incorporation.

If a company, or any member or creditor or workman thereof feels aggrieved by the company having its name struck off from the register of companies, the Tribunal on an application made by the company, member, creditor or workman before the expiry of twenty years from the publication in the Official Gazette of the notice may, if satisfied that the company was, at the time of its name being struck off, carrying on business or in operation or otherwise it is just that the name of the company be restored to the register of companies, order the name of the company to be restored to the register of companies, and the Tribunal may, by the order, give such other directions and make such provisions as deemed just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off from the register of companies.

## PROVISIONS OF COMPANIES ACT 2013 RELATING TO DORMANT COMPANIES

### MEANING OF DORMANT COMPANY

Section 455(1) of the Act defines that when a company is formed and registered under this act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed in form no. MSC. 1

(i) **Meaning of inactive company** - Explanation of the section 455 provides that the “inactive company” means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years

(ii) Significant Accounting Transaction -means any transaction other than

- (a) payment of fees by a company to the Registrar;
- (b) payment made by it to fulfill the requirements of this Act or any other law;
- (c) allotment of shares to fulfil the requirements of this Act; and
- (d) payments for maintenance of its office and records

**Rule 3 of Companies(Miscellaneous )Rules 2014**

Application for obtaining status of dormant company.- For the purposes of sub-section (1) of section 455, a company may make an application in Form MSC-1 along with such fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 to the Registrar for obtaining the status of a Dormant Company in accordance with the provisions of section 455 after passing a special resolution to this effect in the general meeting of the company or after issuing a notice to all the shareholders of the company for this purpose and obtaining consent of at least 3/4th shareholders (in value):

Provided that a company shall be eligible to apply under this rule only, if-

- (i) no inspection, inquiry or investigation has been ordered or taken up or carried out against the company;
- (ii) no prosecution has been initiated and pending against the company under any law;
- (iii) the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon;
- (iv) the company is not having any outstanding loan, whether secured or unsecured:  
Provided that if there is any outstanding unsecured loan, the company may apply under this rule after obtaining concurrence of the lender and enclosing the same with Form MSC-1 ;
- (v) there is no dispute in the management or ownership of the company and a certificate in this regard is enclosed with Form MSC-1;
- (vi) the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities etc.;
- (vii) the company has not defaulted in the payment of workmen's dues;
- (viii) the securities of the company are not listed on any stock exchange within or outside India.

**POWER AND ROLE OF THE REGISTRAR IN CASE OF DORMANT COMPANY**

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

455(3) provides that the Registrar shall maintain a register of dormant companies in such form as may be prescribed in Rule 5 under Companies (Miscellaneous) Rules, 2014.

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

**Rule 4 of Companies(Miscellaneous )Rules 2014****Certificate of status of dormant company.-**

The Registrar shall, after considering the application filed in Form MSC-1, issue a certificate in Form MSC-2 allowing the status of a Dormant Company to the applicant.

**MINIMUM NO. OF DIRECTORS IN DORMANT COMPANY**

455(5) Provides that a dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed in Rule 6 & 9 under Companies (Miscellaneous) Rules, 2014 to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and requisite fee as may be prescribed.

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

**NOTED THAT!**

Rule 6 of Companies (Miscellaneous) Rules, 2014 provides the Dormant Company shall have the minimum number of directors as under—

Public company – 3 directors

Private company – 2 directors

OPC – 1 directors

Rule 9 (c) & Rule 3 provides that fees payable under 455 shall be provided in the Companies (Registration Offices & Fees) Rules, 2014.

Rotation of auditors does not apply to these companies.

**Rule 5 of Companies (Miscellaneous) Rules 2014**

Register of dormant companies- The Register maintained under the portal maintained by the Ministry of Corporate Affairs on its web-site [www.mca.gov.in](http://www.mca.gov.in) or any other website notified by the Central Government, shall be the register for dormant companies.

**Rule 7 of Companies (Miscellaneous) Rules 2014**

Return of dormant companies- A dormant company shall file a “Return of Dormant Company” annually, inter-alia, indicating financial position duly audited by a chartered accountant in practice in Form MSC- 3 along with such annual fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within a period of thirty days from the end of each financial year:

Provided that the company shall continue to file the return or returns of allotment and change in directors in the manner and within the time specified in the Act, whenever the company allots any security to any person or there is any change in the directors of the company.

