M. Com. 3rd Semester

Course: MC-3.3

Corporate Legal Frame Work

Lesson 1 to 16

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CONTESTS

LESSON-1

COMPANY LAW: AN INTRODUCTION

STRUCTURE

1.0 OBJECTIVES

After studying this lesson, you should be able to:

- Define a company
- Describe the Characteristics of a Company
- Explain the concept of Corporate Veil
- Distinguish between a Company and a Partnership

1.1 MEANING OF A COMPANY

In simple words, a company can be defined as a group of persons associated together for the purpose of carrying on a business, with a view to earn profits. However, one must remember that companies also be formed for the promotion of commerce, art, science, religion or charity or any other useful object under the Companies Act.

Section 3(l)(i) of the Act provides that, "a company means a company formed and registered under this Act or n existing company?' Section 3(l)(ii) lays down that, "an existing company means a company formed and registered under any of the previous companies laws." These definitions, however, do not clearly point out the concept of a company; the following definitions are more helpful:

Lord Justice Lindley defines it as follows: "A company is in 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 there from. The common stock so contributed is denoted in money and is the capital of the company. The persons

who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted."

According to Chief Justice Marshall, "a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

Still another definition is given by Haney who observes that, "a company is an incorporated association, which is an artificial person created by law, having separate entity, with a perpetual succession and a common seal."

These definitions clearly bring out the characteristics of a company. A company is created by law. It comes into existence only when it is registered under the Act. It has a personality of its own which is distinct from the personality of its shareholders. The capital of the company is divided into transferable shares and liability of the members is limited to the nominal value of shares held. The persons who hold shares in the company are known as shareholders and they elect the directors who control and manage the affairs of the company. It has a perpetual succession and a common seal. It continues to exist until it is wound up in accordance with the provisions of the Act.

1.2 CHARACTERISTICS OF A COMPANY

The most distinguishing characteristics of a company are:

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

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

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

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

3. Separate legal entity: This means that a company has a legal entity distinct from and independent of its members. The creditors of the company can recover their

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

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

In this case Salomon had for many years carried on a prosperous business as a leather merchant. In 1892, he decided to concert it into a limited company. In the newly formed company, his wife, one daughter and four sons took up one share each of £1 to fulfill the statutory requirement of at least seven members. Salomon, with his two sons, constituted the board of directors. The purchase consideration was paid by the company by the allotment of 20,000 shares of £1 each and £10,000 debentures which gave Salomon charge over all the assets of the company, and the balance was paid in cash to Salomon.

The company almost immediately ran into difficulties and only a year later the then holder of the debentures appointed a receiver and the company went into liquidation. The position on liquidation was as follows: debentures issued to Salomon- unsecured creditors-£7,000 and assets-£6,000. Thus it was found that after paying the debenture holders, nothing was left for unsecured creditors.

The unsecured creditors contended that Salomon, and Salomon and Co. Ltd., are one and the same; Salomon could not owe money to himself. The company was a mere sham and an agent or nominee for Salomon who remained the real proprietor of the business. As such Salomon was bound to pay the unsecured creditors of the company out of his pocket in spite of the fact that his shares had already been fully paid-up. But it was held that once the company was incorporated under the Act, it had separate legal entity independent of its members. Salomon who was holding substantially the whole share capital could also be a creditor of the company. In this case where Salomon was a secured creditor, he was entitled to be repaid in priority over the unsecured creditors. It was observed:

"…When the memorandum is duly signed and registered though there be only seven shares taken, the subscribers are a body corporate capable, forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statue can loose its individuality by issuing the bulk of its capital to one person. The company is at law 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 status

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 have a mind or will of their own, or that there should be any thing like a balance of power in the constitution of the company."

Similarly in *Lee v. Lee's Air Farming Ltd., Lee* incorporated a company. He had himself appointed the 'Managing Director and Chief Pilot of the company. He was killed in an air crash, while working for the company and his widow claimed compensation. It was held that Lee and Lee's Air Farming Ltd. were separate and, as such, a claim for compensation was valid. "In effect the magic of corporate personality enabled him to be the master and servant at the same time."

The Indian courts have also recognised the principle of separate legal entity of a company. For instance, in *Abdul Haq v. Dos Mal* an employee of a company had not been paid salary for several months. He sued a director of the company for the recovery of the amount due to him. It was held that he could not succeed because "the remedy lies against the company and not against the directors or members of the company." This means that a company incorporated under the Companies Act has an independent corporate personality, separate and distinct, not only from the entities of its members but also from the entities of its directors and other managerial personnel.

The same principle of separate legal entity was applied in other cases such as *Dhulia-Amalner Motor Transport Ltd. v. Roythand Rupsi Dharamsi, Flitcroft's Case, T.R. Pratt (Bombay) Ltd. v. E.D. Sasoon and Co. Ltd. Macaura v. Northern Assurance Co. Ltd.*

Not a citizen: Although a company is a legal person distinct from its members, it is not a citizen. This means that a company does not acquire citizenship rights either under the Constitution of India or under the Citizenship Act. A company cannot claim the protection of such fundamental rights as are expressly guaranteed to citizens, such as the right of franchise. However, a company being a person can enforce those fundamental rights which are guaranteed to all persons whether citizens or not.

4. Perpetual succession: A company has perpetual succession and is independent of the life of its members. Its existence is not affected in any way by the death, insolvency or exit of any shareholder. "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." A company can be compared with a river which retains its identity though the parts which compose it are constantly changing. Perpetual succession thus means that in spite of a change' in the membership of the company, its continuity is not affected. Since a company is created by law, it can be wound up by resorting to the legal provisions of the Companies Act. Perpetual succession lends stability and long life to a company as compared to other forms of business organization.

5. Limited liability: One of the important advantages of company is that the liability of its members is limited. In the case of a company limited by shares, the liability of members is limited to the extent of the nominal value of shares held by them. If a shareholder has paid the full nominal value of shares held by him, his liability is nil. This means that a shareholder remains liable to pay the unpaid value of shares, if any. In the

case of a company limited by guarantee, the liability of each member is to contribute a specified amount to the assets of the company in the event of its being wound up while he is a member or within one year of his ceasing to be a member. In effect, we find that a member is not directly liable to a company's creditors but he is a limited guarantor of the company's debt in both cases. However, the Act does not prevent the companies from making the liability of its members unlimited. But such companies are very rare.

6. Transferable shares: In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the rights of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be *ultra vires*. However, in the case of a private company, the articles shall restrict the rights of members to transfer their shares in compliance with its statutory definition.

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

7. Common seal: A company in an artificial person. It cannot act on its own. It acts through natural persons who are known as directors. All contracts entered into by the directors must be under the common seal of the company. The common seal, with the name of the company engraved on it, is used as a substitute for its signature. No document issued by the company shall be binding on it unless it bears the common seal which is duly witnessed by at least two directors of the company.

8. Separate property: A company, being a legal person, is capable of owning, enjoying and disposing of property in its own name. The property of the company is to be used for the company's business and not for the personal benefit of its shareholders. A member does not have insurable interest in the property of the company. Members have no direct proprietary rights to the company's property, merely due to their shares. It is also important to note the claim of the company's creditors will merely be against the company's property and not that of shareholders.

9. Capacity to sue and being sued: The company is a legal person and it can enforce its legal rights. Similarly it can be sued for breach of its legal duties.

1.3 LIFTING THE CORPORATE VEIL

The principle of separate legal entity was established in the famous case of *Solomon v. Salomon & Co. Ltd.* as explained earlier. This precede it has been followed in a number of cases and it has come to be regarded as a fundamental principle of company law. When a company has been formed and registered under the Act, all dealings with the company will be in the name/of the company, and the persons behind the company will be disregarded however important they may be. This shows that once the company is registered under the Act, there is a veil drawn between the company and its members. This veil is partition or curtain between the company and its members. Following this principle the courts in most cases have refused to go behind the curtain and see who are the real persons composing the company.

But sometimes the necessity of the situation may compel the authorities to disregard the corporate legal entity and look to individual members who are in fact the real beneficial owners of all corporate property, and this in fact is what is known as, "Lifting or Piercing the Corporate Veil." Thus the doctrine of lifting the corporate veil may be understood as the identification of a company with its members and when the corporate veil is lifted the individual members may be held liable for its acts or entitled to its property.

The courts will lift the corporate veil where it is essential to secure justice, where it is in the public interest to do so or where it is for the benefit of revenue. But it must be kept in mind that a separate legal entity is still the general rule. The corporate entity will be disregarded only in exceptional cases. These case may be divided in two:

(1) Under express statutory provisions.

(2) Under judicial interpretation.

The following instances may be included under (1):

1(i) Reduction of membership below the statutory minimum: When the company carries on business for more than six months after its number of members is reduced below seven in the case of a public company and below two in the case of a private company, every person who is cognizant of the fact and is a member during the time the company so carries on business after these six months, is severally liable for all the debts of the company contracted during that time. However, the member or members will enjoy the privilege of limited liability for the six months (Sec. 45). We find that this section enables creditors to look beyond the company to its members for satisfaction of their amounts.

1(ii) Fraudulent trading: Sometimes in the course of the winding up of a company, it may appear 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. In such a case, the court may declare that those who were knowingly partly to such conduct of business shall be personally liable for all or any of the debts of the company without any limitation of liability. The Official Liquidator, the liquidator, any creditor or contributory of the company can make an application to the court in this connection. (Sec. 542)

1 (iii) Misdescription of the company: Section 147 requires that the name of the company must be fully and properly mentioned on all documents issued by it. Where the name of the company is not properly indicated as required by Section 147, persons who have committed the act or made the contract shall be personally liable for it. Thus, where a bill of exchange is accepted by an officer of the company and the name of the company is not properly indicated as required by Section 147, the officer shall be personally liable to the holder of the bill if the company fails to pay it.

1 (iv) For establishing the relationship of a holding and subsidiary company: When one company controls the composition of the board of directors of another company or holds majority of its shares, the former is called the holding company and the latter is known as the subsidiary company. The separate corporate entitles of both the companies shall exist in the eyes of law. It has been held that even a hundred per cent subsidiary is a

separate legal entity and its holding or parent company is not liable for its acts. Similarly, a holding company cannot sue to enforce rights which belong to its subsidiary.

But for establishing the relationship of a holding and subsidiary company, the court may lift the corporate veil and look behind to the persons who control the companies. Section 212 also provides for group accounts. It provides that there shall be attached to the balance sheet of a holding company, a copy of the balance sheet, profit and loss account, directors' report and auditors' report of each subsidiary and a statement of the holding company's interest in each subsidiary.

Again, the court may, on the facts of a case, refuse to grant a subsidiary company an independent status and treat the subsidiary company as only a branch of holding company. "Circumstances such as the profits of the subsidiary company being treated as those of the parent company; the control and conduct of the business of, the subsidiary company resting completely in the nominees of holding company; and the brain behind the trade of the subsidiary company being really the holding company, may indicate that in fact the subsidiary company is only a branch of the holding company.

1 (v) In case of an investigation of the affairs of the company: Section 239 provides that where an inspector is appointed t investigate the affairs of a company, he shall also have the power to investigate the affairs of any other body corporate in the same management or group. The object of this section is to provide for investigation into the affairs of some companies which may be so related that it is necessary to bring the affairs of those companies also under investigation.

1 (vi) In case of an investigation of the ownership of a company: Where it appears to the Central Government that there is good reason to do so, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company for the purpose of determining the true persons (a) who are or have been financially interested in the success or failure of the company; or (b) who are or have been able to control or materially influence the policy of the company.

This will be done by lifting the corporate veil so as to ascertain the real persons controlling it. (Sec. 247) Under. (2), the following may be included:

2 (i) For determining the character of the company: "A company may assume an enemy character when persons in dc facto control of its affairs are residents in an enemy country or wherever residents are acting under the control of enemies." Thus whenever it is suspected that the company is owned or controlled by enemies, the court may lift the corporate veil and examine the characters of the persons constituting it. It becomes necessary to do so because the company can neither be loyal nor disloyal, it can neither be a friend nor an enemy as it is an artificial person. It is the persons behind the corporate fiction who determine its loyalty or disloyalty, or its character.

In *Daintier Co. Ltd. v. Continental Tyre & Rubber Co.*, a company was incorporated in England. It had the object of selling tyres manufactured by a German company situated in Germany. In the English company the bulk of shares was held by the German company and the directors of the English company were Germans resident in Germany. In brief, the English company was controlled by Germans. During First World War the English company filed a suit to recover a trade debt. It was held that the company had become an enemy company as it was controlled by residents in an enemy country and, as such, the

suit filed by the English company was dismissed. It would be against policy to allow alien enemies to trade under the corporate facade.

But a company registered in England and carrying on business in an enemy country is not necessarily an alien enemy.

2 (ii) In case of fraud of misconduct: The court shall also lift the corporate veil where it finds that the company has been formed to defraud creditors or to defeat the provisions of any law or to avoid any legal obligations. In short, the corporate veil will be pierced where the company has been formed for any fraudulent or unlawful purpose. This is well illustrated by the case of *Gilford Motor C. v. Home.*

In this case Home was appointed Managing Director of *Gilford Motor Co.* The appointment was made on the condition that he would not solicit or entice away the customers of the company while in office. He, in the course of time, formed a company to carry on his own business and this company solicited the customers of *Gilford Motor Co.* It was held "that the company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation. Evidence as to the formation of the company and as to the position of its shareholders and directors leads to that inference. The defendant company was a mere channel used by the defendant Home for the purpose of enabling him, for his own benefit, to obtain the advantage of the customers of the plaintiff company, and that the defendant company ought to be restrained as well as the defendant Home."

Similarly in *Jones v. Lipman Lipman* agreed to sell land to Jones. Subsequently, in order to avoid an order of specific performance, he framed a company and sold the land to it. Lipman and a clerk of his solicitor were the only shareholders and directors of the newly formed company. Jones applied to the court for an order to specific performance against Lipman and the company. The court looked into the reality of the situation, ignored the original transfer to the company and ordered specific performance against Lipman and the company both on the ground that the company was nothing but mere cloak for Lipman who could compel the company to transfer the land to Jones.

2. (iii) For the benefit of revenue: The court may also lift the corporate veil in the interests of revenue. The court will not hesitate to look behind the corporate facade where it is found that the company has been formed for evasion of taxes. In such cases individual shareholders may be held liable to pay income-tax. A clear illustration is provided by the case of *Re Sir Dinshaw Maneckjee Petit.*

In this case the-assessee was enjoying a huge dividend and interest income from investments held by him. Four private companies were formed by him and each private company would take over a part of his investments. He was to be allotted shares in each company, in lieu of which he would transfer a part of his investments to them. However, the actual transfer was to take place only when the company called upon him to do so, something that was never done. It may also be noted that the entire issued capital of the company was held by him and his nominees, while he also held investments as a trustee of the company.

Later, as soon as the interest and dividends were received, the amount was credited to the company, and on the same day was withdrawn as a loan from the company to the assessee. This loan was never paid back by him. In this way the income of the assessee

was reduced. But the court held that She company was, in fact, not carrying on any business. It was being used as a tool to reduce *Petit's* tax liability. Company and assessee were held to be one and the same.

However, the court may refuse to identify the shareholders with the company if this results in loss of revenue 'of the Government or if it is not beneficial for' the revenues of the State. In *Bactia E. Guzdar v The Commissioner of Income-tax, Bombay G* was a member of a tea company. She received certain amount as dividend in respect of shares held by her in the company. Under the Income-tax Act, then in force, sixty per cent of the income of a tea company was exempt as agricultural income and only forty per cent of the income was taxed as income from manufacture and sale of tea. G also claimed that her dividend income should be regarded as agricultural income up to sixty per cent as in the case of a tea company. But it was held that although the income in the hands of the company was partly agricultural, the same income when received by G as dividend could not be regarded as income from agriculture.

A similar illustration is found in the facts of *Commissioner of Income-tax, Calcutta v. Associated Clothiers Limited** In this case, the assesses, Associated Clothiers, formed a company holding all its shares. They sold certain properties to the new company. The difference between the selling price and the cost of the property in the hands of the assessees was assessed as their income. On behalf of the assessees, it was contended that it was not a commercial sale yielding any profit which was liable to taxation. Their contention was that the transfers was from self to self as all the shareholders and all the directors of these two companies were the same at the relevant time and their objects in the memorandum were for all practical purposes identical. But the court rejected this and held that it was a sale from one entity to another and not a transfer from self to self.

1.4 DIFFERENCES BETWEEN A COMPANY AND A PARTNERSHIP

We have already seen that a company is an artificial entity created by law, with limited liability, perpetual succession and a common seal, and that its capital is divided into transferable shares.

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called, individually, "partners" and collectively, a "firm", and the name under which their business is carried on is the firm's name.

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

(1) A company conies into existence only when it is registered under the provisions of the Companies Act. However, a partnership is created by an agreement between partners. Registration of a partnership firm under the Partnership .Act is optional.

(2) A private company must be constituted by at least two persons, and by at least seven in case of a public company. A partnership can be created by two persons.

(3) In a public company, there is no limit on the maximum number members while in a private company the number of members shall be restricted to fifty excluding its present and past employees. In the case of a partnership carrying on banking business, the maximum number of partners can be ten, and in the case of any other business twenty.

(4) A company has a separate legal entity distinct from the members who constitute it. A partnership, commonly called a firm, has no legal existence apart from its members. This means that partners and firm are one and the same.

(5) In the case of a company, property belongs to the company and not to its individual members, whereas the property of a partnership firm belongs to individual partners comprising the firm.

(6) A shareholder may enter into a contract with a company, whereas a partner cannot enter into a contract with a firm. However, a partner can enter into a contract with other partners.

(7) Creditors of the company are not the creditors of individual shareholders. They can proceed against the company alone Creditors cannot hold the shareholders directly liable for their amounts. The creditors of a partnership firm are the creditors of individual partners and a decree obtained against a firm can be enforced against them."

(8) A shareholder is not an agent of the company whereas a partner is an agent of his firm in connection with partnership business.

(9) The liability of partners is unlimited. The liability of shareholders is usually limited. However, the law does not prevent a company from rendering the liability of members unlimited.

(10) Shares of a company are freely transferable. However, in the case of a private company the articles restrict the rights of members to transfer their shares. In a partnership, a partner cannot transfer his share without the consent of his co-partners.

(11) In a company, restrictions in the articles are effective as there is constructive notice of the memorandum and articles to every person who deals with the company. But in the case of a partnership, restrictions on a member's authority contained in the partnership deed are of no avail against outsiders.

(12) A company has perpetual succession. Death, insolvency or the exit of any shareholder does not affect the existence of the company. It comes to an end only when it .s liquidated according to the provisions of the Act. Unless otherwise provided, a partnership comes to an end when a partner dies or becomes insolvent.

(13) In a company, the shareholders do not interfere in affairs of the company directly. It is managed by a board of directors, who are elected by the shareholders. But a partnership is managed by all partners or any of them acting for all.

(14) Each partner is the agent of every other partner in all matters connected with the business of the partnership. Every partner has the authority to act on behalf of all and can, by his actions, bind all the partners of the firm. In a company, no shareholder is an agent of another shareholder. Neither a shareholder can bind other shareholders by his actions nor he is bound by the actions of other shareholders.

(15) A company's powers are defined by the memorandum. The articles contain rules and regulations for internal management, and any change in these documents can be made only by following the legal procedure laid down in the Companies Act. In the case of a partnership, rules regarding management of the business of the firm and the powers

of the firm are spelt out in the partnership deed which can be easily altered with the consent of all the partners.

(16) A company is also subject to strict control by the Companies Act with regard to various matters such as maintenance of books of account, share capital, distribution of profit, etc. There are no such statutory obligations in a partnership.

(17) A Company powers are defined by the memorandum. The articles contain rules and regulations for internal management, and any change in these documents can be made only be following the legal procedure laid down in the Companies Act. In the case of a partnership rules regarding management of the business of the firm and the powers of the firm are spelt out in the partnership deed which can be easily altered with the consent of all the partners.

1.5 SUM UP

The Companies Act, 1956 defines a company as "a company formed and registered under the Act of existing company." An 'existing company' means a company formed and registered under earlier companies Act.

The essential features of a company are:

1) It is an artificial person created by law and has an independent legal entity.

2) The liability of members of a company is limited.

3) A company has a perpetual succession.

4) Its shares are freely transferable.

5) The company must have a common seal.

6) A company can own and dispose off property in its own name.

7) A company can sue and be sued in its own name.

The company is a legal person distinct from its members. There is a veil, known as corporate veil, between the company and its members. Sometimes, it may become necessary to pierce this veil and look at the persons behind the company. This is known as "lifting or piercing the corporate veil."

1.6 KEY – WORDS

Company: An association of persons registered under the companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

Company limited by shares: A company having the liability of its members limited to the value of shares held by them.

Perpetual Succession: Continued existence irrespective of the life or sanity of its members.

Corporate Veil: A line of demarcation or a veil is drawn between the company and its members.

1.7 CHECK YOUR PROGRESS

1. Define a company.
2. Define the characteristics of a company.
3. What is meant by corporate veil?

1.8 REFERENCES

1. Business and Corporal Law, Saravanarel and Mahaputra, HPH.
2. Business Law, N.D. Kapoor, New Age.
3. Legal Aspects of Business, Pathak, TMH.

1.9 TERMINAL QUESTIONS

1. Distinguish between a company and a partnership.
2. Describe the characteristics of a company.
3. Discuss the concept of corporate veil. Under what circumstances can this veil be lifted.

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LESSON-2

CLASSIFICATION OF COMPANIES

STRUCTURE

2.0 OBJECTIVES

After studying this lesson, you should be able to:

- Distinguish between private and public company
- Explain one-man company, foreign companies and government companies
- Describe the holding and subsidiary companies

2.1 INTRODUCTION

DEPENDING on the mode of incorporation, there are three classes of joint stock companies:

(1) Chartered companies: These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered companies incorporated in England. - The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide

powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charter, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

(2) Statutory companies: These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India; Stale Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading Corporation and Life Insurance Corporation re examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alterations in the powers of such companies can be brought about by legislative amendments. The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts, [Sec. 616 (d)]

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

(3) Registered or incorporated companies: These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar. Such companies derive their powers from the Companies Act from the memorandum of association (every company registered under the Act has to prepare a memorandum). Rules and regulations for internal management are contained in the articles. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories, as Section 12(2) provides that a company incorporated under the Act may be either (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.

2.2 CLASSIFICATION OF COMPANIES BY LIABILITY OF MEMBERS

(1) 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 a company limited by shares. The main attraction of these companies is that the liability of their members is limited to the nominal value of shares held by each member. If the shareholder had paid the full nominal value of shares held by him, his liability is nil. The liability of the shareholder to pay the unpaid amount can be enforced during the existence of the company as also during its winding up. Companies limited by shares are by far the most common and may be either public or private.

(2) Companies limited by guarantee: A company that has the liability of its members limited by the memorandum 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 [Sec. 12(2b)]. It may further be noted the guarantee amount is required to be paid only when the company is wound up.

Generally, non-trading companies are formed with a guarantee capital. Such companies are not intended for purpose of making profits and distributing these among

their members. Rather, they are formed for the promotion of art, science, culture and sports, etc. Such companies may be registered with or without a share capital.

In the case of a company limited by guarantee, the articles shall state the number of members with which the company s to be registered [Sec. 27(2)]. Section 13(3) provides that the memorandum of a company limited by guarantee should also state that each member undertakes to contribute to the assets 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 (i) payment of liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, (ii) payment of costs, charges and expenses of winding up, and (iii) for adjusting the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

(3) Unlimited companies: A company that has no limit on the liability of its' members is termed an unlimited company [Sec. 12(2C)]. 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 not have share capital.

In an unlimited company, the articles shall state the number of members with which the company is to be registered, and, if the company has a share capital, the amount of share capital with which the company is to be registered [Sec. 27(1)]. This may be either a public company or a private company though these days, such companies are rare.

2.3 PRIVATE AND PUBLIC COMPANIES

On the basis of the number of members, companies can be divided in two: (i) private companies, (ii) public companies.

A *private company* is a company which, by its articles, (a) restricts the right to transfer its shares, if any; (b) limits the number of its members to fifty, excluding members who are or were in the employment of the company; and (c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company.

Where two or more persons hold one or more shares jointly in the company, they shall be treated as a single member for the purpose of this definition. [Sec. 3(I)(a/)]

In a private company without share capital, the articles need not contain the provisions for restricting the right of members to transfer shares. [Sec. 27(3)]

The minimum number required to form a private company is two. A private company shall add the words "Private Limited" at the end of its name, and it may commence its business immediately after obtaining a certificate of incorporation. But it should be noted here that a public company, after obtaining the certificate of incorporation, has to company with certain formalities to obtain a certificate of commencement of business, after which only it is entitled to do so. Private companies are usually family concerns, since shares are generally held by members of the family. The basic point of a private company is that shareholders have the advantage of limited liability and its affairs remain secret to a considerable extent.

A *public company* is that which is not a private company [Sec. 3 (I)(iv)]. This means that it may invite the general public to subscribe for any shares in, or debentures of, the

company. However, this is not binding on the company. Similarly, the limit of a maximum of fifty members as applicable to a private company does not apply to a public company. However, the minimum number of members required to form a public company is seven. At the same time the articles need not contain a clause for restricting the right of members to transfer their shares. These are freely transferable. It should be noted that a public company must add the word "Limited" at the end of its name.

DIFFERENCES BETWEEN PRIVATE AND PUBLIC COMPANY

(1) *Number of members.* The number of members in a private company is two while public company must have at least seven.

The maximum number of members in a private company cannot exceed fifty, excluding its present or past employees. In the case of a public company, there is no maximum limit on members.

(2) *Name of the company.* In a private company, the words "Private Limited" shall be added at the end of its name. In a public company, the word "Limited" only shall be added at the end of its name.

(3) *Transfer of shares.* In a private company, the articles restrict the right of members to transfer their shares whereas in a public company, the shares are freely transferable,

(4) *Public subscription.* A private company cannot invite the public to purchase its shares or debentures. A public company may do so.

(5) *Issue of deferred shares.* A private company can issue deferred shares carrying disproportionate Voting rights. But a public company cannot issue such shares.

(6) *Issue of prospectus.* Unlike a public company, a private company is not expected to Issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.

(7) *Minimum number of directors.* A private company shall have at least two directors, and a public company, at least three.

(8) *Restrictions on appointment of directors.* In a public company, the directors must file with the Registrar, their consent to act as such in writing. Similarly, they must sign the memorandum or enter into a contract for their qualification shares. At least two-thirds of the directors of a public company must retire by rotation. They cannot vote on a contract in which they are personally interested. These restrictions, however, do not apply to the directors of a private company.

(9) *Managerial remuneration.* In a public company the overall limit of managerial remuneration is 11 percent of net profits. However, this restriction does not apply to private company.

(10) *Issue of share warrants.* A private company cannot issue share warrants while a public company can.

(11) *Holding of statutory meeting.* A private company is not required to hold a statutory meeting whereas a public company must do so after one month, but before six months of obtaining the certificate of commencement of business.

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

(13) *Allotment of shares.* A private company can proceed to allot shares even before the minimum subscription is subscribed or paid. But a public company can not allot shares without raising minimum subscription.

(14) *Issue of right shares.* While making further issue of capital, a public company is required to first offer such further shares to its existing shareholders on a pro-rata basis. But a private company is not required to do so.

In addition to the above, a private company enjoys certain special privileges which are not granted to a public company. These are described below in detail.

SPECIAL PRIVILEGES OF PRIVATE COMPANIES

Though public as well as private companies are governed by the Companies Act, yet private companies are exempted from certain of its provisions. These exemptions are the special privileges of a private company. The idea underlying this sort of differentiation is that a public company raises money from the general public and therefore in order to protect the interests of investors, a strict control on public companies is required. In the case of private companies, the money is Invested by private individuals, generally members of the same family, and as the number of members is comparatively small, the Act can aftort to exempt such companies from some of its provisions. These privileges can be studied as follows:

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

(1) A private company may be formed with only two persons as members. [Sec.12(1)]

(2) It may commence allotment of shares even before the minimum subscription is subscribed for or paid (Sec. 69)

(3) It is not required to either issue a prospectus to the public or file a statement in lieu of a prospectus. [Sec. 70(3)]

(4) Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. [Sec. 81(3)]

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

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

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

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

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

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

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

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

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

(b) Additional special privileges of independent private companies: In addition to the privileges specified above, the independent private companies enjoy the following additional privileges:

(1) An independent private company is not prohibited from giving financial assistance directly or indirectly for purchase or s of its own shares. [Sec. 77(2)]

(2) It may issue any kind of shares and allow disproportionate voting rights. [Sec. 90(2)]

(3) A transferor or transferee of shares shall have no right of appeal to the Company Law Board against a refusal by the company to register a transfer of shares except as regards transmission by court sale or sale by other public authority. (Sec 111)

(4) Provisions of the Act in respect of matters specified in Sections 171 to 186, namely, general meetings, notice, quorum, chairman, proxies, voting, poll, etc., shall not be applicable to a private company to the extent to which it makes its own regulations. by its articles. [Sec. 170(1)]

(5) An independent private company is exempted from many provisions of the Act relating to directors, managing director or manager. These exemptions are given below:

(a) Restrictions contained in Section 198 regarding overall maximum managerial remuneration shall not apply to an independent private company. Section 198 fixes overall maximum managerial remuneration at eleven percent of net profits.