**Rule 8 of Companies (Miscellaneous) Rules 2014**

Application for seeking status of an active company- (1) An application, under sub-section (5) of section 455, for obtaining the status of an active company shall be made in Form MSC-4 along with fees as provided in the Companies (Registration Offices and Fees) Rules, 2014 and shall be accompanied by a return in Form MSC-3 in respect of the financial year in which the application for obtaining the status of an active company is being filed. The Registrar shall initiate the process of striking off the name of the company if the company remains as a dormant company for a period of consecutive five years.

(2) The Registrar shall, after considering the application filed under sub-rule (1), issue a certificate in Form MSC-5 allowing the status of an active company to the applicant.

(3) Where a dormant company does or omits to do any act mentioned in the Grounds of application in Form MSC-1 submitted to Registrar for obtaining the status of dormant company, affecting its status of dormant company, the directors shall within seven days from such event, file an application, under sub-rule (1) of this rule, for obtaining the status of an active company.

(4) Where the Registrar has reasonable cause to believe that any company registered as ‘dormant company’





# Lesson 34

## An Introduction to E-Governance and XBRL

### LESSON OUTLINE

- Introduction
- Important features of the e-Governance project of MCA
- Terms used while e-filing the forms
- Features of e-form and e-filing process
- XBRL

### LEARNING OBJECTIVES

The era of technology has significantly impacted the world at large. The technological advancement leads to the revolutionary changes in every part of life. The functions under the gamut of companies have also impacted. The advancement in the technology is not static; it is developing day by day.

The concept of physical filing has given way to electronic filing. Now, the filing of forms with the Registrar of Companies is done in electronic manner. The companies submit the returns, forms and other information in electronic mode. The data captured by electronic mode being easier to use and it helps the regulators to take steps immediately.

Further, the development of XBRL is the milestone in the usability of the information. The XBRL is the language which can be used make the information readable. After reading this lesson you will be able to understand the concept of e-governance, e-filing of forms and XBRL.

*“Developing and implementing IT governance design effectiveness and efficiency can be a multidirectional, interactive, iterative, and adaptive process.”*

**– Robert E Davis**

## Introduction

Governance refers to the exercise of political, economic and administrative authority in the management of a country's affairs, including citizens' articulation of their interests and exercise of their legal rights and obligations. E-Governance is the performance of this governance via the electronic medium in order to facilitate an efficient, speedy and transparent process of disseminating information to the public, and other agencies, and for performing government administration activities. E-governance refers to the use of information technologies in improving citizen-government interactions, cost-cutting and generation of revenue and transparency.

In the year 2006, MCA-21, India's largest e-governance initiative by the Ministry of Company Affairs and a mission project under Govt of India's national e-Governance plan, was launched with a comprehensive online portal to enable e-Filing under the MCA-21 project. With the start of MCA-21, corporations, professionals and the public at large were no longer required to visit the Registrar of Company offices and they were able to interact with the Ministry using the MCA-21 portal from their offices or home or the facilitation centres. The project also facilitated electronic submission of forms, which require a unique Digital Signature Certificate (DSC). Since then MCA has taken several steps for providing improved client oriented services and facilitating ease of doing business in India.

The project marked a new era of responsive, customer oriented, transparent and efficient governance.

## Important features of the e-Governance project of MCA

- (1) **DSC Services:** Digital Signature Certificates (DSC) is the digital equivalent of physical or paper certificates. A digital certificate can be presented electronically to prove one's identity, to access information or services on the Internet or to sign certain documents digitally. The Information Technology Act, 2000 has provisions for use of Digital Signatures on the documents submitted in electronic form in order to ensure the security and authenticity of the documents filed electronically. This is secure and authentic way to submit a document electronically.

All filings done by the companies/LLPs under MCA21 e-Governance programme are required to be filed using Digital Signatures by the person authorised to sign the documents. Digital Signature Certificate (DSC) can be obtained by directly approaching Certifying Authorities (CAs) with original supporting documents and self-attested copies or by using Aadhar/eKYC based authentication or through a letter/certificate issued by a Bank containing the DSC applicant's information as retained in the Bank database can be accepted.

Directors, Manager and Secretary of the Company and practicing professionals i.e. CA, CS & CWA have to register their DSC on MCA portal to do filings etc.

- (2) **DIN Services:** DIN is a unique Identification Number allotted to an individual who is appointed as director of a company, upon making an application in form DIR-3 pursuant to section 153 & 154 of the Companies Act, 2013. Central Government (Office of Regional Director (Northern Region), Ministry of Corporate Affairs) allots the DIN upon processing the form DIR-3 filed by the applicant. Further person who is appointed as a director upon filing form INC-29 will be issued a DIN by the approving authority (Central Registration Centre). Any person intending to apply for DIN shall have to make an application in eForm DIR-3 on the MCA portal. A provisional DIN is approved and provided only after scrutiny of the documents attached with the application.



- (3) Viewing Master Data and Documents of Companies/LLP: A facility has been made available to the general public to view master details or view public documents of any company/LLP registered with Registrar of Companies. This facility may be availed by clicking “View Company Master Data”. A similar facility has also been made available in respect of the 'Register of Charges' for the companies/LLPs by clicking on to the 'View Index of Charges' and for the viewing the details of the signatories of any company/LLP by clicking on 'View Signatory Details'. To view the Master Data - Company/LLP Name or CIN/LLPIN of the Company/LLP is required.

CIN Number or Company CIN No. is a unique identification number assigned by Registrar of Companies (ROC) functioning in various states under Ministry of Corporate Affairs (MCA), Govt. of India. After formation of a company, concerned ROC issues a certificate containing its unique Corporate Identification Number (CIN No. or CIN Code) along with its approved name. Every company must quote this unique Company CIN No. whenever a correspondence or data forms submitted to MCA, particularly in audits and reports.

- (4) E-filing of forms: An e-form is the electronic equivalent of the paper form. The Ministry of Corporate Affairs provides a platform where all the filing can be done electronically. All the e-forms along with the instructions to file them are available on the website of MCA at the link – <http://www.mca.gov.in/MinistryV2/companyformsdownload.html>. This has envisaged that all company related documents would be filed electronically. The new e-forms have been devised and notified by the Ministry for this purpose.
- (5) Online payment of fees: The MCA provides different modes of payment like Credit card/ Debit Card (Pay online), Net Banking (Pay online), Challan (Generate the Challan online, fill it and deposit it off-line at an authorized bank branch), NEFT etc. Stamp Duty is applicable on filing of certain forms which shall be electronically paid through MCA21 system. A person applying for certified true copy is also required to pay stamp duty through MCA21 portal.
- (6) Central Registration Centre: The Central Registration Centre (CRC) is an initiative of Ministry of Corporate Affairs (MCA) in Government Process Re-engineering (GPR) with the specific objective of providing speedy incorporation related services in line with global best practices. CRC is presently tasked to process applications for name availability (INC-1) and forms related to new companies incorporations. This initiative of MCA is in line with its objective of speedier processing of incorporation related applications and facilitating “Ease of Doing Business” to incorporate.

eBiz Governance Project: MCA has linked three of its objectives incorporation of company, name application and DIN application with eBiz platform. Its focus is also to improve the services to improve the business environment in the country by enabling fast and efficient services through online portal.

- (7) Tracking SRN/ transaction status: Every request submitted on MCA portal is identified by a unique number known as the Service Request Number (SRN). It is a nine character alphanumeric string starting with an alphabet (A-Z) which is printed on the top left hand side of a Receipt or Challan. All the transactions status can be tracked by entering SRN.

### **Some terms used while e-filing the forms**

#### **Pre-fill**

Pre-fill is functionality in an e-Form that is used for filling automatically, the requisite data from the system without repeatedly entering the same. For example, by entering the CIN of the company, the name and registered office address of the company shall automatically be pre-filled by the system without any fresh entry.

## Attachment

An attachment refers to a document that is sent as an enclosure with an e-Form by means of an attached file. The objective of the attachment is to provide details relevant to the e-Form for processing. While some attachments are optional some are mandatory in nature.