(b) All its directors can be permanent life directors and the provisions relating to retirement of directors by rotation (one-third ever year) shall not apply to it. (Sees. 255 and 256)

(c) Two or more directors may be appointed by a single resolution. But in a public company, each director shall be appointed by a separate resolution put to vote separately. (Sec. 263)

(d) The directors may vote on resolutions in which they are interested. (Sec. 300)

(e) There are not restrictions on the board of directors to sell the whole or part of the undertaking. (Sec. 293)

(f) There are no restrictions on a private company to make loans to its directors or to provide guarantees or securities for moneys borrowed or lent by them. (Sec. 295)

(g) Provision requiring Sanction of the Central Government for increasing the number of directors beyond the limit fixed by the articles shall not apply to an independent private company. (Sec. 259)

(h) Restrictions as to number of companies which can be managed by a director (twenty companies) or by a managing director (two companies) or by a manager (two companies) shall not apply to independent private companies. (Sees. 278, 316 and 386)

(i) Provision prohibiting appointment of managing director or manager for more than five years at a time shall not apply to it. (Sec. 317)

(j) No government approval is required for appointment or reappointment of managing or whole- time director or manager. Similarly no Government approval is required to amendment of provisions relating to managing or whole-time director or manager. (Sees. 268 and 269)

(k) Provisions of Section 270 specifying the time within which the share qualification is to be obtained by a director (within two months after his appointment as a director), and the maximum amount in respect of share qualification (five thousand rupees or the nominal value of one share where it exceeds five thousand rupees) shall not apply to an independent private company. (Sec. 273)

The above provisions and restrictions are applicable to public companies, while private companies are not required to comply with them.

(6) No person other than a member of the private company is entitled to inspect or obtain copies of the profit and loss account and the balance sheet filed with the Registrar. [Sec. 220(1)]

(7) Restrictions on making loans to other companies under the same management shall not apply to it. (Sec. 370)

(8) Provisions regarding prohibition of purchase by company of shares, etc., of other companies shall not apply to an independent private company. (Sec. 372)

(9) Provisions regarding the power of the Company Law Board to prevent change in the board of directors likely to affect the company prejudicially shall not apply to an independent private company (Sec. 409)

(10) Contracts entered into by an agent of a private company, which is not the subsidiary of a public company, if entered into by him on behalf of the company as undisclosed principal, need not be recorded by a memorandum n writing. (Sec. 416)

2.4 CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

(1) Conversion by default: Where the articles of a company include the provisions relating to a private company, but default is made in complying with any of these provisions, the company shall cease to be entitled to the privileges and exemptions

conferred on private companies under the Act, and the Act shall apply to the company as if it were not a private company.

The Company Law Board may relieve the company of the consequences of non compliance with the aforesaid restrictions, if it is of the opinion that the non-compliance was accidental or inadvertent. The Company Law Board shall grant relief on such terms and conditions as it may think just and expedient. (Sec. 43)

(2) Conversion under Section 43A (Deemed to be public companies): The Companies (Amendment) Act, 1960 introduced Section 43A. Private companies, as mentioned earlier, have certain privileges and e compared to public companies because they do not use public money. But it was found that certain companies, registered as private companies, were using public money to a considerable extent as a large number of shares in them were held by public companies. In this way these private companies were availing of privileges and exemptions granted to a private company,, but at the same time using public money for conducting their business. It was to check this tendency that Section 43A was added to the Act. A private company shall be deemed to be a public company in the following cases:

(a) Where not less than twenty-five per cent of the paid up share capital of a private company is held by one or more public companies or private companies which had become public companies by virtue of this section, i.e., Section 43A, the private' company will be deemed to be a public company from the date on which the aforesaid percentage is so held.

However, in computing the above percentage, the shares held by a banking company oh trust or as executors or administrators of the decreased shareholder shall not be taken into account. (Sec. 43A (1)]

(b) Where the average annual turnover of a private company is rupees twenty-five crores or more during the relevant period, the private company will become a public company after the expiry of three months from the last date of the relevant period. [Sec. 43A (1A)]

Prior to this, the limit of average annual turnover was rupees ten crores or more. The term "relevant period" means a period of three consecutive financial years. The term "turnover" means the aggregate value of realizations made from the sale or supply or distribution of goods or on account of services rendered or both.

(c) Where a private company holds not less than twenty-five per cent of the paid-up share capital of a public company, it will become a public company from the date it holds such shares. [Sec. 43A (IB)]

(d) Where a private company accepts, after an invitation is made by an advertisement, or renews, deposits from the public, other than its members, directors or their relatives, it shall become a public company on and from the date on which acceptance or renewal of deposits from the public is first made. [Sec. 43A (1C)]

Effect A private company, which has become a public company by virtue of Section 43A, loses all the advantages of a private company except that its articles of association may continue to include those provisions (such as restrictions on transfer of shares, limitation of the number of members to fifty and prohibition of invitation to the public to

buy shares or debentures), that make it a private company. Such a company may continue to have two directors and less than seven members.

Information to Registrar: Information must be given to the Registrar within three months of the company being deemed to be a public company who will make the necessary changes including alteration in the certificate of incorporation issued to the company and its memorandum of association. [Sec. 43A(2)].

A private company which has become a public company by virtue of the above provisions shall continue to be a public company until it becomes a private company again with the approval of the Central Government [Sec. 43A(4)].

Submission of certificates: A private company having a share capital will have to file with the Registrar along with its annual return a certificate to the effect that no company or companies has or have held twenty-five per cent or more of its paid-up share capital. The, certificate shall also state that its average annual turnover was less than rupees twenty five crores during the relevant period and that it did not accept or renew deposits from the public. [Sec. 43A(8)]

A private company shall also file another certificate along with the annual return. This certificate shall be signed by both the signatories to the return stating that since the date of the annual general meeting with reference to which the last return was submitted, the private company did not hold twenty five per cent or more of the paid-up share capital of one or more public companies. [Sec. 43A(9)]

(3) Conversion by alteration of articles of association: Section 44 lays down the method by which a private company may be converted into public company. The procedure is as follows:

(i) It shall pass a special resolution to alter its articles so as to eliminate the provisions relating to a private company. (The provisions relating to a private company are limitation of the number of members to fifty, restrictions on transfer of shares, and prohibition of an invitation to the public to purchase it shares and debentures).

(ii) Within thirty days, a prospectus or a statement in lieu of a prospectus together with a copy of special resolution and a copy of altered articles should be filed with the Registrar.

(iii) It shall increase the number of members to at least seven if it is less than seven. It must also increase the number of directors to at least three.

(iv) It shall delete the word 'Private' from its name. If the change of flame involves anything more than removing the word 'Private', written approval of the Central Government must be obtained.

The company shall cease to be a private company from the date of the alteration. The conversion of a private company into public and the consequent change of name would not affect the identity of the company.

2.5 CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

In order to convert a public company into a private company, the following steps are essential:

(i) A public company shall pass a special resolution 'to alter its articles so as to include in it 'the provisions relating to a private company, such as limiting the number of members to fifty, restricting the transfer of shares and prohibiting invitation to the public to purchase its shares and debentures.

(ii) The sanction of the Central Government must be obtained.

(iii) A copy of the special resolution and a printed copy of the articles as altered shall be filed with the Registrar within one month of the date of receipt of order of approval of the Central Government. (Sec. 31)

2.6 ASSOCIATION NOT FOR PROFIT

Licence to drop the word 'Limited': The memorandum of every company shall state the name. of the company. The word "Limited" will be added at the end of the name of a public company, and the words "Private Limited" will be added at the end of the name of a private company. However, under Section 25, the central Government may, by licence, direct that the association be registered as a company with limited liability, without the addition to its name of words "Limited" or "Private Limited."'

Conditions for granting licence. The Central Government shall grant a licence only when it is satisfied that (a) the association is about to be formed as a limited company to promote commerce, art, science, religion, charity, or any other useful object; and that (b) it intends to apply its profits, if any, or other income to promote its objects and to prohibit the payment of any dividend to its members.

On registration, it shall enjoy alt the privileges and be subject to all the obligations of limited companies.

The principle of limited liability generally takes the form of a guarantee company in the case of such association. [Sec. 25(1),(2)]

A licence may be granted by the Central Government on such conditions and subject to such regulations as it thinks fit. These conditions and regulations are binding on the company to which a licence is granted. These conditions and regulations shall be included in the memorandum or the articles of association, if the Central Government so directs. [Sec. 25(5)]

A body in respect of which a licence under this section is in force shall hot alter its memorandum with respect to its objects, except with the approval of the Central Government signified in writing. [Sec. 25 (8)(a)].

Partnership firms as members: Though a partnership firm is not a legal person - like a body corporate, still it may be a member in a licensed company in its own name and it is on the dissolution of the firm that its membership shall cease. [Sec. 25(4)]

Revocation of licence: The licence may at any time be revoked by the Central Government and, upon revocation, the Registrar shall enter the word "Limited" or the words 'Private Limited" at the end of the name upon the register of the body to which the licence was granted, and the body shall cease to enjoy the exemptions granted by this section.

Before a licence is so revoked, the Central Government shall give notice in writing of its intention to the body and shall afford it an opportunity of being heard in opposition

to the revocation. [Sec. 25(7)] Upon r of a licence granted under this section to a body, the name of which contains the words, "Chamber of Commerce," that body shall, within a period of three months from the date of revocation or such longer period as the Central Government may think fit to allow, change its name to a name which does not contain these words. [Sec. 25(9)]

2.7 ONE-MAN COMPANIES

In these companies, one man holds practically the entire share capital of the company. He takes a few other members who are no more than dummies or nominees of the former. This is done to fulfill the statutory requirement of at least seven members in the case of public company, and at least two members in the case of a private company. These other members usually subscribe the memorandum for one share each. In this way the person who holds the entire bulk of the share capital, except a few shares held by his nominees, enjoys full control over the company and is thereby enabled to do his business with limited liability.

Such a company is perfectly valid in the eyes of the law. It has its own entity which is separate from the entity of its members.

In *Solomon v. Solomon & Co. Ltd.,* Salomon was holding substantially the entire share capital in his name, and to fulfill the statutory requirement of at least seven members, his wife, a daughter and four sons joined him to form the company. These other members took only one share of £1 each.

It was held that the company is perfectly in order. It enjoys a separate entity of its own. Solomon & Co. Ltd. and Salomon were treated separate even when Solomon was holding practically the entire share capital of the company. It was pointed out that the Act requires at least seven persons, each of whom should hold at least one share. Once this conditions is fulfilled, it does not matter whether the members are independent or dummies.

The principle established in *Salomon v. Saloman & Co. Ltd.* has been followed in a number of cases. In fact it has become the basic principle of the company form of organization.

2.8 FOREIGN COMPANIES

Ordinarily, a foreign company is understood as a company incorporated outside India but for the purpose of Section 591 a foreign company means a company which is incorporated outside India but has an established place of business in India.

RULES AS TO FOREIGN COMPANIES

(1) Registration of documents: A foreign company which establishes a place of business in India is required to deliver the following documents 10 the Registrar for registration within thirty days of the establishment of such place of business:

(i) A certified copy of the constitution of the company. If it is not in English, a certified translation in English there of.

(ii) The full address of the registered or principal office of the company in foreign country;

(iii) A list of the directors and secretary of the company giving name in full, residential address, pationality of origin, his business occupation and any other directorship or directorships held by him.

(iv) The names and addresses of one or more persons resident in India who are authorized to accept service of notice and other documents on behalf of the company.

(v) The full address of the office of the company in India which is deemed its principal place of business in India. (Sec. 592)

(2) Alterations: Alterations in any of the documents of particulars mentioned above must be notified to the Registrar within the prescribed time. (Sec. 593)

(3) Accounts: Every foreign company shall, in every calendar year, make out a balance sheet and profit and loss account under the provisions of this Act as if it is an Indian company. It shall also file with the Registrar three copies of the balance sheet and profit and loss account and other documents required under the Act. The Central Government may modify or cancel the application of this rule for any foreign company. (Sec. 594)

(4) Name: Every foreign company shall (i) state the name of the country of its incorporation in every prospectus inviting subscriptions in India for its. shares or debentures; (ii) conspicuously exhibit on the 'outside of every office or place where it carries on business in India the name of the company and the country in which it is incorporated, in English and in one of the local languages: (iii) cause the name of the company and the country in which it is incorporated to be stated in English on all business letters, bill heads and letter paper and in all notices and other official publications of the company; and (iv) If liability of the members of the company is limited, cause notice of this fact to be stated in English and one of the local languages, on the outside of every office or place where it carries on business in Indian and on its letter paper, bill heads etc. (Sec. 595)

(5) Service. Any process, notice or document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any authorized person of the company and either left at his address or sent to the address by post. (Sec. 596)

(6) Delivery of documents. Any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi, in addition to delivery of such documents to the Registrar of the Slate in which the principal place of business of the company is situated. (Sec. 597)

(7) Failure to company with the above provisions. If the company fails to comply with any of the provisions, (a) the company and every officer or agent of the company who is in default shall be punishable with a fine which may extend to one thousand rupees, and in case of continuing default, with an additional fine which may extent to one hundred rupees for every day during which the default continues. (Sec. 598): (b) it shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof. But the company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction until it has complied with the above provisions. (Sec. 599)

(8) Application of other provisions of the Companies Act. The provisions relating to registration of charges (Sees. 124 to 145) will apply to a foreign company in respect of charges on property created in India. The provisions of Section 118 relating to the rights of members and debenture holders to obtain and inspect a copy of the trust deed for securing any issue of debentures of the company shall apply to foreign companies. Similarly the provisions of Section 209 shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India the books of account with respects to moneys received and expended, sates and purchases made and asset and liabilities in relation to its business in India.

On and from the commencement of the Companies (Amendment) Act, 1974, the following provisions of the Act shall be applicable to foreign companies:

(a) The provisions of Section 159 relating to the annual return to be made by a company having a share capital, subject to such modifications of adaptations as may be made therein by the rules made under this Act.

(b) The provisions of Section 209(A) relating to inspection of books of account by the Registrar or officer of the government.

(c) The provisions of Section 233(A) relating to the powers of the Central Government to direct special audit of the company's accounts.

(d) The provisions of Section 233(B) relating to audit of cost accounts in certain cases.

(e) The provisions of section 234 to 246 (both inclusive) relating to the powers of the Registrar to call for information or explanations and investigation of the affairs of company by the appointment of inspectors. (Sec. 600)

Under Section 591(2), the Central Government may notify that the provisions of the Act as may be specified by it shall apply to a foreign company in which Indian citizens and bodies corporate incorporated in India hold not less than fifty per cent of the paid-up share capital of the company.

It may be noted here that the above provisions apply to a foreign company only in respect of its Indian business.

(9) Fees for registration documents: There shall be paid to the Registrar for registering any document, such fees as may be prescribed. (Sec. 601).

(10) Prospectus: A prospectus inviting subscriptions for shares or debentures issued by a foreign company must be dated and it shall state the following particulars:

(i) name of the company;

(ii) name of the country in which it is incorporated and the date of incorporation;

(iii) the instrument constituting or defining the constitution of the company;

(iv) the enactments under which the incorporation was affected;

(v) the address in India where the said instrument, enactments or copies thereof can be inspected;

(vi) whether the company has established a place of business in India, and if so, the address of its principal office in India; and

(vii) matters specified in Part of Schedule II and reports specified in Part II of that Schedule, subject always to the provisions contained in Part III of the Schedule. (Sec. 603)

The prospectus shall also state whether the liability of members is limited. [Sec. 595 (d)]

Where the prospectus includes a statement purporting to be made by an expert, the prospectus shall contain a statement that the expert has given and has not withdrawn h consent to the statement. [Sec. 604 (1)]

Section 605 provides that no prospectus shall be issued unless a copy of the prospectus certified by the chairman and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered.

The liability for misstatement in the prospectus is the same as that for a prospectus issued by an Indian company. (Sec. 607)

(11) Winding up. Where a body corporate incorporated outside India that has been carrying on business in India ceases to do so, it may be wound up as an unregistered company. It may be wound up even if it has been dissolved or ceased to exist according to its own law of incorporation. (Sec. 584)

2.9 GOVERNMENT COMPANIES

There was a time when the State was concerned only with problems relating to the maintenance of law and order. But now the relationship between the State and economy has undergone a considerable change. There has been a growing participation of the State in the industrial development of the country. Considering this tendency, the Companies Act also includes provisions for government companies. The basic feature of these provisions is to enable the Government to undertake business ventures and to combine the operating flexibility of privately organized companies with the advantages of State regulation and control in the public interest.

Definition: A government company is one 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 party by one or more State Governments. The subsidiary of such a company is also a government company. (Sec. 617)

It is worth noting that a government company is not an agent of the Government unless it performs, in substance, governmental functions.

On the same grounds it was held in *Ranjit Kumar v. Union of India* 'that employees of a government company are not holders of civil posts under the State. In matter of industrial adjudication, the principles applicable to private companies will govern government companies.

SPECIAL PROVISIONS RELATING TO GOVERNMENT COMPANIES

Appointment of auditors: The auditor of a government company shall be appointed or reappointed by the Central Government on the advice of the Comptroller and Auditor General of India. [Sec. 619 (2)]

Conduct of audit: The Comptroller and Auditor General of India have the power to direct the manner in which the company's accounts shall be audited by the auditor and to give such an auditor instructions in regard to any matter relating to the performance of his functions as such. He also has the power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf. [Sec.619 (3)]

Audit report to be submitted to the Comptroller and Auditor General of India: The auditor shall submit a copy of his audit report to the Comptroller and Auditor General of India who shall have the right to comment upon or supplement the audit report in such manner as he may think fit. [Sec. 619(4)]

Audit report to be placed before the annual general meeting: Any such comments upon, or supplement to, the audit report shall be placed before the annual general meeting of the company at the same time and in the same manner as the audit report. [Sec. 619(5)]

Annual reports to be placed before Parliament: Where the Central Government is a member of a government company, the Central Government shall prepare the annual report on the working and affairs of the company within three months of it annual general meeting before which the audit report is placed. The annual report is to be laid before both Houses of Parliament together with a copy of the audit report and the comments or supplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(1)]

Where in addition to the Central Government, a State Government is also a member of a government company that State Government shall cause a copy of the annual report to be laid before the State Legislature together with a copy of the audit report and the comments or supplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(2)].

Where the Central Government is not a member of a government company, every State Government which is a member of that company or where only one State Government is a member of the company, the State Government shall cause an annual report on the working and affairs of the company to be prepared within three months of its annual general meeting before which the audit report is placed. The annual report is to be laid before the State Legislature together with a copy of the audit report and comments or supplementary report of the Comptroller and Auditor General of India. [Sec. 619(A)(3)]

The Amendment Act of 1988 makes it obligatory for laying of an annual report on a government company before both the Houses of Parliament or the State Legislature even in the case of government company in liquidation. [Sec. 619(A)(4)]

Provisions of Section 619 to apply to certain companies: Section 619(B) empowers the Central Government to appoint auditors on the advice of the Comptroller and Auditor General of India for the purpose of the audit of accounts of companies in which not less than fifty-one per cent of the paid-up share capital is held by Government,

government companies and public financial corporations. The Comptroller and Auditor General of India shall have powers to direct the manner in which the company's accounts shall be audited.

Power of the Central Government to modify Act in relation to government companies: The Central Government may direct that the provisions of the Act specified in the notification (other than Sections 619 and 619 A) shall not apply to any government company. In a similar way it may direct that specified provisions of that Act will apply with modifications as mentioned in the notification. [Sec. 620(1)1

A copy of every such notification proposed to be issued shall be laid before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions. If the Parliament disapproves of the issue of the notification, it shall not be issued. The Parliament may approve it with modifications. In such a case the modified notification may be issued. [Sec. 620(2)]

A government company shall comply with all the provisions of the Act unless it is specifically exempted, as mentioned above. Like other companies, it can also be wound up under the provisions of the Companies Act.

2.10 HOLDING AND SUBSIDIARY COMPANIES

When a company has control over another company, it is known as a holding company. The company which is so controlled is known as a subsidiary company.

Section 4(4) provides that a company shall be deemed to be the holding company of another, if, but only if, that other is its subsidiary.

Conditions of holding and subsidiary relationship: A company shall be deemed to be a subsidiary company of another only if any or more of the following conditions are satisfied:

(1) Where the corn position of its board of directors is controlled by the other company [Sec. 4(I)(a)]. The composition of a company's board of directors shall be deemed to be controlled by another company if other company, by exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of directorships. [Sec. 4(I)(a)]

A company shall be deemed to have power to appoint to a directorship in each of the following three cases: (a) if a person cannot be appointed to a directorship without the exercise in his favour by that other company of such a power as aforesaid; (b) if a person's appointment to a directorship follows necessarily from his appointment as a director or manager or to an other office of employment in that other company; (c) if the directorship is held by n individual nominated by that other company or subsidiary thereof. [Sec. 4(2)]

(2) Where the other company holds more than half in nominal value of its equity share capital; or where the other company, holds more than half of the total voting power of such company, if such company has preference shareholders who had, before the commencement of the Act of 1956 and therefore, still have, the same voting rights in all respects as the holders of equity shares. [Sec. 4(I)(b)]

In determining whether one company is a subsidiary of another, shares held or power exercisable in the following cases shall not be taken into account; (a) any shares held or power exercisable by that other company in a fiduciary capacity; (b) where the shares are held or power is exercisable by any person by virtue of the provisions of any debentures or of a trust deed for securing any issue of such debentures; and (c) where shares are held or power is exercisable by a lending company by way of security only for the purpose of a transaction entered into in the ordinary course of that business. [Sec. 4(3)]

(3) Where one company is a subsidiary of any company that is another's subsidiary, e.g. company B is a subsidiary of company A, and company C is a subsidiary of company B. Accordingly, company C becomes a subsidiary of company A. If company D is a subsidiary of company C, company D will become a subsidiary of company B and consequently also of company A. [Sec. 4(1)(c)]

Case of a foreign Company: In the case of a body corporate which is incorporated in a country outside India, a subsidiary or holding company of the body corporate under the law of such a country shall be deemed to be a subsidiary or holding company of the body corporate within the meaning and for the purposes of this Act also, whether the requirements of this section are fulfilled or not. [Sec. 4(6)]

Case of a private company: It may further be noted that a private company which becomes a subsidiary of a public company shall lose some of the privileges and exemptions conferred on an independent private company.

A private company, being a subsidiary of a body corporate incorporated outside India, which if incorporated in India, would be a public company within the meaning of this Act, shall be deemed for the purposes of this Act to be a subsidiary of a public company unless the entire share capital in that private company is held by that body corporate whether alone or together with one or more other bodies corporate incorporated outside India. [Sec. 4(7)]

Membership of holding company: Section 42 provides that a company cannot be a member of its holding company and any allotment or transfer of shares in a company to its subsidiary or nominee for its subsidiary will be void. This section shall not apply where the subsidiary is concerned as the legal representative of a deceased member of the holding company or where the subsidiary is trustee for some other shareholder and the holding company or its subsidiary is not beneficially interested except as tender of money in the ordinary course of a business. Where at the commencement of the Act a subsidiary was a member of the holding company, it may continue its membership but without any voting rights except in the two cases mentioned above.

Section 77 provides that no public company or no subsidiary private company shall in any way provide money to any person to enable him to buy any share in the company or in its holding company.

Balance sheet of holding company: Under section 212(1), there shall be attached to the balance sheet of a holding company the following documents in respect of each subsidiary; (a) a copy of the balance sheet of the subsidiary; (b) a copy of the profit and loss account; (c) a copy of the report of its board of directors; (d) a copy of the report of its auditors; and (e) a copy of the holding company's interest in the subsidiary at the end of

the financial year; (f) if for any reason, the board of directors of the holding company is unable to obtain information on any of the above matters, a report in writing to that effect must be attached to the balance sheet of the holding company; (g) where the financial year of the subsidiary company does not coincide with the financial year of the holding company, a statement indicating the change in the holding company's interest in the subsidiary between the gap of the two companies' financial years must be attached.

Rights of holding company's representatives and members: A holding company may, by resolution, authorize its representatives to inspect the account books of its subsidiary companies and the books of account of any such subsidiary shall be open to inspection by those representatives at any time during business hours. [Sec. 214(1)]

Although the corporate veil may be lifted for determining whether the relationship of a holding and subsidiary company does exist between two companies yet each company has its own separate legal entry.

2.11 ILLEGAL ASSOCIATION

An association is a group of persons associated together for some common object. The maximum number of members who can carry on business for gain without registration as an association is ten in the case of banking business, and twenty in the case of any other type of business. Section 11 provides that no company, association or partnership consisting of more than twenty persons (ten in the case of banking business) shall be formed for the purpose of carrying on any business with a view to gain, unless it is registered as a company under the Companies Act or is formed in pursuance of some other Indian law. If it is not so registered/it is deemed to be an illegal association, although none of the objects for which it may have been formed is illegal.

Conditions of an illegal association: An association will be deemed an illegal association in the following conditions:

(1) the association must consist of more than ten persons in the case of banking business, and twenty in the case of any other business;

(2) the association must have been formed for the purpose of carrying on business;

(3) the object of the association must be the acquisition of the gain for itself or for its members; and

(4) the association must not have been registered as a company under the Companies Act or must not have been formed in pursuance of some other Indian law.

Single Joint Hindu Family exempted: Section 11 shall not apply to joint Hindu Family carrying on a business as such. Such a family can carry on family business with more than twenty members without getting itself registered as a company under the Companies Act or any other Indian law.

Rules for counting number of members: Section 11 does not apply to a Joint Hindu Family carrying on a business. But where a business is conducted by two or more joint families, Section 11 applies and in computing the number of persons for this section, minor members of such families shall be excluded any only adults of both joint families shall be counted. [Sec. 11 (3)]

But if the "karta" of a family enters into partnership in his representative capacity on behalf of his family, he shall be treated as an individual.

A sub-partner in a firm does not affect the number of partners in a firm for the purpose of Section 11.

A partnership has no separate legal entity of its own and if it is a member of an association, it will not be counted as one person. Rather each partner will be counted as separate member of the association.

Conducting business for gain: For the application of Section 11, there must be a business for the acquisition of gain. Where an association is formed and members contribute sums to be applied for the medical relief of members and the balance is distributed at the end of every year amongst the members, it is held not to be a business." It was held in Smith v. Anderson that association formed for mutual indemnity and trusts for hazardous securities formed for the purpose of investment and saving of loss do not constitute a business and as such need not be registered.

Similarly, where more than twenty members carrying on a similar business entered into a "pooling agreement to eliminate competition and the members gained out of this pooling agreement)" it was not considered to be an association formed for the purpose of carrying on business under Section 11. It was considered a trade association formed with the object of protecting its members from unnecessary competition.

It may further be noted that an association conducting a business whose object is not acquisition of gain, need not be registered under the Act. "Gain refers to acquiring or obtaining something. It is not limited to pecuniary gain or commercial profit. Accordingly an association formed for the purpose of promoting art, science and religion or for charitable purposes need not be registered.

The profits made by an illegal association are liable to assessment to income-tax."

CONSEQUENCES OF IILEGAL ASSOCIATION

An illegal association has serious consequences and limitations:

(i) It is not recognized by law and hence it has no legal existence. It was pointed out that the consequence of illegality of a partnership is that its members have no remedy against each other for contribution or apportionment in respect of partnership dealings and transactions.

(ii) In cannot enter into a contract.

(iii) It cannot sue any member or any outsider if the illegality becomes apparent.

(iv) It cannot be sued by a member or an outsider for it does not have contractual capacity.

(v) It cannot enforce a contract."

(vi) It cannot be dissolved through the court

(vii) It cannot be wound up under the Act at the instance of a creditor, member or the association itself."

Members, however, can ask for a refund of money paid by them provided the money has not already been used for conducting the business of the illegal association. The court may, under general jurisdiction, administer trusts, without reference to this Act, wind up an unregistered society and make the manager account for and distribute assets.

It may be noted here that the illegality of unregistered association cannot be remedied by a subsequent reduction of members to below twenty. Similarly a contract made by an illegal association before registration cannot be made valid and be sued upon even 'if the company is subsequently registered.

(viii) Further, every member of the illegal association shall be personally liable for all liabilities incurred in business. [Sec. 11(4)]

(ix) Moreover every member of such an association shall be punishable with fine which may extend to one thousand rupees. [Sec. 11(5)]

2.12 SUM UP

There are three classes of joint stock companies namely chartered companies statutory companies and registered or incorporated companies. A company that has the liability of its members limited by its shares held by them is termed a company limited by shares.

A company that ahs the liability of its members limited to contribute to the assets of the company in the event of its being wound up, is known as a company limited by guarantee. A company that has no limit on its liability its members is known as unlimited company. A private company is a company which restricts the right to transfer its shares, limits the number of its members to fifty and prohibits any invitation to the public to subscribe for any shares in or debentures of the company.

A public company is that which is not a private company is. It may invite the general public to subscribe for shares or debentures of the company.

One man holds practically the entire share capital of the company. Foreign company means a company which is incorporated outside India but has an established place of business in India. A government company is one in which not less than fifty-one percent of the paid up share capital is held by the government.

Holding company is known as a company which has control over another company. The company which is so controlled is known as a subsidiary company.

2.13 KEY – WORDS

Company Limited By Shares: A Company that has the liability of its members limited by its shares held by them is termed as a company limited by shares.

Unlimited Company: A company that has no limit on the liability of its members is known as unlimited company.

Private Company: Is a company which restricts the right to transfer the shares, limits the number of its members to fifty and prohibits any invitation to the public to subscribe for any shares or debentures of the company.

One – Man Company: One man holds practically the entire share capital of the company.

Foreign Company: A company which is incorporated outside India but has an established place of Business in India.

Government Company: A Company in which not less than fifty one percent of the paid up share capital is held by the Government.

2.14 CHECK YOUR PROGRESS:

1. Define a company limited by guarantee.
2. Describe one man company.
3. Discuss the public and private companies.

2.15 REFERENCES:

1) Business and Corporate Law, Saravaravel and Mahaputra, HPH.
2) Business Law, N.D. Kapoor, Newage.
3) Business Law, Gulshan, Excel.
4) Legal Aspect of Business, Pathak, TMH.