The attachments to an e-Form will be only in Adobe PDF format. MCA portal shall not accept attachment file of more than 2.5MB and the user is advised to keep the attachment size to minimum.

## Check Form

By clicking “Check Form”, the user will be in a position to find out whether the mandatory fields in an e-Form are duly filled-in. For example, if the user enters alphabets in “Date of Appointment of Director” field, he/she will be asked to correct the entered information.

If the size of attachment is much bigger then the details may be submitted in a floppy or compact disc at the ROC office. For example, In the case of Annual Return filed by the companies having large shareholders base, the list of shareholders may be submitted separately in a CD at the concerned ROC office indicating SRN No. of e-form filed

## Modify

Once the user has done ‘Check Form’, the form gets locked and it cannot be edited. If the user wishes to make any alterations, the form can be overwritten by clicking “Modify” button.

## Pre-Scrutiny

Pre-scrutiny is a functionality that is used for checking whether certain core aspects are properly filled in the e-Form. The user has to login on MCA portal to perform the pre-scrutiny of e-form. The necessary attachments and digital signatures should be affixed before submitting the e-Form for pre-scrutiny. The difference between check form and pre-scrutiny is that the Check form is done by internal features of the form which ensure that all the mandatory and required field are filled up and attachment are made to the e-form, while Pre-Scrutiny is a complete legal and technical scrutiny of an e-form done by the MCA portal before accepting the form.

## Features of e-form and e-filing process

An e-Form contains certain standardized features. Each e-Form contains the form reference and the description as well as the particular section of the Companies Act or the relevant rules or regulations under which it is required to be submitted. It starts with the Corporate Identity Number (CIN), which works as a unique identifier of an Indian Company and the Foreign Company Registration Number in the case of a Foreign Company that is required to be filled up. By entering the CIN, the company details to the extent these are available in static form in the database, are automatically filled in by using the pre-fill functionality.

- The e-Form contains a number of mandatory fields which are required to be filled-in. Certain other fields are non-mandatory in nature which may be filled-in as may be relevant in any particular case.
- An instruction kit is available for each e-Form, which contains details of the instructions for properly filling the e-Form.
- An e-Form may be filled in either online or offline. Online filling implies that the e-Form is filled while being still connected to MCA portal through the Internet. Offline filling denotes that the e-Form is downloaded into the user’s computer and filled later without being connected to the Internet.
- An e-Form may require certain mandatory attachments to be filed along with it. Optional

attachments may also be filed with an e-Form. The list of such attachments is displayed in the e-Form.

- Next to attachment, there is a declaration that is sought from the person filing the e-Form to the effect that the information given in the e-Form and the attachments is correct and complete.
- Most of the e-Forms require the digital signature of the Managing Director or Director, Manager or Secretary of the company for successful filing/ submission.
- Further, the digital signature of a third party may also be required in certain cases. In the case of an e-Form for creation or modification of charges, such digital signature is also required from the Bank or Financial Institution.
- In certain cases, certification from the Chartered Accountant or Cost Accountant or Company Secretary in whole-time practice is also required to authenticate the particulars contained in the e-Form. For example, this requirement is mandatory in the case of an e-Form for creation or modification of charges.
- There are built-in facilities to check the filled-in e-Form for requisite validations, to do pre-scrutiny and to modify the e-Form when the same is required to be re-submitted.
- When the “Submitted” button is pressed, the e-Form gets uploaded into the MCA central document repository.
- Thereafter, the requisite fees as applicable for the e-Form should be paid either on-line or off-line.
- Once the e-Form has been accepted and payment of fees has been acknowledged, a work item is created and assigned to the appropriate MCA employee based on pre-defined assignment rules as part of MCA back office workflow automation.
- In the case of an e-Form, the authorized officer affixes his/her digital signature for registering/approving/rejecting the same.
- After the processing of the e-Form is completed, an acknowledgement email is sent to the user regarding its approval/rejection.

## **XBRL**

XBRL stands for eXtensible Business Reporting Language. XBRL is a language for the electronic communication of business and financial data which has revolutionized business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data.

XBRL is a data-rich dialect of XML (Extensible Markup Language), the universally preferred language for transmitting information via the Internet. It was developed specifically to communicate information between businesses and other users of financial information, such as analysts, investors and regulators. XBRL provides a common, electronic format for business reporting. It does not change what is being reported. It only changes how it is reported.

XBRL is a world-wide standard, developed by an international, non-profit-making consortium - XBRL International Inc. (XII). XII is made up of many hundred members, including government agencies, accounting firms, software companies, large and small corporations, academics and business reporting experts. XII has agreed the basic specifications which define how XBRL works.

## XBRL tags

In XBRL, information is not treated as a static block of text or set of numbers.

Instead, information is broken down into unique items of data (e.g. total liabilities = 100). These data items are then assigned mark-up tags that make them computer-readable. For example, the tag <Liabilities>100</Liabilities> enables a computer to understand that the item is liabilities, and it has a value of 100.

Computers can treat information that has been tagged using XBRL 'intelligently'; they can recognize, process, store, exchange and analyse it automatically using software.

Because XBRL tags are formed in a universally-accepted way, they can be read and processed by any computer that has XBRL software. XBRL tags are defined and organized using categorization schemes called taxonomies.

## XBRL taxonomies

Different countries use different accounting standards. Reporting under each standard reflects differing definitions. The XBRL language uses different dictionaries, known as 'taxonomies', to define the specific tags used for each standard. Different dictionaries may be defined for different purposes and types of reporting. Taxonomies are the computer-readable 'dictionaries' of XBRL. Taxonomies provide definitions for XBRL tags, they provide information about the tags, and they organize the tags so that they have a meaningful structure.

As a result, taxonomies enable computers with XBRL software to:

- understand what the tag is (e.g. whether it is a monetary item, a percentage or text);
- what characteristics the tag has (e.g. if it has a negative value);
- its relationship to other items (e.g. if it is part of a calculation).

This additional information is called meta-data. When information that has been tagged with XBRL is transmitted, the meta-data contained within the tags is also transmitted.

Taxonomies differ according to reporting purposes, the type of information being reported and reporting presentation requirements. Consequently, a company may use one taxonomy when reporting to a stock exchange, but use a different taxonomy when reporting to a securities regulator. Taxonomies are available for most of the major national accounting standards around the world.

## BENEFITS OF XBRL

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision-making. All types of organisations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data.

XBRL enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time-consuming comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and manipulate XBRL information.

## Data Collection and Reporting

By using XBRL, companies and other producers of financial data and business reports can automate the

processes of data collection. For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently if the sources of information have been upgraded to using XBRL. Once data is gathered in XBRL, different types of reports using varying subsets of the data can be produced with minimum effort. A company finance division, for example, could quickly and reliably generate internal management reports, financial statements for publication, tax and other regulatory filings, as well as credit reports for lenders. Not only can data handling be automated, removing time-consuming, error-prone processes, but the data can be checked by software for accuracy.

### **Data Consumption and Analysis**

Users of data which is received electronically in XBRL can automate its handling, cutting out time-consuming and costly collation and re-entry of information. Software can also immediately validate the data, highlighting errors and gaps which can immediately be addressed. It can also help in analysing, selecting, and processing the data for re-use. Human effort can switch to higher, more value-added aspects of analysis, review, reporting and decision-making. In this way, investment analysts can save effort, greatly simplify the selection and comparison of data, and deepen their company analysis. Lenders can save costs and speed up their dealings with borrowers. Regulators and government departments can assemble, validate and review data much more efficiently and usefully than they have hitherto been able to do.

### **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015**

Rule 3 of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 provides that the following class of companies shall file their financial statement and other documents under section 137 of the Act, with the Registrar in e-form AOC-4 XBRL and the consolidated financial statements, if any, with form AOC-4 CFS.

The following class of companies are:

- (i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or
- (ii) all companies having paid up capital of rupees five crore or above;
- (iii) all companies having turnover of rupees hundred crore or above; or
- (iv) all companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011:

Provided that the companies in banking, insurance, power sector, non-banking financial companies and housing finance companies need not file financial statements under this rule.

Rule 4 of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 provides that a company required to furnish cost audit report and other documents to the Central Government under sub-section (6) of section 148 of the Act and rules made there under, shall file such report and other documents using the XBRL taxonomy given in Annexure-III for the financial years commencing on or after 1st April, 2014 in e-Form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014.