2.16 TERMINAL QUESTIONS:

1. Distinguish between private and public company.
2. Describe Government companies.
3. Describe one man Company.

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LESSON-3

FORMATION OF A COMPANY

STRUCTURE

3.0 OBJECTIVES

After studying this lesson, you should be able to:

- Understand the word promotion in the formation of a company
- Describe the role of promoters
- Discuss the Capital subscription and Commencement of business

3.1 INTRODUCTION

A company is an artificial entity created by law for the purpose of carrying on any object such as business, sports, research, charity, etc. However, most companies are formed for the purpose of conducting business. The process of forming a company can be divided into four distinct stages: (*i) promotion; (ii) registration or incorporation; (iii) capital subscription;* and *(iv) commencement of business.*

As regards a private company, it needs to go through the first two stages only. As soon as it receives the certificate of incorporation, it can commence business. This is so because it cannot invite the public to subscribe to its shares and must arrange to raise the capital privately. But a public company, having a share capital, has to go through all

four stages mentioned above and only then will it be entitled to commence its business. We shall now discuss each of these four stages.

3.2 PROMOTION

This is the first stage in the formation of a company. *Gerstenberg* in his book, Financial Organization and Management of Business, has defined "promotion" as, "the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a, business concern for the purpose of making profits there from First of all the idea of carrying on a business which can be profitably undertaken is conceived either by a person or by a group of persons who are called promoters. After conceiving the idea, the promoters make detailed investigations to find out the weaknesses and strong points of the idea, to determine the amount of capital required and to estimate the operating expenses and probable income. When the promoter is satisfied that the idea, as originally conceived, can be put into practice profitably, he takes the necessary steps for assembling the proposition. These steps include securing the cooperation of the required number of persons who will associate themselves with the project and act as the first directors of the company to be floated, securing the necessary patents, acquisition of a suitable site for the factory, arrangements for machinery and equipment, tentative arrangements for personnel and so on.

After assembling the proposition, the promoters prepare a detailed financial plan showing therein total cost of the project, sources of finance, etc. They must also decide at this stage whether the company to be formed is to be a private company or a public company. The minimum number of members required to form a company is seven in the case of a public company and two in the case of a private company. They must also arrange in advance the success of the company floatation by finalizing contracts with the underwriters and the Issue Houses. Finally, they should get prepared necessary documents such as memorandum of association, articles of association, the prospectus and arrange for their publication. These documents are prep with the help of a legal experts and the promoters have to see that the particular requirements of the Act are incorporated therein.

3.3 PROMOTERS

Though the Act nowhere defines the term "promoter", a number of judicial decisions have attempted to explain it. The best definition comes from L.J. Browen who says that, "it is not term of law but of business, usefully summing up in a single commercial word, a number of business operations, familiar to the commercial world by which a company is brought into exist

Lord Blackburn has beautifully stated that, "it is a short and convenient way of designating those who set in motion the machinery by which the Act enables them to create an incorporated company?'

Justice Cockburn defines a promoter as, "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."

So long as the work of formation continues, those who carry on that work retain the character of promoters. However, if the board of directors is formed and it undertakes

the remaining work respecting company formation, the promoters' functions come to an end.

Not everybody connected with the formation of a company can be called a promoter. Thus professional advisers, legal as well as others, are not promoters. Similarly when those engaged in starting a new enterprise, consult experts to advise them of the full facts with regard to the proposed enterprise and its future prospects (e.g. value's, surveyors, engineers etc.) they cannot be called promoters.

A person may also not be regarded as a promoter if his signature appears at the foot of the memorandum or if he had initially subscribed for some shares. Even the fact that money paid by him against shares was utilized in the expenses of the formation of the company, would not make him a promoter.' Individuals do not become promoters because they buy property, subsequently sold by them to a company at a profit, even though the consideration consists of shares in the same company. But where certain persons buy property with a view to selling it later to a company to be formed by them, such persons will be regarded as promoters from the moment they took first step to carry out that object.

LEGAL POSITION OF PROMOTERS

Not an agent or trustee: The legal position of a promoter is somewhat peculiar. He is not a trustee for the company because there is no company yet in existence. For the same reason, he cannot be the company's agent either.

Fiduciary position of a promoter: The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed. Lord Blackburn observed in this connection:

> "Those who accept and use such extensive powers are not entitled to disregard the interest of the corporation altogether. They must make a reason use of the powers which they accept from the legislature; and consequently they do stand, with regard to that corporation when formed in what is commonly called a fiduciary relation to some extent?'

Fiduciary duties of a promoter: Two important results follow from the fiduciary position of promoters:

(a) A promoter cannot be allowed to make any secret profits. If it is found that in any particular transaction of the company, the promoter has obtain d a secret profit for himself, he will be bound to refund the same to the company; (b) He is not allowed to derive a profit from the sale of his own property unless all the material facts are disclosed. If a promoter contracts to sell the company a property without making a full disclosure, and the property was acquired by him at a time when he stood in a fiduciary position towards the company, the company may either rescind the sale or affirm the contract and recover the profit made from it by the promoters.

It is thus clear that it is not the profit made by promoter which the law forbids but the non-disclosure of it. A promoter who sells his property to a company formed by him is not precluded from making a profit provided a full disclosure is made by him to the company.

It is worth noting here the facts of Erlanger v. New Sombrero Phosphate Co.

A syndicate of which E was the head, purchased an island containing phosphate mines. A company was formed to purchase property from him and he also named some fictitious persons as its directors. The property was later sold to the company by a contract between the company and a nominee of the Syndicate at a price which was twice the price paid by E for its original purchase. The purchase agreement was approved at the meeting of shareholders, but no material facts were disclosed. Later on when the company went into liquidation, the liquidator filed a Suit against E to recover the profits made by him in the said transaction. E tried to defend it on the ground that the directors had full knowledge regarding the sale. But his plea was rejected by the court and it was held that as there had been no disclosure by the promoters of the profits they were making, the company was entitled to rescind the contract and recover the purchase money from E and other members of the Syndicate.

The disclosure may be made either (a) to an independent board of directors; or (b) directly to prospective shareholders by means of prospectus or articles.

In relation to disclosure it must be kept in mind that the promoters must make a full disclosure. A half disclosure is sometimes worse than none. Thus in *Gluckstein v. Barnes,* a syndicate was formed to purchase a property called "Olympia" with a view to reselling it to a company. The syndicate first bought charges on the property at a discount and made a profit of £20,000. The syndicate afterwards bought the property, on which it held charges for £1,40,000 with a view to re-selling It to a company to be formed by it. The syndicate then sold the property to "Olympia Ltd', a company formed by it for £ 1,80,000. In the prospectus that was issued, the syndicate disclosed the profit of £40,000 and not the former one of £20,000. It was held that the trustees ought to have disclosed the profit of £20,000, that they had not disclosed it and that they were bound to pay it to the company.

Consequences of non-disclosure: It has already been observed that where promoters do not make disclosures of material facts while selling their property to the company, the sale may be set aside at the instance of the company. If, however, rescission has become impossible, the company is entitled to claim damages from the promoters and the measure of such' damages is the profit made by the promoters upon the purchase and resale of the property.

LIABILITY OF PROMOTERS

As we have already seen, the promoter is liable to account to the company for all secret profits made by him without full disclosure to the company. The company can also sue for rescission of the contract of sale by the promoter of the company, where the promoter has not disclosed his interest therein.

Besides, Section 62(1) holds the promoter of a company liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. However, Section 62 also provides certain grounds on which a promoter can avoid his liability.

Similarly Section 63 provides for criminal liability for misstatements in the prospectus and a promoter may also become liable under this section. Section 56 lays

down matters to be stated and reports to be set out in prospectus. A promoter may also be held liable by shareholders for non-compliance of this section.

He may also be sued for damages in an action for deceit under the general law in case of fraudulent misstatement in the prospectus. A promoter is also liable to be publicly examined by the court as to his conduct and dealings, where an order has been made for winding up the company by court and the Official Liquidator has made a report to the court starting that in his opinion a fraud has been committed by the promoter in the promotion or formation of the company or in relation to the company since its formation. (Sec. 478)

Similarly he may be held liable to compensate the company if he has misapplied or retained or become liable or accountable for any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company. (Sec. 543)

REMUNERATION OF PROMOTERS

A promoter is not entitled to recover any remuneration for his services from the company unless the company, after its incorporation, enters into a contract with him for this purpose. It may be noted that he has no claim against the company for remuneration even if it may have been settled previously. The inability of a company to contract before its incorporation makes it impossible for promoters to obtain contractual rights to remuneration for their services. In some cases, articles of the company provide for the directors paying a specified sum to promoters for their services but this does not give the latter any contractual right to sue the company: It is simply an authority vested in directors.* Even if there is a clause in their articles authorizing the directors to pay the expenses, the latter are not justified in paying out money without due inquiry.

The remuneration may be paid in any of the following ways: (a) a commission may be paid to the promoter on the purchase price of the business or property taken over by the company through him; (b) the company may grant him a lump sum either in cash or in the form of shares; (c) he may purchase the business or other property and sell the same to the company at an inflated price. He must make a disclosure to this effect; (d) he may take a commission at a fixed rate on shares sold; or (e) promoters may take on option to subscribe within a fixed period for a certain portion of the company's un-issued shares at par. This is a valuable option if the shares are likely to hit a premium.

Whatever be the nature of a remuneration or benefit, it must be disclosed in the prospectus if paid within the proceeding two years from the date of the prospectus.

3.4 PRELIMINARY CONTRACTS

Preliminary contracts are contracts made on behalf of a company yet to be incorporated. Such contracts are generally entered into by promoters to acquire some property or right for and on behalf of the company to be formed. The promoters enter into the preliminary contracts with third parties, generally as agents or trustees of the company. Such contracts are not legally binding on the company because two consenting parties are necessary to a contract, whereas the company, before incorporation, is a non-entity." Even a company cannot atify such contracts after incorporation because, for valid

ratification, the principal must have been in existence at the time when the promoters entered into such contracts.

Company not bound by preliminary contracts. A company is not bound by preliminary contracts even if it takes benefits of work done on its behalf. It can be well illustrated by the case of Re English and Colonial A solicitor of a company about to be formed prepared memorandum and articles of association on the instructions of persons who ultimately became directors of the company. He also paid the necessary registration fees. The company went into liquidation and he claimed the fees and expenses. It was held that the company was not bound to pay the fees and expenses to the solicitor and therefore it could not be sued in law for those expenses, much as it was not in existence at the time when the expenses were incurred. Similarly, the company cannot enforce such contracts made before incorporation by the promoters.

In *Natal Land Co. v. Pauline Colliery* Syndicate the company agreed with C, and agent of syndicate about to be formed, to grant to the syndicate the lease of coal mine. The syndicate was subsequently registered, and the lease refused. It was held that the syndicate was not entitled to a specific performance of the said contract against, the company, there being no binding contract between the company and the syndicate.

This means that as regards preliminary contracts, the company, when formed, can neither be bound by such a contract nor has it any right to sue a third party into fulfilling it.

Promoter's liability for preliminary contracts. It has already been made clear that the company is neither bound by, nor can have the benefit of, a pre-incorporation contract. It is the promoter who remains personally liable for a pre contract. This is because where a contract is made on ehaIf of a company known to both the parties to be nonexistent, the contract is deemed to have been entered into personally by the promoters and they will be held personally liable for such contract. In order to relieve the promoter from the above liability, the company may adopt such contracts by entering into fresh contracts with third parties on the same terms and conditions as given in preliminary contracts entered into by promoters for and on behalf of the company yet to be formed. Only then is there a contract between the company and the vendor.

Even the fact that the adoption of the preliminary contract is made one of the objects of the company in its memorandum or articles, or that the company has passed a special resolution to adopt it, will not create a contract between the company and the vendor.

Similarly if a company acts on the basis of contract made before its formation under the mistaken belief that the contract is binding on it, it is no evidence of a new contract and it does not bind the company.

But in *Howard v. Patent Ivory Co.,* where the promoters had made a contract for purchase of property for the company to be formed and the contract of sale was carried into effect by the conveyance of property and by issue of debentures which was to be the consideration, it was held to be an evidence of a fresh contract between lhe company and vendor and the company could not repudiate the contract.

In order to be on the safe side promoters generally include a clause in the preliminary contracts stating that if the company makes a contract in term's of the

preliminary contract, his liability shall cease; if one the other hand, the company does not do so within a certain time, either party shall have a right to rescind it.

Specific performance of preliminary contracts: However, the principles enunciated and illustrated above have really had no application in our country iii view of the provisions of Specific Relief Act, 1963. Section 17 and 19 of this Act lay down that where the promoters of a company have, before its incorporation, entered into contracts for the purpose of the company and such contracts are warranted by terms of incorporation, specific performance may be obtained by or enforced against the company if the company has accepted the contract after its incorporation and has communicated such acceptance to the other party.

The term "contracts for the purposes of the company" used above refers to such contracts as are necessary for the incorporation and working of the company, for instance, contracts for the preparation and printing of the memorandum and articles of association or contracts for the supply of necessary raw materials or machinery for the functioning of the company. However, for such a contract to be enforceable, it is necessary that the company has accepted the contract after its incorporation and has communicated such acceptance to the other party.

Preliminary contracts and provisional contracts: Any contract made by a public company after incorporation but before' the date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificate of commencement of business is obtained. Such provisional contracts become binding automatically on the issue of the certificate of commencement of business. [Sec. 149(4)]

This means that there are three situations in the case of a public company in which contracts are made on its behalf:

(i) Contracts made before its incorporation-preliminary or pre-incorporation contracts.

(ii) Contracts made after incorporation of a public company but before obtaining the certificate of commencement of business-provisional contracts.

(iii) Contracts made by a public company after obtaining the certificate of commencement of business are legally binding on the company.

It may be noted here that a private company can commence business immediately after obtaining the certificate of incorporation. Therefore, contracts which are made before incorporation of a private company are known as preliminary or pre-incorporation contracts. But a private company becomes legally bound by all such contracts which are made after its incorporation. Hence, there is no need for provisional contracts in the case of a private company.

3.5 INCORPORATION

This is the second stage of formation of the company. In this stage the company is registered with the Registrar of Companies under the Companies Act. Section 12 provides that for forming a public company at least seven persons and for forming a private company at least two persons are required. These persons will subscribe their names to the memorandum of association and will also comply with the requirements of the

Companies Act in respect of registration to form and incorporate a company, with or without limited liability. Accordingly the company formed under this section may be (a) a company limited by shares; (b) a company limited by guarantee; or (c) an unlimited company.

However, before registration the promoters must take the following steps:

(i) they must obtain the approval of the proposed name from the Registrar of Companies. To take approval of the name, an application has to be made in the prescribed form. The application should be filed with the prescribed fee and it will be better for promoters to select and send 3 or 4 names in order of preference;

(ii) they must have necessary documents prepared and printed;

(iii) they must obtain the licence under the Industries (Development and Regulation) Act, 1961, if it is required in case of the business to be started by the company; and,

(iv) they must prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

FILING DOCUMENTS WITH THE REGISTRAR

The following documents are to be filed with the Registrar of Companies of the State in which the registered office of the company is to be situated, along with an application for registration and necessary fees:

(1) The memorandum of association of the company, which shall be printed, divided into paragraphs and signed by each subscriber who shall add his address, description and occupation in the presence of at least one witness who shall attest his signature. [Sec. 33(I)(a)]

(2) The articles of association of the company, if any, which shall also be duly signed by subscribers of the memorandum of association. A public company limited by shares may not have its own articles and, in that case, Table A, the model set of articles, shall be applicable but this fact must be specified on the memorandum. However, all other companies must prepare their articles which shall be filed with the Registrar along with the memorandum. [Sec. 33(I)(b)]

(3) The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or hole time director or manager. [Sec. 33(I)(c)]

It may be noted here that the above clause has been inserted by the Companies (Amendment Act), 1988.

(4) Notice of address of the registered office of the company must be given to the Registrar within 30 days of incorporation if it cannot be filed at the time of registration. (Sec. 146)

(5) A list of persons who have given their consent to act as directors of the company must be filed with the Registrar.

(6) The written consent of every proposed director signed by him, along with a written undertaking to take up and pay for qualification shares, if any, must be filed with the Registrar. This is, however, not necessary for companies other than public companies limited by shares. [Sec. 266(1)(5)]

(7) A declaration that all the requirements of this Act in respect of registration have been complied with. The declaration can be made by any of the following: (a) an advocate of the Supreme Court or a High Court; (b) an attorney or a pleader entitled to appear before a High Court; (c) a secretary or chartered accountant in whole-time practice in India, who is engaged in the formation of a company; or (d) a person named in the articles as a director, manager or secretary of the company. [Sec. 33(2)]

Registration of company: The Registrar will examine the documents. He may, however, accept the declaration as sufficient evidence of compliance with the Act. If he is satisfied that all requirements of the Act in respect of registration have been complied with, he will register the company and place its name in the Register of Companies. A certificate of incorporation will be issued whereby the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company, that the company is limited. [Sec. 34(1)]: If the requirements of registration have been complied with, the Registrar has no power to refuse registration." But if the Registrar improperly refuses to register the company, he may be compelled to register the company by an order of the court."

Where the documents are refused registration, the fee paid at the time of filing of documents with the Registrar is not refundable.

Effect of registration: From the date of incorporation mentioned in the certificate of Incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum. It becomes capable of exercising all the functions of an incorporated company having perpetual succession and a common seal. (Sec. 34(2)]

CONQUSIVENESS OF CERTIFICATE OF INCORPORATION

The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing on it is conclusive, even if wrong This is illustrated by the decision in Jubilee Cotton Mills Ltd. v. Lewis In this case, the necessary documents were delivered to the Registrar for registration on 6th January. Two days later, the Registrar issued the certificate of incorporation but dated it 6th January instead of 8th January, the day on which the certificate was issued. On 6th January, some shares were allotted to Lewis. The question arose whether the allotment made before the certificate was actually issued was void. It was held that the certificate of incorporation is conclusive evidence of all that it contains. The company comes into existence from the date mentioned in the certificate, even if wrong. Therefore, in law the company was formed on 6th January and allotment of shares was valid.

Not only does the certificate created the company, the certificate is conclusive for all purposes. Section 35 lays down that a certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto and that the company is duly registered under this Act.

Thus, where the memorandum was materially altered after the signatures of the subscribers but before registration, and the company was registered by the Registrar and the certificate of incorporation issued, it was held that the certificate is conclusive and no

court has power to annul it. "When once the certificate of incorporation is given, nothing is to be inquired into as to the regularity of the prior proceedings."

Where even five subscribers to the memorandum were minors, it was held that though the Registrar should not have issued the certificate, it was conclusive for all purposes.

Similarly, where the objects of the company are illegal but it has obtained a certificate of incorporation, the certificate would prevent any doubt from being raised as to the legal personality of the company, but the certificate would not validate the illegal objects.

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

3.6 CAPITAL SUBSCRIPTION

It has already been pointed out that a private company can commence business immediately on receipt of the certificate of incorporation. But a public company cannot commence business unless it obtains another certificate called 'the certificate of commencement of business' from the Registrar of Companies. For this purpose, a public company has to go through 'capital subscription stage' and 'commencement of business stage'.

Making necessary arrangements for raising capital: In the capital subscription stage, the company makes necessary arrangements for raising the capital of the company. It may noted here that after the incorporation of a company, the affairs of the company are taken over by the directors. Usually, the promoters are the first directors of the company. In order to make necessary arrangements for raising the capital of the company, a meeting of the board of directors will be convened to deal with the following business:

(a) Appointment of secretary and fixing the terms and condition of his appointment. Usually, the appointment of pro tern secretary appointed by the promoters at promotion stage is confirmed.

(b) Appointment of bankers, brokers, solicitors and auditors.

(c) Adoption of preliminary contracts entered by the promoters on behalf "of the company in the pre-incorporation stage.

(d) Adoption of underwriting contracts in order to secure minimum subscription.

(e) Adoption of draft 'prospectus' or 'statement in lieu of prospectus.

(f) Appointment of managing director or manager and other responsible officers of the company.

(g) Approval of the design of the common seal of the company and authorizing the custody thereof.

(h) Listing of shares on the stock exchange.

It may be noted here that the new comprehensive guidelines issued by the Securities and Exchange Board of India (SEBI), have scrapped the need for prior approval

for raising capital from the Controller of Capital Issues with the repeal of the Capital Issues (Control) Act, 1947. (Text of the Guidelines issued by the Securities Exchange Board of India (SEBI) is given in the Appendix at the end of the book).

Inviting public subscription: Where the directors of public company wish to invite the public to subscribe for its shares, they will file a copy of the prospectus with the Registrar of Companies. On the advertised date the prospectus will be issued to the public. No prospectus can be issued unless a copy of it has been filed with the Registrar. Prospective investors can obtain a copy of the prospectus either from the company's registered office or its bankers. Investors are required to forward their applications for shares along with application money to the company's bankers mentioned in the prospectus. The bankers will then forward all applications to the company and the directors will consider the allotment of shares. If the subscribed capital is at least equal to the minimum subscription as disclosed in the prospectus, the directors will allot shares to the applicants. Allotment letters will be sent to those applicants who have been allotted shares in the company whereas letters of regret will be sent to those who have been refused. A return as to allotment is filed with Registrar. In due course of time, a register of members will be prepared and share certificates will be issued to shareholders in exchange of letters of allotment. If the company does not receive applications, which an cover the minimum subscription within 120 days of the issue of prospectus, no allotment can be made and all moneys received will b refunded.

Arranging capital privately: Sometimes a public company may decide not to approach the general public for selling its shares as it may be in a position to obtain the required capital privately. In this situation the company will file a statement in lieu of pr with the Registrar at least three days before the allotment of shares. It need not issue a prospectus. It may also be noted that the contents of a prospectus and a statement in lieu of a prospectus are more or less the same. (Sec. 70)

3.7 COMMENCEMENT OF BUSINESS

A private company can commence business immediately after obtaining certificate of incorporation. But a public company cannot commence business until it receives the certificate of commencement of business.

Companies issuing prospectus: A company which has issued a inviting the public to subscribe for its shares cannot commence any business or exercise any borrowing powers unless, (a) shares payable in cash have been allotted to an amount not less than the minimum subscription; (b) every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others; (c) no money is liable to be repaid to the applicants for failure to apply for, or to obtain, the permission for the shares or debentures to be dealt in on any recognized stock exchange; and (d) a declaration duly verified by one of the directors or the secretary that the above requirements have been complied with is filed with the Registrar. If the company has not appointed a secretary, it can get the declaration signed by a secretary in whole-time practice. [Sec. 149(1)]

Companies not issuing prospectus: Where a company with a share capital has not issued a prospectus inviting the public to subscribe for its shares, it shall not commence any business or exercise any borrowing power, unless (a) a statement in lieu of a

prospectus is filed with the Registrar (b) every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others; (c) a declaration duly verified by one of the directors or the secretary that above requirements have been complied with is filed with the Registrar. If the company has not appointed a secretary, it can get the declaration signed by a secretary in whole-time practice. [Sec. 149(2)]

When the company fulfils the above conditions, the Registrar shall certify that it is entitled to commence business and that the certificate shall be conclusive evidence that the company is so entitled. [Sec. 149(3))

Provisional contracts: Any contract made by a public company after incorporation but before the date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificate is obtained. [Sec. 149(4)]

Thus where the goods are supplied to the company which never becomes entitled to commence business, no one can sue the company for -the price of goods supplied to it.

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

3.8 SUM UP

Promotion is the first step in the formation of a company. A promoter occupies a unique position in relation in the company as he is neither an agent nor a trustee of the company and yet has fiduciary relationship with the company. Contracts enleied units before the incorporation of a company are termed as pre-incorporation or preliminary 36 contract. Such contracts are no legally bindings on the company because at the time of making of the contract, the company was not in existence. Promoters get the necessary document prepared, printed and tile them in the office of the Register of companies along with the prescribed fee for registration. On sereting of these documents, If the registrar is satisfied that all the formalities prescribed by the companies act have been compiled with he issues to the company under his signatures, a certificate of incorporation. From this date the company begin its corporate existence. A private company and a company without share capital can commerce business immediately on incorporation.

3.9 KEY WORDS

Promoters: Those who promote the formation of a company.

Preliminary Contracts: Contracts made before the incorporation of a company.

Incorporated: Constituted as a body corporate legally authorised to act as a person.

Fiduciary Relation: The relationship based on mutual trust and confidence.

3.10 CHECK YOUR PROGRESS:

1) What do you understand by promotion?

2) Discuss the function of a promoter.

3) Describe commencement of business.

3.11 REFERENCES:

1) Bagrial, Ashok K, company Law, Vikas Publication Home.

2) Chawla, R.C. and K.G. Garg, Mercantile Law, Kalyani Publishers.

3) Kapoor, N.D., Elements of Company Law, Sultan Chand & Sons.

3.12 TERMINAL QUESTIONS:

1) What are the different stages in the formation of a company? Discuss.

2) Define the term promoter and explain the functions performed by him.

3) Discuss the legal position of the promoter.

4) Why pre-incorporation contract are not buildings on the companies?

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LESSON-4

MEMORANDUM OF ASSOCIATION

STRUCTURE

4.0 OBJECTIVES

After studying this lesson, you should be able to:

- Explain the meaning and purpose of Memorandum of Association.
- List the various clauses of the memorandum of Association.
- Explain the doctrine of ultra vires
- Explain the procedure for alteration of different clauses of Memorandum of Association.

4.1 INTRODUCTION

A company's memorandum of association is of supreme importance. The first step in the formation of a company is to prepare a memorandum of association because no company can be formed or registered under the Companies Act without it. It is the charter of the company. "It contains 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 of the shareholders." It sets out the constitution of the company and provides the foundation on which the company is built. It lays down the objects and scope of activities of the company, and also defines the relationship of the company with the outside world. Its importance can be gauged by the fact that it contains rules regarding the capital structure of the company, the liability of its n and its scope of

activities. "Its purpose is to enable shareholders, creditors and those who deal with the company to know what is its permitted range of enterprise."

It may be noted here that a memorandum not only defines the powers of the company but also confines them. Nothing beyond the powers as defined by the memorandum shall be attempted by the company. If this is done, it shall be considered *ultra vires*. It was rightly pointed out in *Ashbury Railway Carriage & Co. V. Riche* that, "the memorandum is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit."

Purpose of memorandum: The purpose of a memorandum is two-fold. In the first place, it gives protection to shareholders who learn from it the purposes to which their money can be applied. In the second place, it gives protection to persons who deal with the company and who can infer from it the extent of the company's powers. They can know with certainty as to what the objects of the company are and as to whether the contractual relation to which they contemplate entering with the company is within the corporate objects of the company.

Unalterable charter to some extent: Memorandum of association is a fundamental document of the company. Being the very basis of the company, it is not allowed to be altered by the company every now and then in the interests of its members, creditors and the outside public dealing with it. The unalterable character of the memorandum is recognized by Section 16 of the Companies Act, 1956. It lays down that a company shall not alter the conditions mentioned in its memorandum except in cases and in' the manner and to the extent provided in the Act in Sections 17-19. That is why the memorandum is regarded as an unalterable charter of a company.

Form of memorandum: Section 14 of the Act lays down that the memorandum shall be according to the prescribed form or as near to it as the circumstances admit. These prescribed forms, as given in Schedule I of the Act, are as follows:

Table B for memorandum of a company limited by shares.

Table C for memorandum of a company limited by guarantee and not having a share capital

Table D for memorandum of a company limited by guarantee and "having share capital.

Table E for memorandum of an unlimited company.

Printing and signing of memorandum: The memorandum shall be (a) printed; (b) divided into paragraphs numbered consecutively; and (c) signed by each subscriber (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any. (Sec. 15).

4.2 CONTENTS OF MEMORANDUM

Section 13 of the Companies Act lays down that the memorandum of association of every company shall contain the following clauses: -

(1) Name Clause: In this clause the name of the company, with "Limited" as the last word of the name in the case of a public company and "Private Limited" as the last words in the case of a private company, must be stated. It may be noted here that a company has a separate legal entity' and is recognized b its name.

Licence to drop the word 'Limited. 'Where it is proved to the satisfaction of the Central Government that an association is (a) about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object, and (1,) intends to apply its profits, and other income in promoting its objects and prohibits the payment of any dividend to its members, it may direct that the association be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited' (Sec. 25) Undesirable names to be avoided: Ordinarily, a company is free to adopt any name it likes. But the name should not be one which, in the opinion of the Central Government, is undesirable. A name which is identical with or which closely resembles the name of an existing company may be considered undesirable by the Central Government. (Sec. 20)

Generally, no company can trade with a name identical or similar to that of an already existing company, so as to deceive the prospective customers of one into trading with the other.

When a company has been registered under a name that resembles the name of an existing company, the existing company can apply for an injunction restraining the new company from the use of such a name. It may be noted here that since a company is recognized by its name, which becomes a part of its business reputation, it would be injured if a new company were to adopt it.

Before the court grants an injunction restraining the new company from using the name, it must be shown that resemblance between the two names is such as is calculated to deceive or mislead. In Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Co. Ltd., where a company was incorporated to conduct the business of motor vehicle assurance under a name somewhat similar to that of a motor dealers' trade protection association, the court refused an injunction to the association because the difference between the activities of the company and the association preclude any possibility of confusion.

In *Ewing v. Buttercup Margarine Co.,' Ewing* was carrying on business under the name of Buttercup Dairy Company as a wholesale and retail provision merchant. A new company, Buttercup Margarine Co., was formed with the object of manufacturing and selling margarine in wholesale. Ewing applied to the court for restraining the new company from using the name, contending that it was calculated to deceive and that people were likely to be confused into thinking of both companies as one or closely related. The court granted an injunction.

The court, however, will not grant an injunction to prevent the use of a purely descriptive word with a definite meaning and in common use. In *Aerators Ltd. v. Tollitt* the business of the plaintiff was the sale of apparatus by which small quantities of liquids could be aerated. The defendant proposed to register a company to be called Automatic Aerators Limited, the object of which was to work patents in respect of aeration of liquids in large quantities. The court did not grant the injunction as both companies had different

patents and apparatus although the main object of both was to manufacture apparatus for the instantaneous automatic aeration of liquids.

Certain names prohibited by statute: A company cannot adopt a name which attracts the provisions of the Emblems and Name (Prevention of Improper Use) Act, 1950. This Act prohibits the use of the name and emblems of the United Nations and the World Health Organization, the official seal and emblems of the Central and State Governments, the Indian national flag, the name and pictorial representation of Mahatma Gandhi and the Prime Minister of India.