### **LESSON ROUND-UP**

- An e-form is a re-engineered conventional form, represents a document in electronic format.
- In the year 2006, MCA-21, India's largest e-governance initiative by the Ministry of Company Affairs and a mission project under Govt of India's national e-Governance plan, was launched with a comprehensive online portal to enable e-Filing under the MCA-21 project.



EXECUTIVE PROGRAMME  
**COMPANY LAW**

**EP-CL**

**TEST PAPER**

**A Guide to CS Students**

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet 'A Guide to CS Students" providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download from <http://www.icsi.edu/Portals/0/AGUIDETOCSSSTUDENTS.pdf>

**WARNING**

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

EXECUTIVE PROGRAMME  
**COMPANY LAW**

TEST PAPER

Time Allowed: 3 hours

Maximum Marks: 100

**NOTE:** Answer All Questions.

*Total Number of Questions: 6*

*All references to the sections relate to Companies Act 2013, unless stated otherwise*

1. Comment on the following:

- (a) Contravention of provisions of the Act with respect to accepting deposits by companies.
- (b) A public company which is OPC shall have secretarial audit conducted.
- (c) The company in the general meeting may with the approval of the Central Government authorize managerial remuneration exceeding 11% of the net profit of the company. Explain the statement.
- (d) Amongst others, Directors Responsibility Statement forms an important content of Board's Report.

*(5 marks each)*

***Attempt ALL parts of either Q.No. 2 or Q. No. 2A***

2. Distinguish between the following:

- (a) Extra Ordinary Meeting and Annual General Meeting.
- (b) Cost Auditor and Secretarial Auditor.
- (c) Interim Dividend and Final Dividend.
- (d) Small company and One Person company.

*(4 marks each)*

OR

- 2A. (i) ABC Pvt Ltd is preparing its Board Report. Suggest Company Secretary whether it is necessary for a Company to provide extract of annual return which shall form of part Board Report.
- (ii) Criminal liability for a mis-statement in prospectus. Discuss.
- (iii) There are certain restrictions on making application under section 248 in certain situations. Discuss.
- (iv) Discuss the provisions related to appointment of director elected by small shareholders.

*(4 marks each)*

***Attempt ALL parts of either Q. No. 3 or Q. No. 3A***

- (i) Explain the provisions of the Companies Act, 2013 relating to procedure to be followed for transacting business of the general meeting of members of the company through Postal Ballot.



- (ii) Discuss the provisions of striking off the name of Company.
- (iii) List the disclosures to be made with the board's report under the Companies Act, 2013.
- (iv) Discuss the provisions for appointment of Secretarial Auditor.

*(4 marks each)*

**OR (Alternate question to Q.No. 3)**

- 3A. (i) Array Ltd wants to appoint Manager and Managing Director at the same time. Advise whether the company can do so.
- (ii) Explain the provisions of Voluntary Winding Up.
- (iii) Explain the provisions of the Companies Act, 2013 relating to procedure to be followed for transacting business of the general meeting of members of the company through Postal Ballot.
- (iv) Explain the compliances for the transfer of shares.
- (4 marks each)*
4. (i) Can a Board delegate the issuance of duplicate share certificate to its committee. If yes, who shall sign such certificate?
- (ii) Describe the procedure for the appointment of Statutory Auditor in a Government Company.
- (8 marks each)*
5. (i) XYZ Ltd wants to appoint an Internal auditor. Advise the company assuming yourself as a company secretary regarding such appointment.
- (ii) Explain the provisions under Companies Act, 2013 regarding framework for constitution of National Financial Reporting Authority.
- (iii) Mr. Z is working as a director in ABC Ltd but he has been convicted of the offence dealing with related party transaction under section 188 from last preceding two years .Whether Mr. Z can be appointed as a Director in another public Company?
- (iv) Mention five transactions are not deemed to be deposits.
- (4 marks each)*
6. Write notes on the following:
- (i) Subsidiary Company
  - (ii) One Person Company
  - (iii) Winding up of the Company
  - (iv) Vacation of office of Director
- (4 marks each)*
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