Publication of name: Every company shall paint or affix its name and the address of its registered office outside every office or place in which the business of the company is conducted [Sec. 147(l)(a)]. Similarly every company shall have its name engraved in legible characters on its seal. [Sec. 147(l)(b)]

Every company shall have its name and the address of the registered office mentioned in legible characters on all its business letters, bill heads, letter paper, all notices and other official publications, all negotiable instruments issued or endorsed by the company and on all other orders, receipts, invoices and letters of credit. [Sec. 147(l)(c)]

(2) Registered office clause: This clause states the name of the State in which the registered office of the company will be situated. But the full address of the registered office must be communicated to the Registrar within 30 days of incorporation or from the date it commences business, whichever is earlier. All communications and notices to the company shall be addressed to its registered office. (Sec.146)

The situation of registered office determines its domicile and all important books and statutory registers shall be kept at its registered office.

(3) Objects clause: This is the most important clause in the memorandum. It defines the sphere of the company's activities, the aims 'that its formation seeks to achieve and the kind of activities or business that it proposes to conduct. A company cannot conduct any business foreign to its objects clause. If anything unauthorized by the objects clause is undertaken, it is considered ultra vires and hence not binding on the company.

Why, objects! The objects clause of the memorandum gives protection to shareholders who learn from it the purposes for which their money can be applied. It ensures them that their money will not be risked in any business other than that for which they have been asked to invest. Similarly, it also protects individuals who deal with the company and who can infer from it the extent of the company's powers. The creditors of the company who are to receive repayment of their moneys from the assets of the company feel secure if they know that the funds of the company will not be utilized for any object not mentioned in the objects clause.

Choice of company's objects: Subscribers to the memorandum may choose any object or objects for the proposed company. However, they must keep in mind certain points while drafting the objects clause of the memorandum.

(1) The objects should not include anything illegal or against the general law of the country. For instance, the general law of the country prohibits gambling and thus no company can be formed for this purpose.

(2) They should not include anything in contravention of the Act itself. For example, a clause in the memorandum providing that the company can buy its own shares is invalid, as the Act prohibits purchase of its own shares by the company.

(3) They should not include anything which is against public policy, for instance, trading with alien enemies.

CONSTRUCTION OF OBJECTS CLAUSE

As a result of the Companies (Amendment) Act, 1965, Section 13 lays down that in the case of a company in existence before this amendment, the objects clause of the memorandum should simply state the objects of the company. Bet in the case of a company formed after such amendment, the objects clause must be divided into two groups.

(i) Main Objects: This group will cover the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

(ii) Other Objects: This group will cover any objects not included in the above group. In case of companies (other than trading corporations) whose objects are not confined to one State, the objects clauses should also mention the names of the States to whose territories the objects of the company shall extend.

Ancillary or incidental objects: An act of the company can be covered under "ancillary or incidental to the main object" if it is helpful in the attainment of the latter.

It may be further noted that the objects clause generally includes such words as "to do all such things as are incidental or ancillary to the attainment of the main objects." These words do not increase the area of the company's powers as defined by the preceding clause of the memorandum. These words should be construed as being limited to the doing of such things as are legitimately necessary to the attainment of the objects previously specified. The following instances provide ample illustration of this:

Where a company expended money on scientific research, while its main object was the business of chemical manufacturing, it was held that the act was conducive to attainment of the main object of the company and therefore very much within its powers.

Similarly, where the main object of the company was to supply boats for ferry and it used the boats, when not required for the ferry, in excursion, this was also held to be very much within the powers of the company as it was incidental to its main objects."

However, an act of the company does not become incidental or ancillary merely because it is to the benefit of the company but is not any way helpful or essential to the attainment of its main object. Accordingly, the council having a statutory power to work tramways was restrained from running omnibuses in connection with the tramways. The court held that the council could not undertake the omnibus business as it was in no way incidental to the business of working tramways, however beneficial it might prove to the original business."

(4) Liability clause: This clause states the nature of the liability of members. The memorandum of a company limited by shares or by guarantee shall state that the liability is limited. This means that in the case of a company limited by shares, the member's

liability is limited to the face value of shares or so much thereof as remains unpaid and if his shares are fully paid-up his liability is nil. [Sec. 13(2)]

However, Section 45 provides that where a company has carried on business with fewer members than the statutory minimum for more than six months, every member who is aware of this fact is severally liable for the entire debts of the company contracted after a period of six months and may be severally sued therefore. His liability becomes unlimited.

Further in the case of a company limited by guarantee, this clause shall state the amount which every member undertakes to contribute to the assets of the company in the event of its being wound up. [Sec. 13(3)]

It may be noted here that the liability clause is entirely omitted from the memorandum in an unlimited company.

In a limited company, the memorandum may provide that the liability of the directors or of any director or manager shall be unlimited. (Sec. 322)

(5) Capital clause: This clause states the amount of share capital with which the company is proposed to be registered and the division thereof into shares of fixed amount. This is known as the authorized or nominal capital of the company. The stamp duty and registration fee are payable on authorized or nominal capital. A company cannot issue more shares than are authorized for the time being by the memorandum. The Act does not lay down-any rules for fixing the authorized capital of the company but it should be sufficiently high considering the immediate needs of the business and possible expansion in the near future. It is not essential to mention here the rights attached to different classes of shares which may be provided for in the article. This clause is to be omitted in the case of companies with unlimited liability and the companies limited by guarantee having no share capital.

(6) Association or subscription clause: In this clause the subscribers declare that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case-of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any. This clause generally runs in this form: “We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the memorandum of association and we respectively agree to take the number of shares in the capital of the company, set opposite of our respective names.”

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

Further, the subscribers of the memorandum appoint the first directors of the company. If they do not appoint any, the subscribers themselves become the directors by the very fact of incorporation. They shall hold office until the directors are elected in the first annual general meeting of the company. (Sec. 254)

4.3 ALTERATION OF THE MEMORANDUM

A company shall not alter the conditions contained in its memorandum except in the cases, in the mode, and to the extent for which express provision is made in this Act. [Sec 16(1)]

The conditions contained in the memorandum can be altered as below:

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

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

In such a case the Central Government can also direct a company within twelve months of registration to change its name. The company must change its name by passing an ordinary resolution and with the approval of the Central Government, within a period of three months from the date of the direction or such longer period as the Central Government may sanction. [Sec. 22(I)(b)]

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

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

(2) Change of objects clause: The objects clause can doubtless be : altered, but the alteration is subject to a number of restrictions. These restrictions are intended to protect the interests of the shareholders and creditors of the company. Section 17 of the Companies Act lays down the procedural and substantive limits on the power of alteration to the objects clause. The idea is that a company is incorporated for the conditions contained in the memorandum and it should not be allowed to make alteration of the objects clause a routine affair.

SUBSTANTIVE LIMITS

Section 17(1) provides that a company may change its objects clause in so far as it is necessary for any of the following purposes:

(1) To conduct its business more economically or efficiently: Under this clause there is only very limited scope for amendment because the business which the company is to Conduct must be the same as before. The change pertains only to the mode of conducting the business enabling the company to do so more economically and efficiently.

In *Re Scientific Poultry Breeders' Association Ltd.*, the main object of the company was to encourage and improve the breeding of poultry. Its memorandum also prohibited payment of remuneration to or division of profits among the members of the governing body. When the business and membership of the company increased, it was found that members of the governing body were unable to give proper attention to the management of its affairs unless some remuneration was paid to them. It passed a special resolution for payment of equitable remuneration to the members of the governing body. When the petition was presented to the court for sanction, it was held that the alteration did not affect the main object of the company and would enable it to carry on its business more economically or efficiently.

(2) *To attain its main purpose by new or improved means*: In this case the emphasis is on attainment of the main objects of the company. The latter is permitted to alter the means of conducting its business, enabling it to take advantage of new scientific discoveries and inventions.

(3) *To enlarge or change the local area of its operations:* In this clause also the business of the company remains the same, the only change is in the areas of its operation. In Indian Mechanical Gold Extracting Co., the memorandum confined the area of its operations to India. The company passed a special resolution deleting the words "in India" from the memorandum so as to enlarge its area of operation. The court confirmed the alteration on the ground that it would enable the company to enlarge its area of operations. The court also directed that the company should change its name in such a manner that it did not give the impression that its business operations were confined only to India.

(4) To *carry on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company.* This clause gives very wide powers to the company to alter its objects clause. A company may take up any, new business which can conveniently or advantageously be combined with the existing business of the company at the date of the proposed alteration.

In Parent Tyre Co., it was held that the additional business which a company, by alteration of its memorandum, may carry on may be wholly different from and bear no relation to its existing business, provided it is capable of being conveniently and advantageously combined with it. Moreover it should not be destructive or inconsistent with the existing business. Whether a business is such or not is for the company's shareholders and managers to judge. In this case a tyre company was authorized to conduct the general business of bankers and financiers. The company in this case had never manufactured tyres as it had always been a holding company. All its funds were invested in Dunlop Rubber Co. Ltd, and it wished to spread its investment risks over a wider range of securities.

Similarly, a company which was formed for generating power was allowed to make alteration in its objects clause under this condition so as to enable it to carry on cold storage and other allied business.

But a company which was formed for carrying on distillery business and other allied objects to that business was not permitted to undertake cinema business as the new business could not conveniently or advantageously be combined with the existing business of the company.

In *Re Cyclist Touring Club,* & company was incorporated to protect and promote the interests of pedal cyclists on public roads. The company passed a special resolution so as to include all vehicles including motors. The court disallowed the alteration as it was inconsistent with the objects of the company because cyclists had to be protected against danger from motorists. The court held that the company would find itself in the impossible position of having to protect one class of members from another.

(5) To restrict or abandon any of the objects specified in the memorandum.

(6) To sell or dispose the whole or any port of the 'undertaking.

(7) To amalgamate with any other company or body of persons.

4.4 PROCEDURAL LIMITS

The following procedure must be followed for altering the objects clause: *(i) Special resolution.* A special resolution authorizing the alteration must

be passed at a general meeting of the company. (Sec. 17)

It is worth noting here that the Companies (Amendment) Act; 1996 has dispensed with the requirement of seeking the confirmation of the Company Law Board for alteration of the objects clause.

(ii) Registration of alteration: A copy of the special resolution authorizing the alteration together with a copy of the altered memorandum shall be filed with the Registrar within one month from the date of such resolution. The Registrar shall register the same and certify the registration within one month. Alteration takes effect when it is so registered. (Sec. 18)

(3) Change of location of the registered office: The procedure for changing the company's registered office may be studied under the following heads:

(a) Change within the same city: If a company intends to change the location of its registered office from one place to another within the same city, town or village all that is required is a resolution of the board of directors and the notice to be given to the Registrar within 30 days of the change. [Sec. 146(2)]

(b) Change from one city to another city in the same State: If a company intends to shift its registered office from one city, town or village to another within the same State, a special resolution should be. passed at a meeting of the shareholders and a copy of the said resolution is to be filed with the Registrar within 30 days of the passing of the resolution. Notice of the new location must be given to the Registrar within 30 days of the shifting of the office. [Sec. 146(2)]

(c) Change from one State to another: A company can shift its registered office from one State to another only for meeting out any of the purposes (substantive limits) discussed above under Section 17 (1). Besides, the following procedure shall be followed for effecting the change:

(i) Special resolution: A special resolution authorizing the alteration must be passed by the company and a copy thereof should be filed with the Registrar within 30 days of the passing of the resolution.

(ii) Confirmation by Company Law Board: The alteration must be confirmed by the Company Law Board. Before confirming the alteration, the Board shall consider the objections of persons whose interests will, in the opinion of the Board, be affected by the alteration. After considering the above factors the Company Law Board may make an order confirming the alteration on such terms and conditions as it thinks fit. It has the discretion even to refuse to confirm the alteration. (Sec. 17)

In this connection it is important to note that the Orissa High Court held that the State in which the registered office of the company is situated could oppose the shifting of the registered office to places outside that State on the ground of loss of revenue and employment opportunities.

But the Calcutta High Court has dissented from the above decision and taken a contrary view. It has held that State has no right to oppose the shifting of registered office from one State to another on the ground of loss of revenue. It was pointed out that the consideration of loss of revenue is not only irrelevant, but if it is accepted it would deprive the company of the statutory power conferred on it by Section 17. The State may, however, object as a creditor in respect of arrears 6f revenue due to it. The Bombay High Court also took a similar view.

(iii) Registration of alteration: Where the alteration involves a transfer of the registered office from one State to another, a certified copy of the order of the Company Law Board together with a printed copy of the altered memorandum shall be filed with the Registrar of each State with three months from the date of the order. The Registrars shall register the same and certify the registration within one month of the date of the filing of such documents. The Registrar of the State from which such office is transferred shall send to the Registrar of the other State all documents relating to the company registered, recorded or filed in his office. (Sec. 18)

If no registration is made within three months with the Registrar, all proceedings connected with the alteration become void. However, if the Company Law Board is satisfied it may extend time for registering the alteration by one month. (Sec. 19)

(iv) Notice of new location to Registrar. Notice of new location must be given to the Registrar with 30 days of the shifting of the office. [Sec. 146 (2)]

(4) Change of liability clause: No increase in members' liability. No change can be made in this clause so as to make the liability of members unlimited. Section 38 provides that the liability of the members or any class of members cannot, by altering the memorandum or articles, be made to take more shares or to pay more for the shares already taken, unless he agrees to do so in writing either before or after the alteration. But a company which is a club or an association can alter its memorandum or articles even if the alteration requires the members to pay recurring or periodical subscriptions or charges at a high rate, without the written consent of the members.

Making directors liability unlimited: A limited company, if authorized by its articles, may alter the memorandum by a special resolution so as to render unlimited the liability of its directors or anyone director or manager. Any person holding the office of director or

manager before the alteration shall not be bound by this alteration until the expiry of his present term or unless he has accorded his consent in writing to this effect. (Sec. 323)

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

(5) Changes in the capital clause: Changes in the capital clause of the memorandum are discussed later in the chapter on 'Share Capital' under the following headings; (a) alteration of capital under Section 94; (b) reduction of capital; (c) reserve liability; (d) variation of the rights of shareholders; and (e) reorganization of capital.

4.5 DOCTRINE OF ULTRA VIRES

A company is incorporated for some specified objects, stated in its memorandum of association. It cannot do anything outside the powers .specified in its memorandum.

Consequently any act done or any contract made by the company which goes beyond the memorandum or which is not expressly or implicitly warranted by it, is ultra vires the company. The result is that such an act or contract is wholly void and will not be binding upon the company. It cannot be ratified even by the unanimous vote of all the members of the company.

The doctrine of ultra wires is best illustrated in Ashbury Railway Carriage and Iron Co. Ltd. v. Riche* A company had been formed, and its object clause was as follows: "To make and sell, or lend on hire, the railway carriages and wagons and all kinds of railway plant, fittings, machinery and rolling stock and to carry on the business of mechanical engineers and general contractors." The company entered into a contract with Messrs. Riche for financing the construction of a railway line in Belgium. Later, the company repudiated the contract on the ground that it was ultra vires. Riche brought action against the company for breach of contract and claimed damages. His contention was that the contract was within the powers of the company as it was covered under the general contractor's business. Moreover, it had been ratified by a majority of shareholders.

The contract was held to be ultra vires the company by the House of Lords and hence it was null and void. Lord Cairns, L.C., observed: "The term 'general contractors' must be taken to indicate the making generally, of such Contracts as are connected with the business of mechanical engineers. If the term 'general contractors' is not so interpreted, it would authorize the making of contracts of any and every description, such as, for instance, of fire and marine insurance and the memorandum, in place of specifying the particular kind of business would therefore, be altogether unmeaning. Hence the contract was entirely beyond the objects in the memorandum of association. If so, it was thereby placed beyond the powers of the company make the contract. If the company could not make it, much less could it be ratified. If every shareholder of the company had been in the room and had said 'That is a contract which we desire to make, and which we authorize the directors to make,' the case could not have stood in any different position from that in which it standsnow. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by Act of Parliament, they were prohibited from doing?'

In *Attorney General v. The Great Eastern Railway* the courts interpreted the rule in a liberal spirit and agreed that the company could do everything incidental to the attainment of its main objects unless it was expressly prohibited.

It may be noted further that incidental objects are not to be treated as separate objects, complete in themselves. They are to be treated as incidental to the company's specified objects and to be used only for the purpose of carrying out those objects.

Main objects Rule of Construction. We find that the principle of ultra wires confines the actions of the company to its objects clause. In order to avoid such hardships companies started including every conceivable kind of business in their memorandum. But this defeated the very purpose of the objects clause. A special rule of construction has in some cases been applied where the objects clause includes a long list of businesses which the company may undertake. The court identifies one business which appears to be the main business of the company and all other businesses are considered merely ancillary to the main object. This is known as the main objects rule of construction. It is best illustrated in the case of *Re German Date Coffee Co.*

In this case the company was formed for working a German patent which would be granted for manufacturing coffee from dates. The company was also to obtain other patents for improvements on and extensions of the said invention. The German patent was not granted to the company. The latter purchased a Swedish patent and the company started making and selling coffee from dates. On a petition of two shareholders, the court held that as the main object of the company had become impossible, it was just and equitable to wind it up.

Acts held to be intro vires: The following illustrations are helpful in understanding the application of the doctrine of intro vires: (I) where a company bound to supply boats for ferry employed the boats when not required, for excursions, this was held to be intro vires (ii) where a hotel company temporarily let part of its premises not required for its business, this was held to be ultra vires (iii) where a company expended money on scientific research, when the main object of the company was the business of chemical manufactures, this was held to be intro vires.

Acts held to be ultra vires: But in the following cases, the transactions were held to be ultra vires: (i) where a railway company undertook to secure capital for, and guarantee profits to, another company about to run steam boats in connection with the line, however beneficial it may be to the railway company, this was held to be ultra vires (ii) where a railway company was working coal and selling coal at a profit, this was considered ultra vires, and (iii) where the council having a statutory power to work tramways, proposed to run omnibuses in connection with the tramways, however beneficial it might prove the original business, it was considered ultra vires.

Acts ultra vires the directors or articles but intro vires the company: There may be certain acts which are intra vires the company but which are ultra vires the directors or ultra vires the articles. If an act is ultra vires the director but ultra vires the company, it can be ratified by the shareholders in the general meeting, and thus the company is bound by it. Similarly, if an act is ultra vires the articles, it can be ratified by altering the articles through a special resolution. It may be noted here that a company can change its articles with retrospective effect.

EFFECT OF ULTRA VIRES TRANSACTIONS

(1) Injection: A company is created for the objects stated in its memorandum. Individuals who buy shares in the company are entitled to believe that their money will not be risked in any business not stated in the company's memorandum. Hence, whenever a company has committed an ultra vires act or is likely to do so, any member of the company may restrain it by getting an injection against it

(2) Personal liability of directors for ultra vires payments. The directors must see to it that the funds of the company are used for carrying on the authorized business as stated in its memorandum. If a director makes an ultra vires payment, he can be compelled to make good the funds used. But the directors who refunded the money could get indemnity as against the person who received the payment with the knowledge that payment to him was ultra vires.

(3) LiabIlity for breach of warranty of authority. Directors entering into ultra vires may be liable to the third party for breach of warranty of authority. It may be noted here that directors are the agents of a company and should act within its powers. The company cannot give directors any authority for ultra vires acts, since it itself does not have any authority for them. If they induce an outsider to enter into a contract with the company in a matter in which the latter does not have power to act, they will be liable to the third party for his loss, provided the third party does not know that they have no authority to enter into a particular contract. In *Weeks v. Propert* a railway company invited applications for a loan on debentures. At the time of inviting the applications the company had already exhausted the limit of £60,000 which it was authorized to borrow by its memorandum. On the basis of this advertisement, the plaintiff offered a loan of £500 which was accepted by the directors and a debenture was issued to him. The loan was held to be ultra vires and void and therefore was not binding on the company. The directors were held personally liable for breach of warranty of authority as by inserting the advertisement, they had warranted that they had the power to borrow, a power that they did not in fact possess.

In order to make the directors personally liable, it must be establithed that their act amounts to an implied misrepresentation of facts and not of law.

(4) Ultra vires acquired property: If the funds of the company have been spent ultra vires in purchasing some property, its right over the property will be protected. Thus, in a case where a company's telephone wires were cut and it had no power in the memorandum to put up the wires, it was held entitled to recover damages for the injury.

(5) Ultra vires contracts: A contract which is ultra vires the company will have no legal effect. It is absolutely void. Such contracts are not binding upon the company and it can neither sue nor be sued on them. An ultra vires contract cannot become intra vires by reason of estoppels, lapse of time, acquiescence of delay or ratification. The reason is that every person who deals with the company is expected to know its powers and if he enters into a contract that is inconsistent with them, he does so at his own risk.

Exceptions: However, the claim of the aggrieved party shall lie in the following cases even though the act of the company is ultra vires:

(i) If the company takes an ultra vires loan and uses it to pay off the lawful debts of the company then the second creditor (lender) steps into to the shoes of paid-off creditor and to that extent will have the right to recover his loan from the company But he cannot tlaim any right to any securities held by the original creditor.

(ii) If the property handed over to the company by virtue of an ultra vires contract exists in specie or it can be traced, the person handing it over can reclaim it.

(iii) If money is lent by a company that does not have the power to lend it, it can be recovered because the debtor will be estopped from taking the plea that the company had no power to lend.

(6) Ultra vires torts: A company will be liable for any tort of its employees if (a) the tort is committed in pursuance of its stated objects; and (b) it is committed by employees within the course of their employment.

A company will not be liable for any torts committed outside its objects. For example, one company had power under its memorandum to run tramways. It started operating omnibuses which was outside the object clause of its memorandum. A driver of one such bus negligent injured a person, who sued the company for damages. It was held that the company could not be held liable for damages because, having no existence outside the memorandum; it could not have appointed the driver.

4.6 SUM UP

A memorandum of a association of a company is the foundation of a company as without it, it cannot be established. It defines the object beyond which the activities of the company cannot go. Further it defines its relationship with third parties which enters into contracts with it. It tells the prospectives shareholders of the company as to the purposes on which money subscribed by them would be spent.

A memorandum of association of a company limited by shares must contain the clauses namely (1) Name clause (2) Registered office Clause (3) Objects Clause (4) Liability Clause (5) Capital Clause and (6) Association Clause.

A company's activities are to be confined to its clause. If a company does something which is beyond its objects clause, then that act in ultravires and is null and void at initio.

Though memorandum of association is a fundamental charter of the company it can be altered to some extent, for certain purposes and by following the procedure laid down in the Companies Act, 1956.

4.7 KEY WORDS

Memorandum of Association: It is a fundamental document containing conditions on the basis of which a company is incorporated.

Registered Office: The registered office of a company determines its domicile. Also this is the office to which notices are served and communications are sent to the company.

Ultra Vires: Something which is beyond the powers of a company to do.

4.8 CHECK YOUR PROGRESS:

1) What do you understand by memorandum of association?

2) Describe limited liability Company limited by guarantee having a share capital.

3) Discuss the company having unlimited liability.

4.9 REFERENCES

1) M.C. Kuchhal, Mordern Indian company law, Shree mahavir Book Depot.

2) ND Kapoor, Elements of Company law, Sultan chand & Sons.

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4.10 TERMINAL QUESTIONS

1. What is the purpose of memorandum of association?
2. Enumerate the different clauses which are included in the memorandum of association.
3. Illustrate the Doctrine of Ultra Vires with suitable examples.
4. Describe the procedure for alteration of the objects clause of a company.

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LESSON-5

ARTICLES OF ASSOCIATION

STRUCTURE

5.0 OBJECTIVES

After studying this lesson, you should be able to:

- Explain the meaning and purpose of Articles of Association.
- Describe the contents of articles of Association.
- Explain the relationship of and distinction between articles and memorandum.
- Explain the doctrine of constructive notice and indoor management.

5.1 INTRODUCTION

The articles of association are the rules and regulations of a company framed for the purpose of internal management. The articles regulate the manner in which the company's affairs will be managed. While the memorandum lays down the objects and purposes for which the company is formed, the articles lay down rules and regulations for the attainment of those objects.

The true nature of articles can be understood from the observations made by Lord Justice Bowen:

"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 creditors. The articles of association are the internal regulations of the company and are for the benefit of share holders." In the words of Lord Cairns in *Ashbury Railway Carriage Co. Ltd. v. Riche.* "The memorandum is, as it were, the area beyond which the actions of the company cannot go; inside that area the shareholders may make such regulations for their own management as they think fit in the form of articles of association."

OBLIGAT1ON TO REGISTER ARTICLES

A public company limited by shares may not file a separate set of articles of association. But an unlimited company, a company limited by guarantee or a private company must prepare their own articles which must be registered along with the memorandum of the company. (Sec. 26)

Articles of an unlimited company: In the case of an unlimited company, the articles shall state the number of members with which the company is to be registered and if it has a share capital, the amount of share capital with which it is to be registered. [Sec. 27 (1)]

Articles of a company limited by guarantee: In the case of a company limited by guarantee, the artic shall state the number of members with which the company is to be registered. [Sec. 27(2)]

Articles of private company: In the case of private company, the articles shall (a) restrict the right to transfer its shares; (b) limit the number of its members to fifty excluding the past and present employees of company; and (c) prohibit any invitation to the public to subscribe for any shares in or debentures of the company. [Sec. 27 (3)]

Adoption and application of Table A: As we already know, a public company limited by shares may not prepare its own articles. If the company does not file its own articles, the regulations contained in Table A of Schedule I shall become the articles of that company. Even when a company limited by shares has its own articles and it is silent on some points, the regulations of Table A will apply. [Sec. 28]

The advantage adopting the regulations of Table A is that Its provisions are legal beyond any doubt.

FORM AND SIGNATURE OF ARTICLES

Article shall be printed, divided into paragraphs numbered consecutively and signed by each subscriber of the memorandum of association (who shall add his address, description and occupation, if any) in the presence of at least one witness, who shall attest the signature and shall likewise add his address, description and occupation, if any. [Sec. 30]

CONTENTS OF ARTICLES

Articles of association contain regulations for the internal management of a company. The latter may make such regulations for this purpose as it thinks fit. The only limitation is that the articles should not be against the provisions of the Companies Act or its memorandum. Any clause of the articles which violates any of the provisions of the

Companies Act or the memorandum will be null and void. Similarly, the articles must be in accordance with the principles of the general law of the country and public policy. Articles generally contain provisions relating to the following matters: (i) the exclusion, whole or in part, of Table A; (ii) share capital, different classes of shares, rights of different classes of shareholders and variations of these rights; (iii) execution or adoption of preliminary agreements, if any; (iv) allotment of shares; (v) lien on shares, (vi) calls on shares; (vii) forfeiture of shares; (viii) issue of share certificates; (ix) issue of share warrants; (x) transfer. of shares; (xi) transmission of shares; (xii) alteration of share capital; (xiii) borrowing powers of the company; (xv) rules regarding me (xv) voting rights of members; (xvi) notice to members; (xvii) dividends and reserves; (xviii) accounts and audit; (xix) arbitration provision, if any; (xx) directors, their appointment and remuneration; (xxi) the appointment and reappointment of the managing director, manager and secretary; (xxii) fixing limits of the number of directors, (xxiii) payment of interest out of capital; (xxiv) common seal; and (xxv) winding up.

LEGAL EFFECT OF MEMORANDUM AND ARTICLES

Section 36 provides that subject to the provisions of the Act, the memorandum and articles shall bind the company and its members to the same extent as if they respectively had been signed by the company and by each member and as if they had contained covenants on the part of the company and of each member to be bound by them.

Summing up the effect of Section 36, it may stated that the articles bind the company to its members, the members to the company, the members to each other, but they do not bind the company to outsiders.

Let us now make an analysis of Section 36 under different heads:

Members bound to the company: Articles constitute a contract between the company and members and therefore every member is bound by the articles as if every one of them had contracted to conform to them. Every member is bound to observe the provisions of articles.

In *Boreland Trustees v. Steel Brothers and Co. Ltd.,* the articles provided that the shares of any member who became bankrupt should be sold to individuals at a price fixed by the directors. B, who was holding 73 shares, became bankrupt and his trustee in bankruptcy claimed that he was not bound by the articles and could therefore sell those shares as he wished. But it was held that the trustee in bankruptcy was bound by the articles and could not claim the shares against the company.

Similarly in *Bradford Banking Company v. Briggs* the articles of a company provided that the company shall have a first charge on shares for the debts due to it from the members. A member owing money to the company, borrowed money from a bank on the security of the shares was held that the company could have priority because of this provision in the articles.

Accordingly, the company is entitled to sue its members for enforcement of the articles and to restrain breach of them.

Company bound to the members: The company is also bound by the provisions of the articles to its members. Any member can sue the company to prevent any breach of

the articles which would affect his rights as a member and he is entitled to an injunction to prevent the breach.

In *Johnson v. Lyttle's Iron Agency* a forfeiture of shares, irregularly effected by a company, was set aside at the instance of the aggrieved member as the company did not comply with the provisions of the articles.

In *Woody. Odessa Water Works Co.* the articles empowered the company to declare a dividend to be paid to the shareholders with the approval in the general meeting. A resolution was passed whereby the dividend was to be paid by issue of debenture bonds and not in cash. At the instance of a member, the court granted an injunction restraining the directors from acting on the resolution.

Not binding on the company in relation to outsiders: The articles do not constitute a contract between the company and outsiders. For instance, where the articles provided for remuneration to be paid to promoters, it does not give any right of action to promoters against the company Similarly in *Brown v. La Trinidad,* where B was to be appointed a director till 1888 as provided in the articles but was removed earlier, the court held that articles do not constitute a contract between company and outsider and therefore Brown was not entitled to bring any action against the company.

It may be noted further that even a member cannot enforce provisions of the articles in some capacity other than that of member. In *Eley v. The Positive Government Life Assurance Company* the articles provided that *Eley* should be the solicitor of the company. He would not be removed from his office except for misconduct. He also became a member of the company. *Eley* acted as solicitor for sometime but ultimately was removed from office without any allegation of misconduct. He sued for breach of contract but the court held that he could not bring action against the company because the right which he attempted to enforce was conferred upon him in a capacity other than that of a shareholder, and that articles do not constitute a contract between the company and outsider.

Even though memorandum and articles may not constitute a contract between a company and an outsider, such as a prompter or a director, an implied contract may be proved from the acts of the parties on the terms set out in the articles. This subject matter was duly considered by the Lahore High Court in Gulab Singh v. The Punjab Zamindara Bank Ltd. * In this case according to certain articles the plaintiff was appointed managing director and acted as such for eleven years and was remunerated in accordance with the terms set out in the articles. Subsequently the company removed him by special resolution at an extra-ordinary meeting. In a suit by the plaintiff for a declaration that he was still the managing director of the company, it was found that the resolution removing him from office was ultra vires. It was held that the articles constituted an implied contract between the company and the plaintiff and therefore the latter was entitled to maintain a suit on the basis of that contract.

Similarly, where an individual entered into a contact with a company to serve as a director and the articles of the company required the director to have a share qualification as set out therein and fixed his remuneration, it was held that though the articles did not constitute a contract between the company and the director, yet the director was entitled to recover his remuneration against the company as fixed by the articles because the

terms of the articles were deemed to have formed a part of his contract with the company."

Between members inter se: Although there is no express agreement between the members of the company, yet articles regulate their rights inter se. But such rights can only be enforced by or against a member through the company or through the liquidator representing the company."

But in *Rayfield v. Hands and others*, it was held that the rights of shareholders as shareholders, and the extent to which such rights are regulated by the articles could be enforced by one member against another without joining the company as party. In this case the articles of the company provided that members wishing to transfer their shares must inform the directors of their intention and the directors must take the said shares equally between them at a fair value. The plaintiff informed the directors of his intention to transfer his shares. But the directors refused the shares and argued that the articles could impose no such obligation upon them in their capacity as directors. But it was held that the directors were obliged to take the shares since the articles imposed an obligation upon them in their capacity as members. As such it was a personal obligation which could be enforced by one member against the other without joining the company as a party.

At the same time it must be noted that the articles constitute a contract between members only as regards matters arising out of the company relationship of members as members. They cannot regulate rights arising out of a commercial contract in which other shareholders have no interest. Hence an arbitration clause in the articles of the company could not be invoked where a member of the company had a commercial dispute of private nature with another member of the company.

5.2 ALTERATION OFARTLCLES

A company has wide powers to alter its articles to suit its requirements from time to time. Section 31 lays down that a company may alter its articles by a special resolution. A copy of the special resolution authorizing the alteration must be filed with the Registrar along with the explanatory statement within 30 days of the passing of the said resolution. The company is also required to file a copy of the altered articles of association with the Registrar within 3 months of the passing of the resolution. The effect of the change must be incorporated in all copies of articles of association issued after the date of alteration. The alteration will be effective from the date of registration by the Registrar.

It may be noted here that the power to alter articles of association is a statutory power and it cannot be taken away by any provision in the memorardum or articles.

An alteration of articles with retrospective effect was held valid provided it was bonafide and for the benefit of the company as a whole.

Once the alteration is made, such alteration shall be valid as if originally contained in the articles. The altered articles will bind the members just in the same way as did the original articles and such altered articles may again be altered by special resolution.

5.3 RESTRICTIONS ON ALTERATION OF ARTICLES

There are certain restrictions on the nature and extent of alterations that can be made in the articles. These are:

(i) Not to be inconsistent with the Companies Act: No such alteration which violates the provisions of the Act can be made.

(ii) Not to be inconsistent with the memorandum: The alteration cannot be such which is contrary to the conditions contained in the memorandum of association of the company. One may note that articles are subordinate to the memorandum and as such must not override.

(iii) Not to be illegal: The alterations should not sanction anything which is illegal.

(iv) Special resolution: Alterations of articles will be made only by a special resolution as defined in the Act. Articles can never be altered by an ordinary resolution even if they provide for such a procedure.

(v) Not to increase liability of members: Any alteration which seeks to impose additional liability on a member of a company to take shares more than what he has already taken or to pay any more money than what he is liable to pay on his shares, shall not be binding upon him unless he agrees in writing, either before or after the alteration. However, this restriction will not apply where the company is a club or any other association and the alteration requires the member to pay recurring or periodical subscriptions or charges at a higher rate, although he does not agree in writing to be bound by the alteration. (Sec. 38)

(vi) Central Government's approval in certain cases: The following alterations shall have not effect unless approved by the Central Government: (a) any alteration which has the effect of converting a public company into a private company [Sec. 31(1)]; (b) any alteration relating to the appointment or reappointment of a managing or whole-time director or of a director not liable to retire by rotation in the case of a public company or private company which is a subsidiary of a public company (Sec. 268); and (c) any alteration resulting in an increase in the remuneration of any director including a managing or whole-time director in the case of a public company or a private company which is a subsidiary of a public company. (Sec. 310)

(vii) Not to constitute a fraud on minority. The alteration shall not be valid if it constitutes a fraud on minority. An action of majority which discriminates between majority shareholders and minority shareholders would constitute a fraud on minority. A special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders so as to give the former an advantage of which the latter were deprived. The following cases would illustrate the concept of fraud on minority:

Menier v. tiooper's Telegraph Works Ltd. In this case, companies A and B were in rivalry. The majority shareholders of company A were also the shareholders of company B. Company A had filed a suit against company B. Later, shareholders of company A passed a. resolution to compromise the action against company B in such manner that the terms of compromise were favorable to company B and unfavorable to company A. The minority shareholders questioned the power of the majority to make the said compromise and the

court set aside the same. It observed: "It would be a shocking thing, if that could be done... then the majority have put something in their pockets at the expense of the minority."

Cook v. Decks In this case the directors of a railway construction company obtained a contract in their own names to construct a railway line. The contract was obtained under circumstances which amounted to breach of trust by the directors who then used their voting powers to pass a resolution of the company declaring that the company had no interest in the contract. It was held that the benefit of the contract belongs in equity to the company and that the directors could not benefit themselves at the expense of the minority. If it were not checked, this would be tantamount to allowing a majority to oppress the minority.

Brown v. British Abrasive Wheel Co. The majority shareholders holding ninety-eight per cent of the shares were willing to subscribe further capital which the company badly needed but only if they were able to acquire the shareholdings of the minority. They passed a special resolution to alter the articles to enable them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to sell its shares and challenged the validity of the majority resolution. It was decided that the alteration was not for the benefit of the company but for the benefit of the majority and accordingly an injunction was granted against the company prohibiting it from carrying out the resolution.

(viii) Bonafide for benefit of the company as a whole. The alteration must be bonafide for the benefit of the company as a whole. The court will restrain the company from making the alteration if the effect of it were to benefit an aggressive, vindictive or fraualuent majority. Any alteration made bonafide, in the interests of the company as a whole, is valid and binding even though the private interests of some members may be affected adversely. For instance, in *Sidebdiiom v. Kershaw, Leese & Co. Ltd.,* the alteration. of the articles empowered the directors to require any member, who carried, on a business competing with that of the company, to sell his shares at a fair price to persons nominated by the directors. The validity of the resolution was challenged on the ground that the alteration will not be for the benefit of the company as a whole.

The court held that it was in the interest of the company as a whole to be protected against competition, and upheld the resolution. The court was of the view that the company as a whole means the corporations as a general body. Individual interests might have to be sacrificed. In this case it was very much in the interest of the company as a whole to get rid of such members who were carrying on a competing business, as they always had the chance to exploit the company's secrets for their personal benefit and at its cost.

(ix) Not to be inconsistent with the order of the Company Law Board: The alteration must not be inconsistent with an order of the Company Law Board. Where by an order of the court (on application under Section 397 or 398 for relief in case of oppression or mismanagement) the company amends its articles, the company will then be precluded from making any further alterations which are inconsistent with the order of the Company Law Board without the leave of the Company Law Board. [Sec. 404(1)]

(x) Not to cause breach of contract: The alteration should not cause a breach of contract with an outsider. Thus, where a contract between a company and an outsider

dearly provided that the articles shall not be altered, the court granted an injunction restraining the company from making the alteration on the ground that it would constitute a breach of contract with an outsider. This is well illustrated by the facts of British *Murac Rubber Syndicate v. Alperton Rubber Co. Ltd*. In this case, an agreement was made between Company A and Company B. Company A had the right to nominate two directors on Company B's board as long as Company A held 5,000 shares in Company B. This was incorporated in the articles. Company A nominated two persons as directors and they were disapproved by Company B. Company B also made an attempt to alter the clause of articles which provided Company A the right of nomination. The court granted on injunction restraining Company B from making the said alteration on the ground that it would constitute a breach of contract with an outsider.

But later it was held that a company may alter its articles even if it causes breach of contract with the outsider. It has statutory power to do so. Where the contract with the outsider is wholly dependent on articles, alteration would be operative, and, accordingly, the person accepting appointment purely on the terms of the articles takes the risk of those terms being altered, and will be bound by the altered article.

But the situation will be different if apart from the articles, there is an independent contract. In *Southern Foundries Ltd. v. Shirlaw, S* was appointed Managing Director in a company for ten years by an agreement dated 21.12.1933. Subsequently, the company was amalgamated with another company and new articles were adopted. The latter gave power to the company to dismiss a director and accordingly S was removed from office as director and the company treated him as having ceased to be one. He sued the company for wrongful repudiation of the contract. It was held that dismissal was breach of contract and therefore the company was liable for damages.

5.4 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between a memorandum and articles are as follows:

(i) The memorandum contains the conditions and objects for which the company is incorporated. It is the charter of the company. Articles of association contain the rules and regulations for the internal management of the company.

(ii) The memorandum is subordinate to the Companies Act whereas the articles are subordinate to the Companies Act as well as the memorandum of association. Articles should be consistent with the provisions of the Companies Act and the conditions contained in the memorandum.

(iii) Every company must have its own memorandum of association. No company can be formed unless it files its memorandum with the Registrar of Companies at the time of its registration. But it is not essential for a public company limited by shares to have its own articles. A public company limited by shares may adopt Table A.

(iv) The memorandum defines the relationship between the company and the outside world whereas the articles define the relationship between the company and members as members only and as members inter se.

(v) Since memorandum is the constitution of the company, it is very difficult to make any alteration in it. Sometimes the company must get the approval of the Central Government and in some cases the sanction of Company Law Board must, be obtained to

make an alteration in the memorandum. Articles can be altered by a special resolution. No sanction of the Central Government or Company Law Board is required.

(vi) Any act committed by the company beyond its memorandum is ultra vires and the company is not bour by it. Even the unanimous vote of all the shareholders cannot ratify it. But if is done by the company beyond its articles, it is simply irregular and can subsequently be ratified by shareholders provided it is within the scope of the memorandum.

(vii) In the case of the contracts ultra vires the memorandum, outsiders have no remedy against the company. But in case of contracts ultra vires the articles, where for example internal procedures have not been complied with, outsiders can enforce the contract against the company provided they had no knowledge of irregularity.

5.5 CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

A company's memorandum and articles of association become public documents on registration with the Registrar of Companies. These documents are available for public inspection in the Registrar's office on payment of such fees as may be prescribed.

Every person who deals with the company is deemed is to know the contents of these two documents." This is known as "Doctrine of Constructive Notice" or "Constructive Notice of Memorandum and Articles." It is presumed the individuals dealing with the company have not only read these documents but that they have also understood their proper meaning. -

Consequently, if a person enters into a contract which is beyond the powers of the company, he cannot acquire any rights under the contract against the company. Thus for example, if the articles provide that a bill of exchange must be signed by two directors, a person dealing with the company must see that this is done. If he has a bill signed by only one director, he cannot claim under, it.

A similar problem arose in *Kotla Venkatswami v. Ram Murthi*. In this case, all deeds etc., were to be signed by the managing director, the secretary and a working director as per articles of the company. R accepted a deed from the company which was signed by. a secretary and a working director on behalf of the company. It was held that R could not claim under this deed. If he had seen the articles, he would not have accepted such a deed as it was not signed by the required persons and hence was invalid.

5.6 DOCTRINE OF INDOOR MANAGEMENT

The "doctrine of indoor management" imposes an important limitation on the "doctrine of constructive notice." Persons dealing with the company are presumed to have, read these documents. Once they are satisfied that the company has power to enter into the proposed transaction, they are required to do no more. They are not bound to enquire into the regularity of any internal proceedings. They are entitled to assume that provisions of articles have been complied with by the company in its internal working. If the proposed contract is within the scope of the company as indicated by these two documents, the company will be bound to the outsider and the claims of the outsider will not be affected in any way by the internal irregularity of the company. This is known as the "Doctrine of Indoor Management" or rule in *Royal British Bank v. Turquand*.

In the above case, the articles empowered the directors to borrow money provided they were authorized by a resolution passed at the general meeting of the company. The directors borrowed money from T and issued a bond to him without the authority of resolution passed at the general meeting. It was held that the company was liable for the money to T because once the articles authorized the directors to borrow money subject to a resolution of the general meeting of the company, T was entitled to assume that the directors were borrowing on the authority of the resolution passed at a general meeting of the company. T is not required to enquire into the regularity of the company's internal proceedings.

The rule was followed in *Premier Industrial Bank Ltd. v. Carlton Mfg. Co. Ltd.* where it was stated: "If the directors have power and authority to bind the company, but certain preliminaries are required to be gone through on the part of the Company before that power can be duly exercised then the person contracting with the directors is not bound to see that all these preliminaries have been observed. He is entitled to presume that the directors are acting lawfully in what they do."

The rule is of great utility in the world of commerce. But for this rule, the form of company organization would not have been that popular. It is based on the principles of justice and public convenience. Firstly, as we already know the office of the Registrar is a public office and hence any person dealing with the company must ensure that the proposed contract with the company is within its powers. He cannot be expected to know more about what is happening inside the company office. "An outsider is presumed to know the constitution of a company; but not what may or may not have taken place within the doors that are closed to him." No one would like to deal with the company if he is also required to ascertain the regularity of the internal proceedings in respect of the proposed transaction. Secondly, the person would be unwilling to deal with the company if the company could escape the liability by denying the authority of officials to act on its behalf in the absence of this rule.

EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management is subject to certain limitations. They are as follows:

(1) Knowledge of irregularity: A person dealing with the company will not be entitled to protection under this rule if he has notice, actual or constructive, that the prescribed procedure has not been complied with by the company.

Thus where Company A lends money to Company B on a mortgage of its assets and the procedure laid down in the articles for such a transaction was not complied with and the directors of the two companies were the same, it was held that the mortgage is not binding. It may be presumed that Company A had notice of irregularity through its directors."

Similarly in Howard v. Patent Ivory Co., the directors were empowered to borrow up to £1,000 and such further sums as the company in general meeting might authorize. Without such consent, they issued to themselves debentures for sums in excess of £1,000. It was held that as they had knowledge of irregularity in the internal, proceedings of the 'company, the company would be liable for £1,000 only. Sums borrowed in excess of this were held to be invalid.

(2) Forgery: It may be noted here that the rule in the *Turquand* case does not protect a person where forgery is involved. A company cannot be held liable for forgeries committed by its officers.

In Ruben v. Great Fingall Ltd. the secretary of the company issued a share certificate by forging the signatures of two directors under the seal of the company. It was contended by the plaintiff that it was not his duty to verify the signatures. Whether the signatures were genuine or not was a part of internal management. But the court held that the certificate is not binding on the company as the rule in *Turquand's* case does not protect forgery. In this connection Lord Loreburn observed as follows: "It is quite true that persons dealing with limited liability companies are not bound to inquire into their indoor management and will not be affected by irregularities of which they have no notice. But this doctrine, which is well established, applies only to irregularities that otherwise might affect a genuine transaction. It cannot apply to a forgery."

(3) Negligence on the part of the outsider: If an individual is put upon enquiry, he cannot claim the benefit under the *Turquand* case in the circumstances under which he would have discovered irregularity if he had made the proper inquiries. In *Underwood v. Bank of Liverpool,* * the sole director paid cheques drawn in the name of the company in his own account. It was held that the bank was put upon inquiry before crediting the cheques drawn in favour of the company in the account of the director. The bank was not entitled to rely upon the ostensible authority of the director.

Similarly a bank was put upon inquiry where the directors of the company secured their indebtedness by a charge upon the assets of the company. It was held that the bank was not entitled to the benefit of the charge which had not in fact been authorized.

It was further held that even the unusual magnitude of the transaction may put a person dealing with the company upon inquiry as to its being authorized.

In Anand Bihari Lal v. Dinshaw & Co., the plaintiff accepted transfer of the company's property from its accountant. The transfer was held to be void because such a transaction is apparently beyond the scope of the accountant's power. It puts the person dealing with the company into inquiry. The plaintiff should have insisted on seeing the power of attorney executed in favour of the accountant by the company. Even a delegation clause is not enough to make the transaction valid unless the accountant is in fact authorized.

(4) No knowledge of articles: In order to claim protection, under the rule of "indoor management", knowledge of articles is essential. The doctrine of indoor management is based on the principle of estoppels and a person who did not consult the company's memorandum and articles and consequently did not act in reliance on those documents, cannot be protected under the rule in *Turquand's* case.

(5) Acts ordinarily beyond the apparent authority. An outsider will not be protected by the rule in *Turquand's* case if the act of the agent is one which would not ordinarily be within his powers simply because under the articles the power of making such a contract might have been entrusted to him. The outsider can hold the company liable only where the power had in fact been delegated, not withstanding a delegation clause to that effect in the articles. The facts of *Anand Bihar Lal v: Dinshaw & Co.,* provide a clear illustration to support this point.

Similarly where the branch manager of a bank drew and endorsed bills on behalf of his company without having received any authority from the company, it was held that drawing of bills was not within the ordinary ambit of 'power of this branch manager and the company was not bound unless the authority was in fact delegated to him to this effect.

5.7 SUM UP

Articles of association is an important document of a company. It contains rules and regulations which govern the management of the internal affairs of the company. They define the duties and rights of the company, its members and directors in their respective opacities.

A company has the statutory right to alter its articles by passing a special resolution. Alteration must not be inconsistent with the Memorandum of association or the provision of the act. Both the documents the memorandum and articles are considered to be public documents. These fore anyone dealing with the company is preserved to have the knowledge of the contents.

5.8 KEY WORDS

Constructive Notice: A knowledge of the contents of documents on the part of those who are dealing with the company is presumed by law.

Inter se: Amongest themselves.

Public Document: Any document which is in the possession of an officer of the government, and is open to inspection is known as a public document.

5.9 CHECK YOUR PROGRESS

1. What do you mean by Doctrine of Indoor Management?
2. Explain briefly the relation between memorandum and articles of Association.
3. What are the usual contents of the article?

5.10 REFERENCES

1) Maheshwari and Maheshwari, Business Laws, HPH.
2) N.D. Kapoor, Elements of Company law, Sultan chand and sons.
3) M.C. Kuchhal, Mordern Indian Company Law, Shri Mahavir Book Depot.

5.11 TERMINAL QUESTIONS:

1) What are Articles of Associations? How can they be altered?
2) Explain the legal affects of the Articles of Association. How far they are binding on outsiders?
3) What is the distinction between a Memorandum and Articles of Association?
4) Discuss the Articles of Associations? How can they be altered?

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LESSON-6

TRANSFER AND TRANSMISSION OF SHARES

STRUCTURE

6.0 OBJECTIVES

After studying this lesson, one should be able to:

- Describe the procedure of transfer of shares.
- Explain the procedure of transmission of shares.

6.1 RIGHT TO TRANSFER SHARES

ONE of the greatest advantages of a company from of organization is that its shares are freely transferable. Section 82 provides that the shares of a member in a company shall be movable property, transferable in manner provided by the articles of the company. The right to transfer shares is a statutory right provided by the Act. However, the articles of the company may impose certain reasonable restrictions regarding the manner in which such transfers will be made, but the right to transfer shares cannot be taken away by any provision in the articles. The latter cannot impose absolute restrictions on the right of the shareholders to transfer their shares. If such absolute restrictions are incorporated in the articles, they will be ultra vires the Companies Act.

In the absence of any restrictions in the articles, the shares may be transferred to anybody even though he be a man of straw.

Thus, where a holder of partly paid up shares with a view to escape liabilities transferred his shares and the transfer was duly approved by the Board, it was held to be a valid transfer in the absence of any collusion between the transferor and the directors.

However, in a private company, the right to transfer shares is closely restricted. Section 3 (1)(iii) provides that the articles of a private company shall restrict the right to transfer its shares if any.

STATUTORY PROVISIONS REGARDING TRANSFER OF SHARES

The statutory provisions regarding transfer of shares are as follows:

1. Instrument of transfer to the delivered to the company: A company shall not register a transfer of shares unless a proper instrument of transfer duly stamped and executed by the transferor and transferee has been delivered to the company along with the certificate relating to the shares. If no such certificate has been issued, the letter of allotment of shares should be submitted to the company. It must specify the name, address and occupation of the transferee.

However, if any instrument of transfer signed both by the transferor and the transferee has been lost, the directors may register the transfer on the application by the transferee on his executing a bond of indemnity. [Sec. 108 (1)]

Proper instrument means an instrument which satisfies all the requirement of the Act, including the stamp duty to be affixed. The instrument of transfer has to be executed by all the joint holders as transferors in the case of shares jointly held.

2. Instrument of transfer to be in the prescribed form: Every instrument of transfer should be in the prescribed form and must be presented to the prescribed authority before it is signed by the transferor and before any entry is made in it. The prescribed authority shall stamp or otherwise endorse on the instrument the date on which it is so presented. Thereafter such instrument of transfer must be executed by the transferor and the transferee and completed in all other respects. It must then be delivered to the company if the shares of the company are dealt in on a recognized stock exchange, any time before the date on which the register of members is closed for the first time after the date of presentation or within twelve months of the date of such presentation, whichever is later. In any other case, the instrument of transfer shall be delivered to the company within two months of the date of such presentation. [Sec. 108(1A)]

These provisions intend to restrict the period of currency of blank transfers. However, the above limits shall not apply where shares are held under a blank transfer by State Bank of India or any schedule bank or any approved financial institution or the Central or State Government, byway of security for repayment of any loan or the performance of any obligation. [Sec. 108 (1C)]

Section 108 (ID) empowers the Central Government to extend the periods mentioned above by such further time as it may deem fit in order to avoid hardship in any particular case.

3. Transfer by legal representative: Ordinarily, a member of the company whose name appears in the register of members can transfer shares, but any transfer made by a legal representative of a deceased member shall be valid although the legal representative is not a member himself (Sec. 109). The legal representative does not become a member unless he consents to be treated as such and to be entered on the register of members.

4. Notice to transferee: An application for registration of transfer of shares of a member in a company may be made either by the transferor or the transferee. Where the application is made by the transferor and relates to partly paid shares, the transfer shall be registered only if the company gives notice of the application to the transferee, and the latter makes no objection to the transfer within two weeks of receipt of the notice. (Sec. 110)

The Act does not require the notice to be given to the transferor in case the application is made by the transferee, although in practice the company also gives such notice to the transferor. The transferor is not bound to reply to the notice and if he does not send any reply, he will not be stopped from denying the validity of the transfer.

5. Refusal by the company to register a transfer: Although the right to transfer shares is a statutory right granted by the Companies Act, yet it is common for articles to provide that directors shall have the power to refuse to register a transfer on reasonable grounds. When directors have the power to refuse registration of a transfer, the power must be exercised in a bonafide and just manner and not arbitrarily or *mala fide* or for collateral motive.'

The power to refuse to register a transfer of shares must be exercised by a resolution of the board. Where the board had power to refuse to register a transfer and it was equally divided, there being no casting vote, it was held that the power to refuse had not been exercised and that therefore, it must be registered. And if one of two directors intentionally fails to attend a board meeting so that the quorum of two will not be reached and accordingly transfers cannot be passed for registration, the transfer must be registered.'

Once a transfer has been recognized and registered, the directors cannot exercise their power of refusal in respect of such transfers.' Similarly directors cannot refuse registration of transfer of fully paid shares unless there is express provision to this effect in the articles.

Usual restriction on transfer of shares: The articles usually empower the directors to refuse registration of transfer of shares on the following grounds:

(a) where the calls are in arrears against the shares to be transferred;

(b) where the transferor is a debtor of the company and the company has a lien on shares;

(c) where partly paid up shares are to be transferred to a minor;

(d) where the transferee is a man of unsound mind;

(e) where partly paid up shares are to be transferred to-a buyer (transferee) who, in the opinion of directors, is financially incapable of paying the remaining unpaid amount on the shares;

(f) where the instrument of transfer is incomplete, irregular or defective or is not properly stamped;

(g) where the transferee is an undesirable person and his entry in the company would be injurious to the general interest of the company.

Notice of refusal: If a company refuses to register a transfer, whether in pursuance of any power under its articles or otherwise, it shall notice of the refusal to the transferee and transferor within two months of the date on which the instrument of transfer was delivered to the company. Notice of refusal must also state the reasons for such refusal. [Sec. 111(1)]

(6) Appeal against refusal: In the case of public company, the transferor or the transferee may appeal to the Company Law Board against the refusal or failure of the company to register the transfer of shares within two months of the transfer being lodged with the company [Sec. 111(2)]

The appeal must be filed within two months of the receipt of the notice of such refusal. Where the company fails to give such notice, the appeal must be lodged within four months from the date on which the instrument of transfer was lodged with the company. [Sec. 111(3)]

The appeal shall be made in writing and shall be accompanied by such fee as may be prescribed. [Sec. 111(10)]

Once the appeal has been made, the Company Law Board shall send notices to the company, transferor and transferee and it shall also give them a reasonable opportunity to make their representations. On the consideration of the whole case, the Company Law Board may either; reverse the decision of the- company or confirm it. In the former case the company shall register the transfer within ten days of the receipt of the order. [Sec. 111(5)]

The Company Law Board has been empowered to make necessary interim orders, orders as to costs and incidental or consequential orders regarding payment of dividends or allotment of bonus or rights shares. [Sec. 111(6)]

It may be noted here that the above right of appeal against refusal is not available in the case of a private company (including a private company which is a subsidiary of a public company) and a deemed to be public company under Section 43A, to the extent the power to refuse registration is exercised under its articles to enforce the restrictions contained therein. [Sec. 111(13)]

But in the case of a private company which is not a subsidiary of a public company, the decision of the company to refuse registration of a transfer of shares, can be challenged in one case. If any share of such a company are, sold in execution of a decree of the court or by orders of a public authority and the company refuses to register the purchaser's name, an appeal may be made to the Company Law Board. Such appeal will be dealt with in the same manner as an appeal against a public company with the difference that the Company Law Board may give an option to the company either to accept the purchaser as a member or to get the shares purchased by a member of the company at a reasonable' price to be determined by the Company Law Board. [Sec. 111(11)]

It is important to note here that the aforesaid right of appeal against refusal to register the transfer of shares will not apply to listed securities of public companies. In the case of listed companies, the registration of transfers and their refusal shall be governed by Section 22A of Securities Contracts (Regulation) Act, 1956. These provisions are discussed in this chapter under the next heading.

THE SECURITIES CONTRACTS (REGULATION) AMENDMENT ACT 1985

The Securities Contracts (Regulation) Act, 1956 has been amended in June, 1985. A new Section 22A has been inserted to ensure free transferability of securities of public limited companies which are listed on the stock exchange. However, the law relating to unlisted securities remains as explained above. The provisions of Section 22A are as follows:

(1) Subject to the provisions of this section, the securities of a company fisted on a recognized stock exchange shall be freely transferable. However, it shall not cover a security which is not fully paid up or on which the company has a lien.

(2) Notwithstanding anything contained in its articles or in Section 82 or Section 111 of the Companies Act, 1956 but subject to the other provisions of this Section, a company may refuse to register the transfer of any of its securities in the name of the transferee on any one or more of the following grounds and on no other ground, namely:

(a) that the instrument of transfer is not proper or has not been duly stamped and executed or that the certificate relating to the security has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with;,

(b) that the transfer of the security is in contravention of any law;

(c) that the transfer of the security is likely to result in such change in the composition of the Board of Directors as would be prejudicial to the interests of the company or to the public interest;

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

(3) A company shall, before the expiry of two months from the date on which the instrument of transfer of any of its securities is lodged with it for the purpose of registration of such transfer, not only form, in good faith, its opinion as to whether such registration ought not or ought to be refused on any of the grounds mentioned in point number -2 above but also:-

(a) if it has formed the opinion that such registration ought, not to be so refused, effect such registration;

(b) if it has formed the opinion that such registration ought to be refused on the ground mentioned in sub-point (a) of clause 2, intimate the transferor and the transferee by notice in the prescribed form about the requirements under the law which has or which have to be complied with for securing such registration; and

(c) in any other case make a reference to the Company Law Board and forward copies of such reference to the transferor and the transferee.

(4) Every reference under sub-point (c) of clause 3 shall be in the prescribed form and contain the prescribed particulars and shall be accompanied by the instrument of transfer of the securities to which it relates, the documentary evidence, if any, furnished to the company along with the instrument, of transfer, and evidence of such other nature and such fees as be prescribed.

(5) On receipt of a reference, the Company Law Board shall, after causing reasonable notice to be given to the company and also to the transferor and the transferee concerned and giving them a reasonable opportunity to make their representations, if any, in writing by order direct either that the transfer shall be registered by the company or that it need not be registered by it.

(6) Where on a reference, the Company Law Board directs that the transfer of the securities to which it relates-

(a) shall be registered by the company, the company will give effect to the direction within ten days of the receipt of the order as if it were an order made on appeal by the Company Law Board in exercise of the powers under Section 111 of the Companies Act, 1956;

(b) need not be registered by the company, the company shall, within ten days from the date of such direction, intimate the transferor and the transferee accordingly.

(7) If default is made in complying with the provisions of this Section, the company and every officer of the company who is in default shall be punishable with fine' which may extend to five thousand rupees.

(8) If in any reference, any persons makes any statement—

(a) which is false in any material particular, knowing it to be false; or

(b) which omits any material fact knowing it to be material, he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.

It will thus be seen that this amendment makes it difficult for companies whose securities are listed on a recognized stock exchange to refuse to register properly executed transfer of any of its securities without a reference to the Company Law Board whose decision shall be final.

CERTIFICATION OF TRANSFERS

Certification of transfer becomes necessary when a shareholder, who owns a number of shares, wishes to sell part of his holdings, but the company has issued him only one certificate. In such a case the transferor presents .the instrument of transfer together with his share certificate before the company. The company gives an endorsement on the instrument of transfer that the share certificate pertaining to the shares has been lodged with the company. This is known as certification of transfer.

The company retains the share certificate for cancellation and the certified instrument of transfer is returned to the transferor with a balance ticket in respect of shares that he^ retains. This ticket is retained by the transferor and the certified instrument of transfer is given to the transferee.

Statutory recognition: Section 112 of the Companies Act recognizes the practice of certification of instruments and such an instrument shall be deemed to be certified, if it bears the words "Certificate Lodged" or words to similar effect.

Effect of certification: The certification shall be taken as a representation by the company to any person acting on the faith of the certification that there have been

produced to company such documents as show a prima fade title to the shares or debentures in the transferor named in the instrument of transfer Such certification is not a representation that the transferor has any title to the said shares or debentures. [Sec. 112(1)]

Liability of company: Certification gives neither warranty of the transferor's title nor any guarantee on the part of the company. But where any person acts on the faith of a false certification made by a company negligently or deliberately, the company will be liable to pay damages or compensation for the loss suffered by him. However, it may be noted that the company is under no legal obligation to certify any instrument of transfer of shares at all.

A certification is deemed to be made by the company when it is signed by a person so authorized t do so.

These provisions apply equally to a certification of a transfer of debentures of a company.

FORGED TRANSFER

When an instrument of transfer does not bear the signature of the real owner of shares, any transfer made on the basis of such an instrument is called a forged transfer. In simple words, where the signature of the transferor is forged, it is a forged transfer.

Consequences of forged transfer: If the instrument of transfer is forged and the company issues a certificate to the transferee in good faith, the title of the real owner is not affected. The company must remove the name of the transferee and enter the name of the original owner in the register of members.

Similarly, if the company has registered a forged transfer of debentures, the court will, on an application by the true owner of the debentures, order that name of the original owner be entered in the register of debenture-holders and the transferee would also be liable to pay to the true owner; what he might have received in respect of interest on the said debentures.

If the transferee who has become a member on a forged transfer further sells those shares, the bona fide purchaser for the value has no right to be registered as a shareholder. He can, however, claim damages from the company which showed that the transferor was the true owner of the shares." The measure of damages will be the market value of shares at that time.

On the other hand, the company is entitled to get damages from the individual who induced it to issue a share certificate on the basis of a forged instrument.

Precautions to avoid forged transfers: In order to avoid the above hardships, the company must be careful while registering the transfers.. Signature of the transferor on the instrument of transfer should be compared with the specimen signatures. Notice of every transfer must be given to the transferor before it is registered by the company.

BANK TRANSFER

When a transferor merely signs the transfer form, without filling in the name of the transferee, and delivers it to the transferee with a share certificate, he is said to have made a blank transfer.

In this way the security goes from hand to hand in the stock market before it is submitted to the company for registration. Blank transfer thus facilitates negotiability of the security. The shares can be transferred from one person to another merely by delivering the blank transfer form and the related share certificate. This saves the trouble of having a new transfer form for each transfer. When, ultimately, the shares come into the hands of a purchaser who does not wish to sell, he fills up the form by signing his own name as the transferee and sends the completed transfer form to the company for registration.

It also saves stamp duty on every sale. It is only the last transferee (who wants to get himself registered as a member) who affixes the stamps and pays a registration fee to the company.

Effect of blank transfer: The delivery of a share certificate with the transfers executed in blank passes not the property in shares but as title, legal and equitable, which will enable the holder to vest himself with the shares, without risk of his being defeated by the registered owner or any other person deriving title from the registered holder.

Until the requisite formalities are complied with, the transferee does not become the legal owner of the shares. Mere delivery of shares along with the blank transfer deed does not by itself make the transferee the owner of the shares.

If the person to whom the share certificates and blank transfers have been handed over, gets himself registered with the company as a holder and then transfers them an honest purchaser, the title of the latter will be protected.

Blank transfers not negotiable instruments: The blank transfers are not negotiable instruments and if a person obtains them by fraud, possession cannot pass a good title to a bona fide purchaser for value.

Life of blank transfers restricted: In order to curb the abuse inherent in the system of blank transfers and to limit its life, Section 108 lays down certain restrictions. The instrument of transfer must be stamped with a date by the Registrar and the instrument .duly executed must be delivered to the company for registration (a) in the case of shares dealt, in or quoted en a recognized stock exchange at any time before the register of members is closed for the first time after the stamped date or within twelve months of the date of presentation to the prescribed authority, whichever is later; and (b) in any other case, within two months of the date of presentation to the prescribed authority.

6.2 TRANSMISSION OF SHARES

When shares pass by operation of law from one person to another, it is known as transmission of shares. This happens when a member dies, becomes insolvent or goes insane. Transmission thus means the passing of title and right to deal wide shares from one person to another by some event such as death, insolvency or lunacy. In all such cases the legal representative or the Official Assignee Or Receiver or administrator appointed by the court, shall be entitled to the shares.

NOMINATION OF SHARES AND DEBENTURES

By Section 109-A, inserted by the companies (Amendment) Act, 1999, every holder of shares or debentures may register the name of any person with the company in whom shares or debentures will be vested in the event of the death of the shareholder or debenture holder.

Joint-holders may together nominate a person to whom all the rights in the shares or debentures of the company shall vest in the event of death of all the joint-holders. On the death of the holder of shares or debentures, the nominee shall become entitled to all the rights in the shares or debentures of the company to exclusion of any claimant whether under will or succession unless the nomination is varied or cancelled in the prescribed manner.

TRANSMISSION OF SHARES UNDER NOMINATION

On the death of the nominating shareholder, the nominee may either get himself registered as the holder of shares or transfer the shares. If the nominee elects to register himself as the holder of shares, he shall 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 holder. It he elects to transfer, he shall notify the election by executing a transfer. All the limitations and restrictions with regard to the right to transfer and registration of transfer shall apply to such notice or transfer as aforesaid.

A person, being a nominee becoming entitled to a share on transmission shall have the same right as to dividend and other advantages and privileges, as if he were the original holder, except that before registration as a member, he shall not exercise any right as member at the meeting of the company. The board may at any time, give notice to. such a person requiring him to make his election as above, and if he does not comply with such notice within ninety days, the board may thereafter withhold payment of all dividends, bonus or other moneys payable in respect of the shares until the requirements of the notice have been complied with.

DIFFERENCES BETWEEN TRANSFER AND TRANSMISSION OF SHARES

(1) When shares pass from one person to another by a voluntary act, it is called a transfer. Where shares pass from one person to another by operation of law, it is called transmission.

(2) Transfer is a general method of transferring property in shares, whereas transmission takes place under special circumstances such as death, insolvency or lunacy.

(3) In the case of transfer, an instrument of transfer duly stamped and executed by the transferor and transferee is essential, in the case of transmission, only proof of the title of the legal representative to the shares and letter of request are required. There is no instrument of transfer.

(4) The transfer of shares is generally against consideration, but in transmission there is none.

6.4 SUM UP

Shares are movable property and can be transferred by the shareholders in the manner prescribed by the Articles. Shares may be transferred by a member to anybody even to a man straw and even with the object of being released from liability of payment of calls. A provision in the article for an automatic transfer of shares of a deceased shareholder shall be illegal and void.

Transfer of shares on account of operation of law is termed as transmission of shares. Transmission of shares occurs in case of death, lunacy or insolvency of an individual member or if the number is a limited company on its liquidation. A company can refuse to register a transmission if these is a provision to that effect in the articles.

6.5 CHECK YOUR PROGRESS:

1) Describe transfer of shares

2) Discuss transmission of shares.

6.6 REFERENCES

1) Maheshwari and Maheshwari, A manual of Business laws, HPH.

2) ND Kapoor, elements of Company Law, Sultan Chand & Sons.

6.7 TERMINAL QUESTIONS:

1) Discuss the cases where a company can refuse a registration of transfer of shares.

2) Differentiate between transfer and transmission of shares.

3) Explain the general provisions of transfer of shares.

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LESSON-7

NATIONAL COMPANY LAW TRIBUNAL

STRUCTURE

7.0 OBJECTIVES

After studying this lesson, you should be able to:

- Explain the national company Law Tribunal.
- Describe the constitution of Appellate Tribunal.
- Examine the powers and functions of the Tribunal.

7.1 INTRODUCTION

Companies Bill has been in talks for past few years and has time and again been amended to adjust to the changing corporate environment. The Companies Act tries to balance two competing factors of management autonomy and investor protection. The economy of India has been witnessing continuous changes, it is going through consistent growth and expansion. In this background of continuous change and growth of economy, the Central Government after due deliberations decided to repeal the Companies Act, 1956 with the introduction of new enactment in the form of legislation to provide for new provisions to meet the continuous changing dynamics of national and international economic environment. These new changes in the proposed legislation are directed towards further acceleration of growth and diversification of the economy in the corporate scenario. It addresses the public concern over corporate accountability and responsibility.

7.2 COMPANIES BILL, 2012

After much delay and deliberations, The Companies Bill, 2012 (hereinafter referred to as the "The Bill") which seeks to repeal existing Company Law, 1956, has been passed by Lok Sabba i.e. the lower house of the Indian Parliament, on December 18,2012. The Bill still needs to be approved by the Rajya Sabha i.e. the upper house of Indian Parliament, and it may therefore undergo further changes. Before the Bill can be notified as a statute replacing the existing Companies Act, 1956, it may possibly undergo modifications.

A completely revamped legislation will be in place with the introduction of the new and amended Companies Act to completely change the operation of cooperates. The Companies Bilihas many amended provisions to meet the ever evolving corporate scenario. The Bill has 470 Clauses and 7 Schedules. The bill has been divided into 29 Chapters. With the introduction of Companies Bill, 2012, many new chapters have introduced, such as viz., Registered Valuers (chapter 17); Government Companies (chapter 23); Companies to furnish information or statistics (chapter 25); Nidhis (chapter 26); National Company Law Tribunal & Appellate Tribunal (chapter 27); Special Courts (chapter 28). The Bill has been drafted after great deliberation and critically analyzing various factors revolving around present corporate environment and the changes/ problems that may arise of new situations created by these changes. The Bill is the result of detailed constructive progress adopted by the Government thereby providing self regulatory process and stringent compliance regime. The Companies Bill tries to take into consideration and meet the dynamics of business, governance and accountability.

7.3 INTRODUCTION OF NATIONAL COMPANY LAW TRIBUNAL i.e. NCLT AND NATIONAL COMPANY LAW APPELLATE TRIBUNAL i.e. NCLAT

One of the important change proposed to be introduced by the Companies Bill, 2012 is in the form of ***Constitution of National Company Law Tribunal i.e. NCLT and National Company Law Appellate Tribunal i.e. NCLAT***

Constitution of National Company Law Tribunal and Appellate Tribunal [Clause 408 & 410]:

The Central Government shall, by notification, constitute, a Tribunal to be known as National Company Law Tribunal and an Appellate Tribunal to be known as National Company law Appellate Tribunal.

Clause 408 corresponds to Section 10FB of the Companies Act, 1956 and seeks to deal with the constitution of National Company Law Tribunal (NCLT). The NCLT shall consist of President and such members as the Central Government may deem necessary.

Clause 410 corresponds to Section 1 OFR of the Companies Act, 1956 and seeks to deal with the formation of National Company Law Appellate Tribunal (NCLAT) consisting of Chairperson and Judicial and Technical Members' which shall not exceed eleven. This may seem to be a pragmatic approach. With the introduction of the bill and the constitution of a National Company Law Tribunal and National Company Law Appellate Tribunal, it is also provided that any proceedings presented before the Tribunal or appeals filed before the Appellate Tribunal shall be disposed of as expeditiously as possible and Tribunal shall make every possible endeavor to dispose of the proceedings.

THIRU R. GANDHI PRESIDENT, MADRAS BAR ASSOCIATION VS. UNION OF INDIA

Whenever some change is proposed, there is bound to be opposition to such change. There have been judicial pronouncements discussing the constitutional validity of some of the provisions of the Companies Bill.

The constitutional validity of NCLT and NCLAT was challenged in Thiru R. Gandhi President, Madras Bar Association vs. Union of India, Department of Company Affairs (2004) (Mad).

Earlier, the amendment to the Companies Act, 1956 to setup the NCLT was rendered unconstitutional by Madras High Court for several reasons; few of amongst those were as under:

"The issue is not whether judicial functions can be transferred from courts to Tribunals. Rather the issue is whether judicial functions can be transferred to Tribunals governed by persons who are not suitable or qualified or competent to discharge such judicial powers or whose independence is suspect"

"A lifetime of experience in administration may make a member of the civil services a good and able administrator; but not a necessarily good, able and impartial adjudicator"

Result and its implication: The Supreme Court of India on 11th May, 2010 gave a ruling validating the provisions of Companies (Second Amendment) Act, 2002 pertaining to transfer of several judiciary and quasi-judiciary powers under the act to an independent tribunal, called NCLT. The creation of a new substitute judicial forum which is to carry out the work which is now being carried out by different High Courts in the country for over nine decades, is to be done with great care so that the new Tribunal will be efficient and effective alternate institutional forum to the High Courts and the Company Law Board. Once the tribunal is established, all company-related matters pending with the Company Law Board (CEB), Board for Industrial and Financial Reconstruction (BIFR), Appellate Authority for Industrial and Financial Reconstruction (AAIFR) and different High Courts across the country will be transferred to the NCLT:

Difference between Court and Tribunals: There axe certain well-recognized differences between courts and tribunals, which are as under,

- While courts are governed by detailed statutory procedural rules and evidence, requiring an elaborate procedure in decision making, tribunals many a times frame their own procedures and are not generally governed by the provisions of procedural and evidence law.
- Court's proceedings are generally conducted in public, whereas tribunal's proceedings are not required to be conducted in public.
- Lawyers are entitled to appear before the courts, they are bodies of general jurisdiction; the Judge sitting in a Court himself hears and decides a case and gives reasons for his decision; and above all, they are independent of the executive as Judges have tenure independent of the executive will. Whereas tribunals have a specialized jurisdiction; there may be statutory prohibition on the lawyers to appear before them (though very often it is not so)."

"Growth" is directly proportional to change, so it can be concluded that Growth in the various dimensions of corporate environment ignited the necessity for change in age old legislation controlling the governing of such corporate. There has been tremendous corporate growth in the recent past like with the introduction of technological advancement in the form of e-governance, the management, functioning and governance of the companies have become very easy and effective. The tremendous growth of the corporate requires a sound mechanism, to handle any disputes that may arise from its working and complications. Therefore, going by the dynamism of the proposals as contained the Companies Bill, 2012, merits of the constitution of the NCLT and NCLAT can't be denied, provided it functions well in the eyes of law intended by the legislature. This is so because establishment of NCLT and NCLAT will surely reduce many delays in the corporate law proceedings as well as multiplicity of litigations involved in such proceedings. Problem arises at the level of implementation and execution front because of the fact that the inefficient structured corporate framework has many pitfalls arising out of bureaucracy and corruption and less initiative by the corporate.

These definitions are self explanatory. There are two classes of members to the National Company Law Tribunal; Judicial Members and Technical Members. The Tribunal shall be headed by the President while the Appellate Tribunal by Chairperson.

7.4 CONSTITUTION OF NATIONAL COMPANY LAW TRIBUNAL (SECTION 408):

The Central Government shall by notification with effect from a specified date constitute a National Company Law Tribunal.

QUALIFICATION OF PRESIDENT AND MEMBERS (SECTION 4O9):

The President shall be a person who is or has been a Judge of a high Court for five years.

Judicial Member:

A judicial member shall be person, who —

(a) is or has been a judge of a High Court; or

(b) is or has been a District Judge for at least five years; or

(c) has for at least ten years as an advocate of a court or held a judicial office or as member of a tribunal.

Technical Member:

A Technical member shall be a person who-

(a) has for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service out of which at least three years as Joint Secretary or above; or

(b) is or has been in practice as a chartered accountant for at least fifteen years; or

(c) is or has been in practice as a cost accountant for at least fifteen years; or

(d) is or has been in practice as a company secretary for at least fifteen years; or

(e) is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial

management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management, conduct of all airs, revival, rehabilitation and winding up of companies; or

(f) is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

7.5 CONSTITUTION OF APPELLATE TRIBUNAL (SECTION 410)

The Central Government shall by notification, constitute an National Company Law Appellate Tribunal, constituting of a Chairperson and not exceeding eleven members for hearing appeals against the orders of the Tribunal.

QUALIFICATION FOR APPELLATE TRIBUNAL (SECTION 411):

The chairperson shall be a person who is or has been Judge of the Supreme Court or the Chief Justice of a High Court

A Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years.

A Technical Member shall be a person of proven ability, integrity and standing having special knowledge and experience, Of not less than twenty-five years, in law, industrial finance, industrial management Or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies.

SELECTION OF MEMBERS (SECTION 412):

The President of the Tribunal and the chairperson and Judicial Members of the Appellate Tribunal, shall be appointed after consultation with the Chief Justice of India.

The Members of the Tribunal and the Technical Members of the Appellate Tribunal shall be appointed on the recommendation of a Selection Committee consisting of —

(a) Chief Justice of India or his nominee — Chairperson;

(b) a senior Judge of the Supreme Court or a Chief Justice of High Court — Member;

(c) Secretary in the Ministry of Corporate Affairs — Member;

(d) Secretary in the Ministry of Law and Justice — Member; and

(e) Secretary in the Department of Financial Services in the Ministry of Finance — Member.

The Secretary, Ministry of Corporate Affairs shall be the Convener of the Selection Committee.

TERMS OF OFFICE (SECTION 413):

The President and every other Member of the Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, but shall be eligible for re — appointment for another term of five years.

A Member of the Tribunal shall hold office as such until he attains,—

(a) in the case of the President, the age of sixty-seven years;

(b) in the case of any other Member, the age of sixty-five years:

A person who has not completed fifty years of age shall not be eligible for appointment as Member. The Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

The chairperson or a Member of the Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five years.

A Member of the Appellate Tribunal shall hold office as such until he attains,—

(a) in the case of the Chairperson, the age of seventy years;

(b) in the case of any other Member, the age of sixty-seven years:

A person who has not completed fifty years of age shall not be eligible for appointment as Member. The Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

7.6 POWER AND FUNCTION OF THE TRIBUNAL

BENCHES OF TRIBUNAL (SECTION 419) :

The Central Government may notification decide the number of Benches of the Tribunal.

The Principal Bench of the Tribunal shall be at New Delhi and shall be presided over by the President.

The Power of Tribunal shall be exercisable by Benches consisting of two members out of whom one shall be a Judicial Member and another Technical Member. However, Tribunal may authorize a single Judicial Member bench to exercise certain matters by general or special order. However, at any stage the Member may refer the matter to President to transfer to a two Member Bench.

The President may constitute one of more Special Benches consisting of three or more Members with m of Judicial Members.

The Decision shall be made according to the Majority.

ORDERS OF TRIBUNAL (SECTION 420) :

The Tribunal may after giving reasonable opportunity to the parties to the proceeding, pass any order as it thinks fit.

The Tribunal may, at any time within two years from the date of the order may rectify any mistake, if the mistake brought to its notice. No rectification shall be made in an order against which an appeal has been preferred.

The Tribunal shall send a copy of every order passed to all the parties concerned.

APPEAL FROM ORDER OF TRIBUNAL (SECTION 421) :

Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.

No appeal shall lie to the Appellate Tribunal from a consent order.

Every appeal shall be filed within a period of forty — five days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved. The Appellate Tribunal may entertain an appeal after the expiry of initial forty — five days but within a further period of forty — five days. The Appellate Tribunal must be satisfied that the appellant was prevent by sufficient cause from filing the appeal within that period.

On receipt of an appeal, the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass order as it think fit.

The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal.

EXPEDITIO US DISPOSAL (SECTION 422) :

Every application or petition presented before the tribunal an every appeal filed before the Appellate Tribunal shall be disposed of expeditiously and every endeavour shall be made to dispose of within three month from the date of presentation or filing.

The Tribunal or Appellate Tribunal shall record the reason for not disposing the application or petition or appeal within this period. The president or Chairperson may extend the period for not exceeding ninety days.

APPEAL TO SUPREME COURT (SECTION 423) :

Any person aggrieved by an order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the Appellate Tribunal to him on any question of law arising out of such order.

The Supreme Court may allow it to be filed within a further period not exceeding sixty days. If, it is satisfied, that the appellant was prevented by sufficient cause from filing the appeal with this period.

PROCEDURE (SECTION 424) :

The Tribunal and Appellate Tribunal shall not bound by the procedure laid down in the Code of Civil Procedure, 1908 but shall be guided by the principles of natural justice.

The Tribunal and the Appellate Tribunal shall have the same powers as of civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of following matters, namely —

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence of affidavits;

(d) requisitioning any public record or document or a copy of such record or document;

(e) issuing commissions for the examination of witness or documents;

(f) setting aside any order of dismissal of any representation for default or any order passed by it exporter and

(g) any other prescribed matter.

Any order made by the Tribunal or Appellate Tribunal may be enforced by that Tribunal as if it were a decree made by a court in a suit pending therein; The Tribunal o Appellate Tribunals may send its order for execution to the court within the local limits of jurisdiction-

(a) the registered office of the company is situated; or

(b) the person concerned voluntarily resides or carries on business or personally works for gain.

All proceedings before the Tribunal or Appellate Tribunal shall be deemed to be judicial proceedings within the meaning and purpose of Sections 193,196 and 228 of Indian penal Code. The Tribunal and Appellate Tribunal shall be deemed to be civil court for the purpose of Section 195 and Chapter XXVI of the Code of Criminal Procedure Code, 1973.

POWER TO PUNISH CONTEMPT (SECTION 425):

The Tribunal and the Appellate Tribunal shall have same jurisdiction, powers and authority in respect of Contempt of themselves as the High Court has under the provision of the Contempt of Courts Act, 1971.

DELEGATION OF POWERS (SECTION 426):

The Tribunal or Appellate Tribunal may by general or special order direct any of its officers or employee or any other person to inquire into any matter connected with any proceeding or appeal before it and to report to it.

TRIBUNAL MEMBERS ECT TO BE PUBLIC SERVANTS (SECTION 427):

The President, Members, officers and other employees of the Tribunal and the Chairperson, Members, officers and other employees of the Appellate Tribunal shall be deemed to be public servants under Section 21 of the Indian Penal Code.

PROTECTION OF ACTION TAKEN IN GOOD FAITH (SECTION 428):

No suit, prosecution or other legal proceeding shall lie against the Tribunal, the President, Member, officer or other employee thereof or against the Appellate Tribunal, the Chairperson, Member, Officer or other employees thereof or liquidator or any other authorized person for the discharge of any function under this Act in respect of any loss or damage caused or likely to be caused by any act which is in good faith done in pursuance of this Act.

POWER TO SEEK ASSISTANCE (SECTION 429) :

The Tribunal may in order to take into custody or under its control all property, books of account or other documents request in writing the Chief Metropolitan Magistrate, Chief Judicial Magistrate or District Collector within whose jurisdiction any such property,

books-of account or other documents of a company are situate or found to take possession thereof. The magistrate or collector shall —

(a) take possession of such property, books of account or other documents; and

(b) cause the same to be entrusted to the Tribunal or other person authorized by it.

The Magistrate or Collector may take steps and use force as may be necessary. No such act shall be called in question on any court or before any authority on any ground whatsoever.

CIVIL COURT NOT TO HAVE JURISDICTION (SECTION 430) :

No civil court shall have jurisdiction to entertain any suit or preceding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine by or under this Act or any other law for the time being in force.

VACANCY NOT TO INVALIDATE (SECTION 431):

No act or proceeding of the Tribunal or the Appellate Tribunal shall be questioned or shall be invalid merely on the ground of the existence of any vacancy or defect in the constitution of the Tribunal or the Appellate Tribunal,

RIGHT TO LEGAL REPRESENTATION (SECTION 432) :

A party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, as the case may be, may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any other person to present his case before the Tribunal or the Appellate Tribunal.

LIMITATION (SECTION 433):

The provisions of the Limitation Act, 1963 shall apply to proceedings or appeals before the Tribunal or the Appellate Tribunal

TRANSFER OF CERTAIN PROCEEDINGS (SECTION 434) :

The Central Government may by notification decide date to transfer following proceedings —

(a) All matters, proceedings or cases before the Company Law Board immediately before the notified date shall transfer to the Tribunal;

(b)All proceedings including arbitration, compromise an recons and winding up, pending before any District Court or High Court shall stand transferred to the Tribunal from Notified date;

(c) Any reference or inquiry pending before the Board of Industrial and Financial Reconstruction or any appeal or proceeding before Appellate Authority for Industrial and financial Reconstruction shall stand abated. The company may make such reference or appeal before the Tribunal Within one hundred and eighty days.

7.7 SUM UP

National Company Law Tribunal has been constituted under section 408 of companies Act 2013. It is a quasi judicial body having jurisdiction in respect of amalgamation, merger and winding up of companies. Besides, this it also deals with the

issues relating to expression and mismanagement rectification of register of member etc. which were earlier with the company law board.

National Company Law Appellate tribunal has been constituted under section 410 of the companies Act 2013. Appeals against orders of NCLT can be made with NCLAT.

7.8 KEY WORDS

National Company Law Tribunal (NCLT): It was constituted under section 408 of Companies Act 2013. It is a quasi judicial body,

National Company Law Appellate Tribunal: It was constituted under section 410of the Companies Act 2013. Appeals against orders of NCLT can be made with NCLAT.

7.9 CHECK YOUR PROGRESS

1) When was National Company Law Tribunal constituted?

2) Discuss the Constitution of NCLT.

7.10 REFERENCES

1) ND Kapoor, elements of Company Law, Sultan Chand & Sons.

2) Maheshwari and Maheshwari, A manual of Business laws, HPH.

3) M.C. Kuchhal, Modern Indian Company Law, Shree Mahavir Book Depot.

7.11 TERMINAL QUESTIONS

1) What is National Company Law Appellate Tribunal?

2) What are the powers of National Company Law Tribunal?

3) What is the difference between NCLT and NCLAT?

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LESSON-8

ONE PERSON COMPANY (OPC)

STRUCTURE

8.0 OBJECTIVES

After studying this lesson, you should be able to:

- Understand the concept of one person company.
- Explain the salient features of one person company.
- Discuss the special provisions and exemptions.

8.1 INTRODUCTION

The introduction of one person company (OPC) in the legal system is a move that would encourage corporatization of micro businesses and entrepreneurship with a simpler legal regime so that the small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliances. This will not only enable individual capabilities to contribute economic growth, but also generate employment opportunity. One Person Company of sole-proprietor and company form of business has been provided with concessional/relaxed requirements under the Companies Act, 2013. With the implementation of the Companies Act, 2013, a single national person can constitute a Company, under the One Person Company (OPC) concept.

"One Person Company (OPC) is an revolutionary concept is a step forward to facilitate more business friendly corporate regulations in India. The Companies Act, 2013 aims pave the way for a more modern and dynamic legislation, to enable growth and greater regulation of the corporate sector in India.

Till recently, if you wanted to setup a private company, you needed at least one other person because the law mandated a minimum of two shareholders. So, far the

person wanting to venture alone, the only option was proprietorship, an onerous task since it is not legally recognized as a separate entity.

OPC will give the young businessman all benefits of a private limited company which categorically means they will have access to credits, bank loans, limited liability, legal protection for business, access to market etc. all In the name of a separate legal entity.

OPC provides a whole new bracket of opportunities for those who look forward to start their own ventures with a structure of organized business. OPC will give the young businessman all benefits of a private limited company which categorically means they will have access to credits, bank loans, limited liability, legal protection for business, access to market etc., all in the name of a separate legal entity.

Single entrepreneur can manage his business on his own. It can have only one member at any point of time. It may have only one director but as per the pro visions of section 149 can however appoint more than 15 directors after passing a special resolution. So, the key difference between OPC and sole proprietorship is the way the liabilities are treated. For Instance, in an OPC the promoter liability is limited in the event of a default or legal issues. Also one person can take a decision without waiting for other director consent and wasting of time and energy in convincing other directors can be avoided.

8.2 THE CONCEPT

One person companies are in existence in certain countries. In India this concept has been mooted by the Ministry of Corporate Affairs by allowing One Person Companies in India in line with UK, China, USA, Australia, Singapore, Qatar, Pakistan and several other countries. One Person Companies have been in existence in UK for several years now. China allowed formation of OPCs as recent as in 2005. A few other countries have also given the legal status for OPCs.

United Kingdom

Historically, United Kingdom is the first one, which paved the way to the one man company through a precedent set in its famous case Saloman v. Saloman & Co. (1897) AC 22.

Section 7 of the UK Companies Act, 2006 deals with method of forming company. It provides that -

(1) A company is formed under this Act by one or more persons—

(a) Subscribing their names to a memorandum of association (see section 8), and

(b) Complying with the requirements of this Act as to registration (see sections 9 to 13).

(2) A company may not be so formed for an unlawful purpose.

One person Company (OPC) is defined in sub section 62 of section 2 of the Companies Act, 2013 which reads as follows:

“One Person Company means a company which has only one member” The Important features of the one person Company (OPC) -

* OPC has only one person as a member/shareholder.

* OPC can be registered only as a Private Company.

* OPC may be either a company limited by share or a company limited by guarantee or an unlimited company.

* An OPC limited by shares shall comply with following requirements:

Shall have minimum paid up capital of INR 1 lac

Restricts the right to transfer its shares

Prohibits any Invitations to public to subscribe for the securities of the company.

* An OPC is required to give a legal identity by specifying a name under which the activities of the business could be carried on.

The words "One Person Company" should be mentioned below the name of the company, wherever the name is affixed, used or engraved.

Eligibility Norms for Incorporation and Nominee Member:

As per rule 3(1) of the Companies (Incorporation) Rules 2014, only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate/form a OPC. Indian resident means who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year.

* A nominee for OPC has to be a natural person who is an Indian citizen and resident in India.

* No person shall be eligible to become a nominee in more than One OPC.

At the time of incorporation of OPC, the sole member of OPC is required to appoint another person as his nominee and his name shall have to be mentioned in the Memorandum of Association of the OPC.

The Nominee so appointed shall become the member in the following situation:

a. In the event of the sole members death; or

b. In the event of the sole member becoming incapacitated to contract.

A nominee so appointed is required to give his written consent for the same which is required to be filed with the Registrar of Company (ROC) at the time of incorporation of the OPC along with Its Memorandum of Association and Articles of Association.

A nominee has the right to withdraw his consent if he so desires.

Following person cannot be member of OPC:

* A minor shall not be eligible to become member or nominee of the OPC or can hold share with beneficial interest.

* Foreign citizen.

* Non Resident.

* A person Incapacitated to contract.

* Persons other than natural person i.e. living human being.

The sole member shall nominate another person as nominee within 15 days of the receipt of 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. The company shall within 30 days of receipt of the notice of withdrawal of consent has to 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 and the written consent of such another person.

As per rule 4 of the Companies (Incorporation) Rules 2014:

1. Memorandum of OPC should mention the name of the nominee by the OPC subscriber with the Registrar in Form No. INC.2

2. The consent of his nominee is to be filed in form no. INC. 3

3. OPC to file with the Registrar within 30 days any change in membership

4. Form no. INC. 4 is to be filed for the Intimation for such cessation and nomination.

Incorporation Stages:

Name Availability:

1. Information required for DIN:

a. DIN No. If available

b. Permanent residential address of the applicant

1. Passport

2. Voters Id Card

3. Driving License

4. Aadhaar Card

5. Or any other valid address proof

c. Educational qualification of the applicant

d. Identity Proof.

Other Information to be provided:

A. The applicant should provide the following details:

1. Proposed name: Maximum 6 names can be quoted which will be considered on the basis of name subscribed (first to last basis)

2. Proposed business to be carried on

3. Capital to be contributed for formation

4. State in which registered office of the OPC to be situated

5. Details of nominee

After obtaining name availability, within 60 days we have to file incorporation documents with ROC. The following are the attachments:

1. Memorandum of Association of the Company

2. Articles of Association of the Company

3. Proof of identity of the member and the nominee

4. Residential proof of the member and the nominee

5. Consent of the nominee in form INC. 3

6. Affidavit from the subscriber and first director to the memorandum in the form no. INC. 9.

7. Specimen signature Inform INC. l0

8. List of all the companies (specifying their CIN) having the same registered office address, if any; specimen signature in form INC.10

9. Consent from director

10. Proof of registered office address

11. Copy of PAN card of member and nominee

12. Details of duration of stay at present address if it is less than one year address of the previous residence has to be provided

13. Details of the name of the nominee

14. Detail of entrenchment of articles

Status-Whether Private Limited or Public Limited

Section 2(68) of the bill provides for the definition of private company to include OPC. It also explicitly excludes OPC from the condition form minimum number of members i.e. 2 for its formation. This implies that all the provisions of the act which is applicable to a private company shall also be applicable to OPC unless otherwise it is specifically excluded from its compliance. Also section 3 of the bill, further clarifies that fact that OPC shall be treated as a private company for all legal purpose with only one member.

TYPES OF OPCs:

One person company may be

1. A company limited by shares or

2. A company limited by guarantee or

3. An unlimited company

Thus OPC may be of the following five types:

1. One person company (OPC) limited by shares

2. OPC limited by guarantee and having share capital

3. OPC limited by guarantee and having no share capital

4. OPC unlimited having share capital

5. OPC unlimited not having share capital.

OPC is required to file annual return:

As per the provisions to section 92(1) of the Companies Act 2013, the annual return in case of OPC shall be signed by the company secretary or where there is no company secretary by the director of the OPC.

Financial Statements:

1. The financial statements of a one person company can be signed by one director alone.

2. Cash Flow Statement is not a mandatory part of financial statements for a One Person Company [Section 2(40)].

3. Board Report to be annexed to financial statements may only contain explanations or comments by the board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

4. OPC 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 and eighty days from the closure of the financial year.

Annual General Meeting:

As per section 96(1) of the Companies Act 2013, the provision relating to holding of AGM is not mandatory for a OPC.

Board Meeting:

At least one board meeting must be held in each half of the calendar year and the gap between the two meetings should not be less than ninety days.

For the purposes of holding board meetings, in case of one person company which has only one director. It shall be sufficient compliance it all resolutions to be passed by such a company at a board meeting, are entered In the minutes book required to be maintained under section 118 and signed & dated by the member and such date shall be deemed to be the date of the board meeting for all the purposes under this act. If OPC has only one director. It is exempted from holding Board meetings.

Taxation of OPC

Though the concept of an OPC has been Incorporated In the Companies Act, 2013 but the concept of same does not exist in tax laws as yet, as a result an OPC can be put in the same bracket of taxation as other private companies. In case of sole proprietorship, business income is added to the individual income and hence tax slab between. 10% and 30% is available. But the same is not the case with private company According to Income Tax Act, 1961 a private limited company is taxable at a flat base rate of 30% in addition to that surcharge and education cess is also applicable. Also, provision of Minimum Alternate Tax (MAT) is also applicable to private company. The concept of one person company is an attempt to organize the unorganized, yet a very large, sector of proprietorship concerns and other entitles which will be convenient to regulate and manage if the same is in the form of One Person Company.

Contracts by One Person Company:

If OPC 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 and where the contract is not in writing. It should be ensured 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 said provision is not applicable in case the contract is in writing and where the contract entered is by the company in the ordinary course of its business.

The company should inform the Registrar about every contract entered into by the company and recorded in the minutes of the meeting of its Board of Directors within a period of fifteen days of the date of approval by the Board of Directors.

Opportunities to Small Entrepreneurs

Small entrepreneurs can carry on their business in form of OPC with status of separate legal entity. The concept is good for entrepreneurs with new ideas and ventures trying to explore the corporate world with minimum compliances and maximum benefits as exemptions. Various small and medium enterprises doing business as sole proprietors might enter into the corporate domain through OPC. The unorganized sector of the economy will find an outlet to show their entrepreneurial expertise.

So the small entrepreneurs enjoy the benefit of OPC and can hence boost the economy of our country.

OPC company is like a One Man Army. The compliance burden is very less and the liability of the members is very limited is an added advantage. OPC is expected to benefit people who are into self employment and many small scale sectors. It is a remarkable feature of the Companies Act, 2013. “OPC should boost the confidence of small entrepreneurs”.

Small Company:

The concept of “Small Company” has been introduced for the first time by the Companies Act 2013. The Act identifies some companies as small companies based on their capital and turnover position for the purpose of providing certain relief/exemptions to these companies. Most of the exemptions provided to a small company are same as that provided to a one person company. The Act also provides for a simplified scheme of arrangement between two small companies, without requiring the approval of Tribunal, i.e. with the approval of Central Government (Regional Director).

Definition

Section 2(85) defines a Small Company as

“small company” means a company, other than a public company,

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

(ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this Section 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;

For qualifying as a small company, it is enough if either the capital is less than rupees fifty lakhs or turnover is less than rupees twenty crores. It is sufficient if either one of the requirement is met without meeting the other requirement. However, these limits may be raised but not exceeding rupees five crores in case of capital and rupees twenty crores in case of turnover.

Further, as per the definition of a small company, holding and subsidiary companies are specifically excluded from the concept of small company. Thus eyen though both the holding company and subsidiary company may fulfill the capital or turnover requirement of a small company, they will still fall outside the purview of small company and accordingly the benefits which are available to a small company cannot be applied to a company which is holding or subsidiary company.

In other words, a holding or a subsidiary company can never enjoy the privileges of a small company even though they may fulfill the capital or turnover requirement of a small company.

Similarly, a company may classify as a small company in a particular year but may become ineligible in the next year and may become eligible again in the subsequent year.

Section 129(3) mandates that a company which has one or more subsidiary companies must prepare consolidated financial statements in addition to standalone statement. However, companies which have subsidiary companies, i.e. holding companies arc outside the purview of small companies. It appears from the above that the requirement of consolidation of financial statements will not arise for small companies. But, explanation provided under sub-Section 3 of Section 129 contains that for the purpose of consolidation, the word “subsidiary” shall include associate company and joint venture. Thus, a small company which has any associate company or joint venture will still be required to prepare consolidated financial statements. This meaning of “subsidiary” is only for the limited purpose of Section 129(3) and not for the purpose of determining whether a company is a small company or not.

8.3 SALIENT FEATURES:

- Only a private company can be classified as a small company.
- Holding company, subsidiary company, charitable company and company governed by any Special Act cannot be classified as a small company.
- For a small company, either the paid up capital should not exceed Rupees fifty lakhs or the turnover as per last statement of profit & loss should not exceed rupees two crores.
- The status of a company as “Small Company” may change from year to year. Thus the benefits which are available during a particular year may stand withdrawn in the next year and become available, again in the subsequent year.

Special Provisions and Exemptions available to a Small Company

As mentioned before, the privileges/exemptions available to a small company are same as that available to a one person company, but not all privileges available to a one person company are available to a small company. For the sake of easy understanding and clarity, all the exemptions available to a small company are provided below.

The annual return of a Small Company can be signed by the company secretary alone, or where there is no company secretary, by a single director of the company.

A small company may hold only two board meetings in a year, i.e. one Board Meeting in each half of the calendar year with a minimum gap of ninety days between the two meetings.

A small company need not include Cash Flow Statement as part of its financial statement.

Provision regarding mandatory rotation of auditor/maximum term of auditor being 5 years in case of an individual and 10 years in case of a firm of auditors is not applicable to an OPC.

8.4 SUM UP

One person company is a new concept introduced by the company act 2013. According to Section 2 (62) of the companies Act, one person company means "a company which has only one person as a member."

A one person company can be incorporated as a private Ltd. company only. It can have only one member at any point of time. It may have only one director. Only a natural person who is an Indian citizen and resident in India is eligible to form and can be a nominee of one person company.

8.5 CHECK YOUR PROGRESS

1) Define one person company.

2) How many directors can be there in one person company?

3) Who can form one person company?

8.6 REFERENCES

1) ND Kapoor, elements of Company Law, Sultan Chand & Sons.

2) Anil Kumar, Company LAW, Taxman Publication.

3) Maheshwari and Maheshwari, A manual of Business laws, HPH.

8.7 TERMINAL QUESTIONS:

1) Define one person company. State its previledges.

2) What are the salient features of one Person Company?

3) How do you register a one person company?

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LESSON-9

CORPORATE SOCIAL RESPONSIBILITY

STRUCTURE

9.0 OBJECTIVES

After studying this lesson, you should be able to:

- Explain the concept of Corporate Social Responsibility.
- Discuss the provisions applicable to companies.
- Describe the history of CSR in four phases.

9.1 INTRODUCTION

A company's sense of responsibility towards the community and environment (both ecological and social) in which it operates. Companies express this citizenship (1) through their waste and pollution reduction processes, (2) by contributing educational and social programs, and (3) by earning adequate returns on the employed resources.

9.2 CSR AND COMPANIES ACT, 2013

The Ministry of Corporate Affirs has notified Section 135 and Schedule VII of the Companies Act 2013 as well as the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 to come into effect from April 1, 2014.

With effect from April 1, 2014, every company, private limited or public limited, which either has a net worth of Rs. 500 crore or a turnover of Rs 1,000 crore or net profit of Rs. 5 crore, needs to spend at least 2% of its average net profit for the immediately preceding three financial years on corporate social responsibility activities. The CSR activities should not be undertaken in the normal course of business and must be with respect to any of the activities mentioned in Schedule VII of the 2013 Act. Contribution to

any political party is not considered to be a CSR activity and only activities in India would be considered for computing CSR expenditure.

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. While these provisions have not yet been notified, is 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. The CSR Rules appear to 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 fulfill the specified criteria. There is a need for clarity with respect to the compliance obligations of a company as well as its holding and subsidiary companies.

The activities that can be undertaken by a company to fulfill its CSR. obligations include eradicating hunger, poverty and malnutrition, promoting preventive healthcare, promoting education and promoting gender equality, setting up homes for women, orphans and the senior citizens, measures for reducing inequalities faced by socially and economically backward groups, ensuring environmental sustainability and ecological balance, animal welfare, protection of national heritage and art and culture, measures for the benefit of armed forces veterans, war widows and their dependents, training to promote rural, nationally recognized, Paralympics or Olympic sports; 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 SC, SI, OBCs, minorities and women, contributions or funds provided to technology incubators located within academic institutions approved by the Central Government and rural development projects. 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.

To formulate and monitor the CSR policy of a company, a CSR Committee of the Board needs to be constituted. Section 135 of the 2013 Act requires the CSR Committee to consist of at least three directors, including an 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 and stipulates that the Committee for a private company and a foreign company need have a minimum of only 2 members. A company can undertake its CSR activities through a registered trust or society, a company established by its holding, subsidiary or associate company or otherwise, provided that the company has specified the activities to be undertaken, the modalities for utilization of funds as well as the reporting and monitoring mechanism. If the entity through which the CSR activities are being undertaken is not established by the company or its holding, subsidiary or associate company, such entity would need to have an established track record of three years undertaking similar activities.

Companies can also collaborate with each other for jointly undertaking CSR activities; provided that each of the companies is able individually report on such projects.

A company can build CSR capabilities of its personnel or implementation agencies through institutions with established track records of at least three years, provided that the expenditure for such activities does not exceed 5% of the total CSR expenditure of the company in a single financial year. 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. This could increase the burden on small companies which do not continue to make significant profits.

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 in the CSR Rules setting out inter alia a brief outline of the CSR policy, the composition of the CSR Committee, the average net profit for the last three financial years and the prescribed CSR expenditure. 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.

9.3 THE FOUR PHASES OF CSR

The history of CSR in India has its four phases which run parallel to India's historical development and has resulted in different approaches towards CSR. However the phases are not static and the features of each phase may overlap other phases.

In the first phase charity and philanthropy were the main drivers of CSR. Culture, religion, family values and tradition and *industrialization* had an influential effect on CSR. In the pre-industrialization period, which lasted till 1850, wealthy merchants shared a part of their wealth with the wider society by way of setting up temples for a religious cause Moreover, these merchants helped the society in getting over phases of famine and epidemics by providing food from their godowns and money and thus securing an integral position in the society. With the arrival of colonial rule in India from the 1850s onwards, the approach towards CSR changed. The industrial families of the 19th century such as *Tata, God, Bajaj, Modi, Birla, Singhania* were strongly inclined tow economic as well as social considerations. However it has been observed that their efforts towards social as well as industrial development were not only driven by selfless and religious motives but also influenced by caste groups and political objectives.

In the second phase, during the independence movement, there was increased stress on Indian Industrialists to demonstrate their dedication towards the progress of the society. This was when Mahatma Gandhi introduced the notion of "trusteeship", according to which the industry leaders had to manage their wealth so as to benefit the common man."/ *desire to end capitalism almost, if not quite, as much as the most advanced socialist. But our methods differ. My theory of trusteeship is no make-shift certainly no camouflage. I am confident that it will survive all other theories."* This was Gandhi's words which highlights his argument towards his concept of "trusteeship". Gandhi's influence put pressure on various Industrialists to act towards building the nation and its socio-economic development. According to Gandhi, Indian companies were supposed to be the "temples of modern India". Under his influence businesses established trusts for schools and colleges and also helped in setting up training and scientific institutions. The

operations of the trusts were largely in line with Gandhi's reforms which sought to abolish untouchability, encourage empowerment of women and rural development.

The third phase of CSR (1960-80) had its relation to the element of "mixed economy", emergence of Public Sector *Undertakings* (PSUs) and laws relating labour and environmental standards. During this period the private sector was forced to take a backseat. The public sector was seen as the prime mover of development. Because of the stringent legal rules and regulations surrounding the activities of the private sector, the period was described as an "era of command and control". The policy of industrial licensing, high taxes and restrictions on the private sector led to corporate malpractices. This led to enactment of legislation regarding corporate governance, labour and environmental issues. PSUs were set up by the state to ensure suitable distribution of resources (wealth, food etc.) to the needy. However the public sector was effective only to a certain limited extent. This led to shift of expectation from the public to the private sector and their active involvement in the socio-economic development of the country became absolutely necessary. In 1965 Indian academicians, politicians and businessmen set up a national workshop on CSR aimed at reconciliation. They emphasized upon transparency, social accountability and regular stakeholder dialogues. In spite of such attempts the CSR failed to catch steam.

In the fourth phase (1980 until the present) Indian companies started abandoning their traditional engagement with CSR and integrated it into a sustainable business strategy. In the 1990s the first initiation towards *globalization and economic liberalization* were undertaken. Controls and licensing system were partly done away with which gave a boost to the economy the signs of which are very evident today. Increased growth momentum of the economy helped Indian companies grow rapidly and this made them more willing. Globalization has transformed India into an important destination in terms of production and manufacturing bases of TNCs are concerned. As Western markets are becoming more and more concerned about labour environmental standards in the developing countries, Indian companies which export and produce goods for the developed world need to pay a close attention to compliance with the international standards.

Current State of CSR in India

As discussed above, CSR is not a new concept in India. Ever since their inception, corporates like the Tata Group, the Aditva Birla Group and Indian Oil Corporation, to name a few, have been involved in serving the community. Through donations and charity events, many other organizations have been doing their part for the society. The basic objective of CSR in these days is to maximize the company's overall impact on the society and stakeholders. CSR policies, practices and programs are being comprehensively integrated by an increasing number of companies throughout their business operations and processes. A growing number of corporates feel that CSR is not just another form of indirect expense but i important for protecting the goodwill and reputation, defending attacks and increasing business competitiveness.

Companies have specialized CSR teams that formulate policies, strategies and goals for their CSR programs and set aside budgets to fund them. These programs are often determined by social philosophy which have clear objectives and are well defined and are aligned with the mainstream business. The programs are put into practice by the

employees who are crucial to this process. CSR programs ranges from community development to development in education, environment and healthcare etc.

For example, a more comprehensive method of development is adopted by some corporations such as *Bharat Petroleum Corporation Limited, Maruti Suzuki India Limited,* and *Hindustan Unilever Limited* Provision of improved medical and sanitation facilities, building schools and houses, and empowering the villagers and in process making them more self-reliant by providing vocational training and a knowledge of business operations are the facilities that these corporations focus on Many of the companies are helping other peoples by providing them good standard of living.

On the other hand, the CSR programs of corporations like *GlaxoSmithKline Pharmaceuticals' focus* on the health aspect of the community. They setup health camps in tribal villages which offer medical check-ups and treatment and undertake health awareness programs. Some of the non-profit organizations which carry out health and education programs in backward areas are to a certain extent funded by such corporations.

Also Corporates increasingly join hands with Non-governmental organizations (NGOs) and use their expertise in devising programs which address wider social problems.

For example, a lot of work is being undertaken to rebuild the lives of the tsunami affected victims. This is exclusively undertaken by SAP India in partnership with Hope Foundation, an NGO that focuses mainly on bringing about improvement in the lives of the poor and needy. The SAP Labs Center of HOPE in Bangalore was started by this venture which looks after the food, clothing, shelter and medical care of street children.

CSR has gone through many phases in India. The ability to make a significant difference in the society and improve the overall quality of life has clearly been proven by the corporates. Not one but all corporates should try and bring about a change in the current social situation in India in order to have an effective and lasting solution to the social woes. Partnerships between companies, NGOs and the government should be facilitated so that a combination of their skills such as expertise, strategic thinking, manpower and money to initiate extensive social change will put the socio-economic development of India on a fast track.

9.4 SUM UP

CSR is not a new concept in India as corporates like the Tata Group, the Aditya Birla Group and Indian Oil Corporation have been evolved in serving the community. The basic objective of CSR in these days is to maximize the Company's overall impact on the society and stakeholders CSR policies, practices and programmes are being comprehensively integrated by an increasing number of companies throughout their business operative and processes companies have specialized CSR teams that formulate policies, strategies and goals for their CSR programs and set aside budgets to found them. CSR programmes ranges from community development to development in education, environment and healthcare, etc.

9.5 CHECK YOUR PROGRESS

1. Discuss CSR concept.

2. Why do we need CSR.
3. Narrate some examples of CSR.

9.6 REFERENCES:

1) Maheshwari and Maheshwari, A manual of Business Law, HPH.
2) Kasma V. Kaushik, CSR in India, Lexis Mexis.
3) Anil Kumar, Company Law, Taxman Publications.

9.7 TERMINAL QUESTIONS.

1. Discuss the main features of CSR.
2. Describe in Phases the Corporate Social responsibility.

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LESSON-10

APPOINTMENT AND MEETING OF DIRECTORS

STRUCTURE

10.0 OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning and legal provisions as to the appointment of directors.
- Explain the powers and duties of directors.
- Describe the legal position of director as agent and trusters.

10.1 INTRODUCTION

You know that the number of members of a company is usually large and are spread all over the country. Hence, they elect some persons to manage these affairs of the company. Such persons are known as directors who are responsible mainly for determining the business policies and directing and controlling the overall affairs of the company. In this lesson you will learn the legal position of directors, their qualifications and disqualifications the method of their appointment, and their powers and duties, and liabilities.

DEFINITION OF A DIRECTOR

The Directors are the persons elected by the shareholders to direct, conduct, manage or supervise the affairs of the company. They manage and control the overall affairs of the company. The day to day working of the company is left to other managerial person appointed for the purpose.

Section 2(13) of the Companies At defines a director as "any person occupying the position of director by whatever name called." This is an inclusive and not an exhaustive definition. To explain the meaning of the term 'director' we can say that directors are the individuals who direct, control, manage or superintend the affairs of a company.

According to explanation 1 to Section 303 of the Act, any person, in accordance with whose directions or instructions, the Board of Directors of a company is accustomed to act, shall be deemed to be director of the company. If a person performs the functions of a director, he will be deemed to be a director, even if he is not so designated. Thus, it is immaterial by what name he is called. However, the experts who give professional advice, shall not be deemed to be directors.

You should note that only an individual can be appointed as a director. According to Section 253 of the Act no body corporate, association, or firm shall be appointed as a director of a company.

POSITION OF DIRECTORS

It is not easy to explain the legal position of the directors because the same have not been defined by the companies Act clearly. Bowen *L.J.* observed "directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may, for the moment and for the particular purpose, be considered." Thus, the real position of a director is not merely that of an agent, or trustee of managing partner, but a combination of all these positions. Let us now discuss their position under various headings as follows:

As Agents: The Company being an artificial person cannot manage its affairs on its own. It has to be entrusted to some human agency known as directors. They are elected representatives of the shareholders and may be termed as agents of the company. The relationship between the company and its directors is that of principal and agent. . Therefore, the general principles of the law of agency govern the relations of the company and its directors. As agents, it is their duty to carry on the business with reasonable care and diligence. They must act within the authority conferred upon them by the Act, memorandum and articles and while entering into contracts on behalf of the company within the scope of this authority, they will bind the company. In other words, if they act beyond the scope of their authority, they will be held personally liable. However, you should note that the acts done beyond the powers of the directors may be ratified by the shareholders in general meeting of the company provided such acts are not beyond the powers of the company.

To bind the company, the directors must act in the name of the company. Directors are the agents of the company and not of the individual shareholders.

It is, however, not correct to say that directors are the agents of the company. because agents are not elected but appointed and secondly, the agents have no independent powers while the directors have independent powers on certain matters.

As Trustees: The 'trustee' means a person who holds and manages the property for the benefit of other persons. Though in the strict legal sense, directors are not the trustees of the company but to some extent they have been treated as trustees of the company. They are the custodians of the motley and properties of the company and as such are responsible for the proper use of such money and property. If they misuse the money or property, they have to refund or reimburse the same.

The directors must exercise their powers in good faith and for the benefit of the company and not for their own benefit. The directors stand in a fiduciary capacity in relation to the company. The same degree of integrity and standard of conduct is expected from the directors as it is expected from a trustee. You should note that directors are trustees for the company and not of individual shareholders.

However, you should remember that directors are not the trustees in the strict sense, because unlike a trustee a director does not enter into contracts in his own name. He enters into contracts for the company of which he is a director and he does not hold any property in trust, because the property is held by the company in its own name.

As Managing Partner: Directors have been described as the managing partners because on the one hand, they are entrusted with the management and control of the affairs of the companies, and on the other hand, they are the shareholders of the company. They manage the affairs of the company for their own benefit as a shareholder and for the general benefit of the company.

But they are not managing partners in the strict sense because the liability of the director is limited to the value of shares held by him whereas the liability of a partner is unlimited. Further, unlike a partner, a director has no authority to bind the other directors and shareholders,

As Employees: Directors are the elected representatives of the shareholders. As such, they are not employees or servants of the company. But under a special contract with the company a director may hold a salaried employment in the company and in that case he will be treated as an employee or servant of the company and he will enjoy all the rights available to an employee.

Thus, it is clear from the above discussion that directors are neither the agents, nor the trustees, nor managing partners, nor employees of the company. In fact, they combine in themselves all these positions. They stand in a fiduciary position towards the company in respect of their powers and capital under their control.

NUMBER OF DIRECTORS AND DIRECTORSHIPS.

The Companies Act has fixed the minimum number of directors which a company must have. According to Section 252 of the Act:

a) every public company shall have a three directors, and

b) every other company shall have at least two directors.

The Companies Act has prescribed only the minimum number of directors but is silent on the maximum number of directors. Subject to this statutory minimum, the articles of association of a company may prescribe the minimum and maximum number of directors for its Board of directors. Within the limits laid down in its articles, the company can increase or decrease the number of its directors, by passing an ordinary resolution in the general meeting (Section 258].

If a public company or a private company which is a subsidiary of a public company wishes to increase the number of directors beyond the limit laid down in the articles, it can do so only with the approval of the Central Government. However, if the Increase in the number of directors does not make the total member of directors more than twelve, the approval of the Central Government will, not be necessary (Section 259).

Number of Directorships: A person cannot be a director in more than twenty companies at the same time. If a person is already holding the office of director in twenty companies and is appointed as a director in some other company, then in such a case the new appointment shall not be effective unless within fifteen days of such appointment he has vacated his office in any one of the companies in which he was already a director. His new appointment shall become void if he f to make a choice within the said fifteen days.

While calculating the number of twenty companies, the following shall be excluded:

i) an unlimited company;

ii) a private company which is neither a subsidiary nor a holding company of a public company;

iii) an association not carrying on business for profit;

iv) alternate directorships.

Any person who holds office or acts as a director of more than twenty companies, shall be punishable with fine which may extend to Rs. 5,000 for each company after the first twenty companies.

10.2 QUALIFICATIONS OF A DIRECTOR

The Companies Act does not lay down any academic qualification for appointment as a company director. The Act does not lay down any share qualifications for a person to be a director. A director need not hold any shares and need not be a member of the company. **However, the articles of association of the company usually provide for the share qualification of a director.** Such shares are known as qualification shares. The directors are required to have these shares so that they also have some financial stake in the company. Regulation 66A of Table A provides that a director must hold at least one share. The articles specify the number or value of shares to constitute qualification shares.

Where the articles provide for qualification shares, a director must obtain qualification shares within two months of his appointment. Any provision in the articles requiring a person to hold qualification shares within a period shorter than two months of his appointment shall be void. You should note that it is not necessary that a person must acquire qualification shares before his appointment.

The nominal value of the qualification shares must not exceed Rs. 5,000 or the nominal value of one share where it exceeds Rs. 5,000. Any provision in the/articles which requires a director to take qualification shares of more than this amount, shall be invalid.

The holder of a share warrant shall not be deemed to be holder of the shares specified in the warrant [Section 270(4)].

If a director does not acquire the qualification shares within two months of his appointment or thereafter does not possess such shares of any time, his office shall automatically become vacant. Further, he shall be punishable with fine which may extend to Rs. 50 for every day from the date of expiry of two months up to the date he acted as a director.

The qualification shares may be obtained by him either directly from the company or from the market.

The provisions regarding qualification shares do not apply to (i) technical directors unless expressly provided in the articles; (ii) directors representing special interest; (iii) directors appointed by Central Government and (iv) in the case of an independent private company.

DISQUALIFICATIONS OF DIRECTORS

The circumstances in which a person cannot be appointed as a director of a company are listed in Section 274 of the Companies Act. A person shall not be capable of being appointed director of a company if:

i) he has been found to be of unsound mind by a competent court;

ii) he is an un-discharged insolvent;

iii) he has applied to be adjudicated as an insolvent and his application is pending;

iv) he has been convicted by a court of any offence involving moral turpitude and sentenced to imprisonment for not less than six months and a period of five years has not elapsed since the expiry of his sentence;

v) he has not paid any call in respect of the 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;

vi) he has been disqualified by an order of the Court under Section 203, of an offence in relation to promotion, formation or management of the company of fraud or misfeasance in relation to the company.

The Central Government may, by notification in the Official Gazette, remove" the disqualifications listed under clause (iv) and (v) above.

A private company which is not a subsidiary of a public company may by its articles, provide for additional grounds for disqualification. Thus, a public company or a private company which is a subsidiary of a public company cannot provide for additional disqualifications in its articles.

10.3 APPOINTMENT OF DIRECTORS

You know that only individuals can be appointed as directors of the company. Any person who is competent to contract and who holds the qualification shares is eligible for appointment as a director of the company. Directors may be appointed in any of the following ways (i) by the articles; (ii) by the shareholders in the general meeting; (iii) by the Board of directors; (iv) by the Central Government and (v) by third parties. Let us now discuss them in detail.

1) By Articles: The names of the first directors are usually given in the articles of the company. In case they are not named in the articles then the subscribers to the memorandum are deemed to be the first directors of the company and they shall hold office until the directors are appointed at the first annual general meeting.

A person cannot be appointed as director by articles, or named as a director, or named as a proposed director in the prospectus unless he or his authorized agent

i) has signed and filed with the Registrar his consent in writing to act as such director; and

ii) has either (a) signed the memorandum for his qualification shares; or (b) taken the qualification shares from the company and paid or agreed to pay for them; or (c)signed and filed with the Registrar an undertaking in writing to take from the company his qualification shares and pay for them; or (d) filed with the Registrar an affidavit that his qualification shares, if any, are registered in his name

The above restrictions, however, do not apply to (i) a company not having a share capital; (ii) a private company; (iii) a company which was a private company before becoming a public company; (iv) a company which issues a prospectus after the expiry of one year from the date on which the company became entitled to commence business.

2) By Shareholders in General Meeting: The first directors of the company shall hold the office till the first annual general meeting. According to Section 255 of the Act, directors of a public company must be appointed every year in its annual general meeting. Unless the articles provide for retirement of all the directors at every annual general meeting, at least two-thirds of the total number of directors must retire by rotation. Thus, only one-third can be the permanent or non-retiring or ex-officio directors.

At every subsequent annual general meeting, out of the two-thirds directors liable to retire by rotation, one-third or the number nearest to one-third must retire. The directors who have been longest in office since their last appointment shall retire, but in case if the date of appointment is the same, the retirement will be determined by an agreement among them and if there is no agreement, it shall be determined by draw of lots.

The retiring directors are eligible for re-election. If a person other than a retiring director wishes to contest the election for directorship, he must give a notice in writing to the company at least fourteen days before the meeting. The company is then required to inform the members either by individual notices or by advertisement of at least seven days before the meeting about such a candidature.

If the vacancies could not be filled up in the annual general meeting, the meeting is adjourned for the next week to be held at the same time and at the same place. If at the

adjourned meeting also the place of the retiring director is not filled up and that meeting has not expressly resolved not to fill the vacancy, then the retiring directors shall be deemed to have been re-appointed as directors.

It should be noted that the appointment of each director in the general meeting must be made by a separate resolution, unless the meeting unanimously decides otherwise. In other words, two or more directors cannot be appointed by one resolution.

3) By Board of Directors: The Board of directors may also appoint directors in the following cases:

i) Additional Directors: The Board of directors may, if authorized by the articles, appoint additional directors. But care should be taken to see that the total number of directors including the additional director must not exceed the maximum number fixed by the articles. Such an additional director shall hold office only up to the date of the next annual general meeting.

ii) Alternate Director: The board may appoint the alternate director if the articles authorize such an appointment. An alternate director is appointed to act in place of a director who remains absent for more than three months from the state in which the meetings of the Board are ordinarily held. Such an alternate director shall hold office till the time when the original director (in whose place he was appointed) returns or on the expiry of the original director's term.

iii) Casual Director: If the office of any director falls vacant for some reason before the expiry of his term of office, such a casual vacancy may be filled by the Board of directors according .to the regulations of the articles. Such a vacancy may be caused by death, resignation, insanity, insolvency etc. The person who is appointed by the Board to fill up the casual vacancy, shall hold the office only up to the date up to which the director in whose place he is appointed, would have held the office.

4) By Central Government: To safeguard the interest of the company, or its shareholders, or the public, the Central Government may appoint such number of directors as the Company Law Board may, by order in writing, specify. **Such directors are appointed to prevent oppression and mismanagement of the affairs of the company.** The Company Law Board may pass such an order on a reference made toil by the Central Government, or on the application of at least one hundred "members, or of member holding at least ten per cent voting rights. Such directors are not required to hold qualification shares and they are not liable to retire by rotation. However, such directors can be removed by the Central Government at any time and appoint some other person in his place.

5) By Third Parties: The articles of the company may authorize the third parties to appoint persons on the Board of directors as their nominee. But the number of directors so nominated must not exceed one-third of the total number of directors. The term 'third parties' here means the debenture holders, financial institutions or banks, etc., who have lent money to the company. The idea behind such appointment is to ensure that the money lent is used only for the purposes for which it has been lent. Such directors are not liable to retire by rotation.

You have learnt that for the appointment of every director, a separate resolution has to be passed. Normally, they are elected by a simple majority. As a result it is possible

that the minority of the shareholders may not be in a position to send their representative on the Board of directors. Therefore, Section 265 of the Act provides them an opportunity to have their representative on the Board. This is done by adopting the system of proportional representation. The articles may have a provision to this effect by which not less than two- third of the total number of directors of the company be appointed by the single transferable vote, or by a system of cumulative voting or otherwise. Such appointments may be made once in three years and any casual vacancy may be filled up by the Board of directors.

VACATION OF OFFICE BY DIRECTORS

According to Section 283 of the Companies Act, the office of a director shall become vacant if

i) he fails to obtain or ceases to hold the qualification shares;

ii) he is found to be of unsound mind by, a competent court;

iii) he applies to the court to be adjudged an insolvent;

iv) he is declared insolvent;

v) he is convicted of any offence involving moral turpitude and sentenced to six month's imprisonment;

vi) he fails to pay any call for six months on shares hold by him;

vii) he absents himself from three consecutive meetings of the Board of directors or from all the meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the board. But if this absence is not deliberate (he might be ill) then it will not result in the vacation of office;

viii) he accepts a loan or any guarantee or security for a loan from the company without the previous approval of the Central Government;

ix) he fails to disclose to the Board his interest in any contract entered into by the company as required by Section 299;

x) he becomes disqualified by an order of the court under Section 203 which restrains fraudulent persons from managing the affairs of companies;

xi) he is removed by an ordinary resolution of the company;

xii) he had been appointed a director by virtue of his holding any office and he ceases to hold such office;

xiii) he is convicted of an offence in connection with the Inspection of books of accounts and other records by the Registrar.

A private company which is not a subsidiary of a public company may, by its articles, provide for additional grounds on which the office of a director shall fall vacant.

The grounds mentioned above for vacating the office of director apply to all companies public or private. On the happening of any of the above events, the director will have to vacate the office. These rules are applicable to all directors by whosoever

appointed and for whatever period appointed. The Board has no power to waive the event or condone the act.

Retirement of a Director

You know that two-third of the directors are Liable to retire by rotation and if a director retires at an annual general meeting and is not re-elected he ceases to hold the office.

Resignation by a Director

A director may resign in accordance with the rules laid down in the articles. If the articles contain no such rule, he can resign at any time by giving a reasonable notice to the company, it is immaterial whether the company accepts his resignation or not. A resignation once made will take effect immediately when the intention to resign is made clear. A resignation cannot be withdrawn, except with the consent of the company concerned.

The resignation letter should be sent to the company at the registered office of the company. The resignation should preferably be in writing, but sometimes even oral resignation may be effective, for example, if it is made at the general meeting of the company.

10.4 REMOVAL OF DIRECTORS

A director can be removed from office before the expiry of his term by (a) shareholders; or (b) Central Government; or (c) Company Law Board. Let us now discuss them in detail.

a) Removal of Shareholders: A company may remove a director by giving a special notice and passing an ordinary resolution. However, they cannot remove (i) director appointed by the Central Government; (ii) a life time director in a private company; (iii) a director representing special interests e.g., creditors or debenture holders; and (iv) a director elected by proportional representation.

Special notice of fourteen days must be given for the resolution to remove a director at any meeting. On receipt of such a notice, the company must forthwith send a copy thereof to the director concerned, who has a right to be heard on the resolution at the meeting.

If the director concerned has sent a written representation to the company, the company may send a copy of the same to all the members. If the representation could not be send because of the shortage of time, it may be read at the meeting.

A vacancy, created by the removal of a director may be filled up by the appointment of another director in this place provided special notice of such appointment has been given to members. A director so appointed shall hold office only for the remaining period of the director removed. Such a vacancy can also be filled up a casual vacancy. **A removed director cannot be reappointed, but he can claim compensation for lo of office.**

(b) Removal by Central Government. The Central Government may remove a director on the recommendation of the Company Law Board. The Central Government may refer the matter to the Company Law Board if it feels that the person has been guilty

of fraud, misfeasance, negligence or breach of trust, or that the business of the company has not been conducted according to prudent comp principles or the company is managed by such a person in such a manner as to cause or likely to cause serious injury to trade, industry or business. If the Company Law Board is satisfied, it shall recommend the removal of such director. The director so removed shall not hold the office of a director or any other office connected with the conduct and management of the affairs of the company for a period of five years. However, the Central Government may, with the previous concurrence of the Company Law Board, remit or reduce this period.

A director who is so removed is not entitled to any compensation for loss of office.

c) Removal by Company Law Board. The Company Law Board is also empowered to remove the director on an application made to it for prevention of oppression or mismanagement. Such a person cannot be appointed in any managerial capacity in the company for a period of five years. Also he cannot sue the company for compensation for loss of office.

10.5 POWERS OF DIRECTORS

You know that the directors are appointed to manage and supervise the overall affairs of the company. Therefore, the Board of directors has the power to do all such things which the company is authorized or empowered to do. **The directors derive their powers from the memorandum or articles of the company and from different provisions of the Companies Act, 1956.**

Section 291 of the Act provides that, subject to the provisions of the Act, the Board of directors of a company shall be entitled to exercise all such powers, and do all such acts and things, as the company is authorized to exercise and do. Thus, the Board of directors cannot exercise such powers which can only be exercised by the company in the general meeting.

The powers of the company are thus divided into two parts: (i) powers to be exercised by the Board of directors, and (ii) powers to be exercised by shareholders in a general meeting. **Within the limits laid down by the Act and the articles, the powers of the directors are supreme and the shareholders cannot alter or restrict their powers by passing a unanimous resolution.** The shareholders can amend the articles or take steps to remove the directors or refuse to re-elect director whose actions they disapprove and appoint other persons replacing them.

Directors are required to act collectively in the form of Board. Directors individually cannot take any decision regarding company's affairs decisions must be taken at the meetings of the Board or by circulation of proposal among the members of the Board. But the Board has the power to delegate authority in certain respects to an individual director or to a committee of directors.

Though, the shareholders cannot generally interfere or restrict the powers of the directors, but, in the following exceptional cases, the general meeting of shareholders may exercise powers conferred on the Board of directors:

i) where the directors act mala fide and against the interest of the company, for example, when their personal Interest clash 4th their duty towards the company;

ii) where the Board of directors for some valid reasons become incompetent to act, for example, all the directors are interested in a particular transaction;

iii) where there is deadlock in management i.e., the directors are unwilling to exercise their powers, for example, when the directors are equally divided and, therefore, cannot come to any decision.

Powers to be exercised by Board only: According to Section 292 the following powers can be exercised by the Board only by means of resolutions passed at meetings of the Board:

a) the power to make calls;

b) the power to issue debentures;

c) the power to borrow money otherwise than on debentures;

d) the power to invest the funds of the company; and

e) the power to make loans.

The first two powers cannot be delegated by the Board to any committee but the remaining three powers can be delegated to any committee or sub-committee, if any. However, such delegation can be made by the Board by passing a resolution at the meeting of the Board which must specify the nature and extent of power which can be exercised by the delegate. The shareholders, in general meeting, can impose restrictions or conditions on the exercise by the Board of any of the above powers.

Other powers to be exercised at Board Meetings. In addition to powers to be exercised at Board meetings under Section 292, there are some other powers which can be exercised only at a meeting of the Board, they are as follows:

i) the power to fill up the casual vacancies on the Board;

ii) the power of sanctioning a contract on which a director is interested;

iii) the power to appoint or employ a person as managing director or manager, if he is already a managing director or manager of another company;

iv) the power of making investments in shares or debentures of companies under the same management;

v) the power of receiving notice of disclosure of shareholdings by directors and persons deemed to be directors;

vi) the power to make declaration of solvency in the case of member's voluntary winding up.

Among the above-mentioned powers, the powers under clause (iii) and (iv) are to be exercised by the Board with the consent of all the directors present i.e., unanimously. You should remember that each director shall have only one vote and all matters will be decided [except (iii) and (iv)] by simple majority of votes. A director cannot appoint a proxy to attend arid vote at the meetings of the Board.

Powers to be exercised with the sanction in general meeting: Section 293 of the Act imposes certain restrictions on the powers of the Board of directors. There are certain

powers which can be exercised by the Board of directors only with the consent of the company in the general meeting, they are:

i) the power to sell, lease or otherwise of the company's undertaking;

ii) the power to remit or give time for the repayment of any debt due by a director;

iii) the power to invest, otherwise than in trust securities, the compensation received for compulsory, acquisition of the company's undertakings or property;

iv) the power to borrow money in excess of the total of the paid-up capital on the company and its free reserves; and

v) the power to contribute to any charitable or other funds not directly connected with the business of the company or the welfare of the employees beyond Rs. 50,000 in a year or 5 per cent of the average net profits for the last three financial years, whichever is greater.

In case the directors sell or lease the company's property without obtaining the consent in the general meeting, the title of the buyer or other person who buys or takes a tease in good t and after exercising due care and caution, will not be affected. Besides, a company whose ordinary business is to sell or lease property is not governed by this rule. You should note that the above restrictions are not applicable to an independent private company. It should also be noted that as regards contributions to National Defence Fund or any other fund approved by the Central Government for the purpose of national defence, Section 293-B empowers the Board of directors to make such contributions without any limit and without obtaining the sanction of the company in general meeting.

Other restrictions on the powers of the Board: In addition to the restrictions imposed by Section 293, there are two more restrictions:

i) Restriction on making political contributions: According to Section 293-A, Government companies and companies which have been in existence for less than three financial years and prohibited from making political contributions. Any other company may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person. The amount of such contribution must not exceed five per cent of its average net profits during the three immediately proceeding financial years. Further, for making such contributions, a resolution authorizing such contribution, should be passed at the meeting of the Board of directors.

Every company is required to give the necessary information in its profit and loss account regarding the amount of contribution and the name of the party or the person to whom the amount has been given.

ii) Restriction on appointment of sole selling or buying agents: The Board can appoint a sole selling or buying agent of the company for any area only after obtaining the sanction in the general meeting of the company and the appointment can be made only for a term not exceeding five years at a time.

Managerial Powers of Directors

The directors are the elected representatives of shareholders and are entrusted with the power to manage the affairs of the company in the best interest of shareholders. The Board of directors has the following managerial powers:

i) power to make contracts with third parties on behalf of the company;

ii) power to recommend dividends;

iii) power to allot, forfeit and transfer shares of the company;

iv) power to appoint director to fill up the casual vacancy;

v) power to take decision regarding the terms and conditions for the issue of debentures;

vi) power to appoint managing director, manager or secretary of the company;

vii) power to form policy and issue instructions for the efficient running of the business; and lastly.

viii) power of control and supervision of work of subordinates.

10.6 DUTIES OF DIRECTORS

Directors of a company occupy an important position in the management of the company and they have vast powers. However, it is expected of them to exercise these powers for the public good and protect and safeguard the interests of the company and share holders.

The duties of directors depend upon the nature and size of the company. While discharging their duties, they must comply with the provisions of the articles and the Companies Act. The duties given in the articles will certainly vary from company to company. A director is not bound to give continuous attention o the affairs of the company, his duties are of an intermittent nature, to be performed at periodical board meetings.

The duties of directors can broadly be classified Under the following two heads:

1) Statutory duties and

2) General duties.

1. Statutory Duties

Some of the statutory duties of directors are:

i) Every director must disclose his shareholdings in the company [Sec. 308].

ii) Every director must disclose his personal interest in contracts to be entered into by the company [Sec. 299].

iii) Directors must not receive any loan from a public company or its subsidiary of which he is a director in contravention of Section 295.

iv) To hold statutory and annual general meetings and lay before the company a Balance Sheet and Profit and Loss Account and other reports.

v) To convene extraordinary general meeting on the requisition of the specified number of members.

vi) Directors must not receive remuneration in contravention of Section 309 read with Section 198.

vii) To file with the Registrar the reports and resolutions as required by the Act.

viii) To maintain books and registers required under the Act and articles,

ix) To perform all such duties as required under the Act and articles.

2. General Duties

There are some duties of a general nature which every director must discharge. The following are some of the general duties:

i) Duty of good faith: The directors occupy a fiduciary position in a company. Fiduciary position means a position of trust and confidence. Therefore, directors must act honestly and diligently in the interest of the company and shareholders. They must not make any secret profits from their dealings with the company. If a director makes some secret profits by utilizing his position, he shall be liable to account for it.

ii) Duty of reasonable care: The directors should discharge their duties with reasonable care. The degree of care expected from him is the same as is reasonably expected from persons of their knowledge and status. If the directors fail to exercise due care and skill in the performance of their duties, they shall be liable for negligence. But they cannot be held liable for mere errors of judgment.

iii) Duty to attend the Board Meetings: The duties of directors are of an intermittent nature to be performed at periodical board meetings. Therefore, it is the duty of every director to attend such meetings. Although a director is not expected to attend all the meetings of the Board, but if he fails to attend three consecutive meetings or all meetings of the Board for a consecutive period of three months (whichever is longer) without obtaining permission, his office shall automatically falls vacant.

iv) Duty not to delegate: The directors must perform their duties personally. They are appointed because of their skill, competence and integrity; therefore, the maxim delegates non protest delegate (a delegate cannot delegate further) is applicable to them. But if permitted by articles of the company, the directors can delegate certain functions to the extent permitted by the Act of the articles.

v) Duty to disclose interest: The fiduciary position of a director requires him to disclose lo the Board his personal interest in any contract to be entered by the company. This is necessary to prevent any conflict between the personal interest of the director and his duties towards the company. It should be noted that there is no ban on company entering into a contract in which a director is interested. What is required is that he must disclose this interest

10.7 LIABILITIES OF DIRECTORS

The liabilities of directors can be discussed under various heads.

1) Liability as shareholder: The director's liability as shareholder is usually the same as that of any other shareholder. But a company may alter its memorandum and make the liability of all or any of the directors unlimited. This, however, will be effective only if the concerned director has given his consent to it. Further, the directors are liable to the calls whenever made, within the permissible time. If calls are in arrear for more than six months, he shall have to vacate the office of director.

2) Liability to outsiders: Directors act for the company, as such they cannot be held personally liable to outsiders for any acts done by them on behalf of the company. They would, however, be personally liable to outsiders in the following circumstances.

i) When they enter into contracts in their own names and not in the name of the company. For example, when they sign a negotiable instrument without mentioning the name of the company, they shall be personally liable.

ii) Where the directors act ultra vires the company i.e., beyond their powers, in such a case company will not be liable but directors will be liable to their parties for breach of implied warranty of authority.

iii) Where they have permitted the issue of a prospectus which contains misstatements or which does not present the true position, the directors shall be personally liable.

iv) Where the directors fail to return the application money within the specified time, if the minimum subscription is not subscribed.

v) Where there is irregular allotment of shares.

vi) Where the directors act fraudulently, for example, when they purchase goods or incur liability at a time when they know that the company will never be liable to pay the amount.

3) Liability to Company: Directors have some duties towards the company by virtue of their office. The directors are liable to the company in the following cases:

i) Ultra vires Acts: Directors are personally liable to the company for ultra vires acts i.e., acts which are beyond their powers. For example, if they pay dividends out of capital, they will be liable to the company %r any loss or damage suffered due to such ultra vires acts.'

ii) Negligence: If the directors perform their functions in a negligent mariner, they incur personal liability to the company. They are, however, not liable for errors of judgment.

iii) Broach of trust: The directors occupy a fiduciary position towards the company. They must act honestly and in the interest of the company. If the directors make some secret profits or use the company's property for their personal use, then they shall be liable to the company.

iv) Misfeasance: The misfeasance means willful misconduct or willful negligence resulting hi some loss to the company. The company can take action against the directors for damages in case of misfeasance.

4) Criminal liability: If the directors fail to comply with the provisions of the Act, they incur criminal liability involving fine or imprisonment or both. Some of the provisions of the at under which the directors incur criminal liability are:

i) Issue of a prospectus containing an untrue statement

ii) Failure to deposit application money in a schedule Bank,

iii) Fraudulently inducing persons to invest money in the company.

iv) Accepting deposits or inviting any deposit in excess of the prescribed limit.

v) Destruction, mutilation, alteration or falsification of any book papers or documents.

vi) Failure to file annual returns.

vii) Default in holding the annual general meeting.

viii) Granting loans to directors without the approval of Central Government.

ix) Failure to maintain proper accounts etc.

5) Liability for acts of co-directors: A director is not liable for the acts of his co-directors unless he was a party to it. A director is not the agent of his co-directors. He cannot be held liable on the ground that he ought to have discovered the fraud. But a managing director or the chairman signing the accounts without understanding its implications cannot escape liability.

10.8 MEETINGS OF DIRECTORS

Directors exercise their powers collectively at periodical meetings of the Board. The rules relating to meetings of directors are following:

i) A meeting of the Board of directors of every company must be held once in every three calendar months and at least four such meetings must be held every year. The Central Government may, however, by notification in the Official Gazette, exempt any class of companies from the above mentioned rule. This has been done to help small sized companies where it is not necessary to hold meeting once" in every three months.

Though the Act does not state anything about the place where the meetings of the Board should be held, but since register of contracts and other books are kept of the registered office, the intention is that such meetings should be held at or near the place of the registered office of the company.

ii) Notice of every meeting of the Board must be given in writing to every director in India at his usual address. The Act prescribes no particular form of notice or mode of service or length of period of notice. Thus even a few minutes notice would be sufficient. The failure to give notice to any director renders the meeting invalid.

iii) The quorum for a meeting of the Board of directors of a company shall be one-third of its total strength (any fraction to be rounded off as one) or two directors, whichever is higher. If at any time there are some interested directors whose number exceeds or is equal to two-thirds of the total strength, then the remaining directors who are not interested shall form the quorum during that time, provided their number is not less than two. In a Board meeting quorum must be present throughout the meeting and not merely at the commencement of the meeting.

iv) If a meeting of the Board could not be held for want of quorum, it shall stand adjourned till the same day in the next week at the same time and at the same place. If that day happens to be a public holiday, then it will be held on the next following day, which is not a public holiday.

v) It is essential that all the proceedings of every meeting of the Board should be recorded in writing in a book called the minute book. Minutes of every meeting must be signed by the chairman in whose presence those resolutions were passed or by the chairman of the next succeeding meeting. As per Section 289, the resolution may also be passed by circulation.

10.9 SUM UP

The directors are the persons elected by the shareholders to direct, conduct, manage or supervize the affairs of the company. The companies Act 2013 does not define the term director. Section 2 (34) simply provides that the term director means "a director appointed to the board of a company." Thus a person will be termed to be a director if he has been appointed to function as director on the board of directors of a company.

A public company must have at least three directors and every other company must have at least two directors. All persons appointed as directors of the company must file with the Register their consent in writing to act as such. Directors legal position is quite interesting. Sometimes they act as agents of the company, sometimes as trusters and sometimes even as managing partners of the company. Directors can be appointed by articles, by shareholders in general meetings, by the board, by the parties and by Central Government.

The directors of a company can also be removed by shareholders by Central Government and by the Company Law Board.

10.10 CHECK YOUR PROGRESS

1) How are the directors of a public company appointed?

2) Discuss the legal position of directors.

3) State the legal provisions of the director of the company.

10.11 REFERENCES

1. M.C. Kuchhal, Modern Indian Company Law, Shree Mahavir Book Depot.

2. N.D. Kapoor, Elements of Company Law, Sultan Chand & Sons

3. Ashok K. Bagrial, Company Law, Vikas Publishing House.

10.12 TERMINAL QUESTIONS

1) Who are the Directors of a Company?

2) Explain the Qualifications and Disqualifications for the office of a director.

3) Discuss the powers and duties of a director.

10.13 KEY WORDS

Director: One who performs the functions of a director.

Share Qualification: The minimum number of shares required to be held by the director so long he is a director.

Board of Directors: The directors of a company collectively constitute the board of directors of a company.

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LESSON-11

MEETING OF SHAREHOLDERS OF COMPANIES

STRUCTURE

11.0 OBJECTIVES

After studying this lesson, you should be able to:

- explain the meaning of a company meeting
- explain the various types of meeting
- explain the rules regarding the notice and quern
- describe the types of resolutions and the purpose for which they can be passed.

11.1 INTRODUCATION

A company, being an artificial person, cannot act by itself like a human being The business of the company is carried on by the elected representative, called as 'directors' The decisions are taken by the directors at the meetings of the Board. But they cannot take on all matters relating to the working of the company. There are certain matters which are to be decided by the general body of shareholders, who are the owners of the company. For this purpose, the meetings of the shareholders are held wherein decisions are taken by shareholders by means of passing resolutions. In this Unit, you will study

the different types of meetings and the business transacted therein. The provisions of the Companies Act lays down the rules regarding the holding and conduct of such meetings. You will also study the various types of resolutions and the purposes for which they are required.

MEANING OF MEETING AND ITS IMPORTANCE

Meeting may generally defined as the gathering, assembly or coming together of two or more persons for transacting any lawful business. For proper working of the company, it is necessary that the shareholders meet as often as possible and discuss matters of mutual interest and take important decisions. Meetings provide a place for fruitful participation where free and frank discussion takes place. The decisions taken at the meetings generally become acceptable and are met with least resistance.

To constitute a valid meeting there must be at least two per because a meeting cannot be constituted by one person. But there are certain circumstances where one person can constitute a valid meeting, they are:

a) Where one person holds all the shares of a particular class, he alone can constitute a meeting of that class;

b) Where the meeting is called by an order of the Company Law Board the Board may direct that one member of the company present in person or by proxy shall constitute a valid meeting.

Company meetings play a significant role in decision making process. They provide an opportunity to shareholders to review the working of the company and take policy decisions, thereby controlling the Board of directors. The directors are duty-bound to follow the decisions taken at the general meeting of shareholders. Meetings constitute a very important aspect in the management and administration in the company form of organization.

11.2 KINDS OF MUTINGS AND THEIR IMPORTANCE

Company meetings can broadly be classified as follows:

1) Meetings of Shareholders: Such meetings. are also known as general meeting of the members which arc held to exercise their collective rights. The meetings of the shareholders may again be of the following four types:

a) Statutory Meeting;

b) Annual General Meeting;

c) Extraordinary General Meeting; and

d) Class Meeting.

2) Meetings of Directors: The directors are to act collectively in the form of a board, and the decisions are taken at the meetings of The Board of directors. These meetings may again be of two types:

a) Meetings of the Board of directors; and

b) Meetings of the committee of directors.

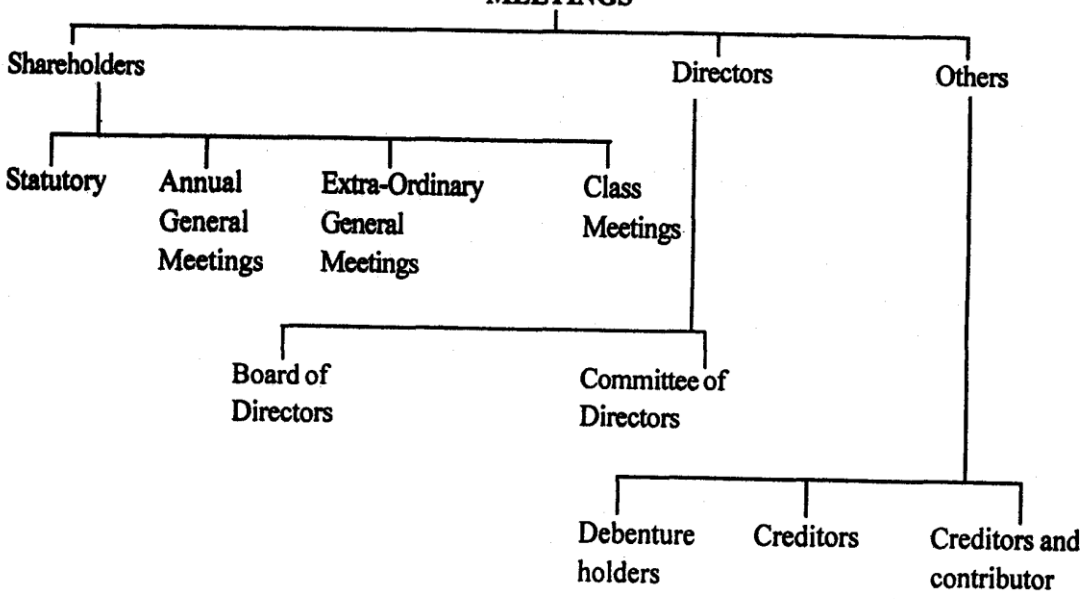
3) Other Meetings: These meetings may be either of the following:

a) Meetings of debenture-holders;

b) Meetings of creditors;

c) Meetings of creditors and contributories on the winding up of the Company

Figure: 9.1



STATUTORY MEETING

This is the first meeting of the shareholders of a public company and is held once in the lifetime of any public company. According to Section 165 of the Companies Act. every company limited by shares or limited by guarantee and having a share capital must hold a general meeting of members of the company within a period of not less than one month and not more than six months from the date on which the company becomes entitled to commence business. This meeting is called as the 'statutory meeting' and it must be specially stated so in the notice calling it. A private company is not required to hold a statutory meeting.

(a) Purpose of Statutory Meeting

The primary objective of holding the statutory meeting is to inform the shareholders about the facts relating to the formation of the company, shares taken up, money received, contracts entered into, preliminary expenses etc. It gives an opportunity to-the members to discuss matters relating to the formation of the company. This enables them to know the position and future prospects of the company. This meeting enables the members to meet the directors and they can satisfy themselves that the money subscribed by them .is being properly used.

(b) Notice of Statutory Meeting

Statutory meeting is treated as a general meeting and as such 21 clear notice in writing must be given to all members of the company. In calculating 21 days, the date on which it is served and the date of the meeting are excluded. A shorter notice will be valid if consent is given by members holding at least 95 per cent of the paid-up capital carrying voting rights, or representing at least 95 per cent of the voting power (Section 171).The consent for a shorter notice may be given either at the meeting or before the meeting.

The notice must expressly state that the meeting is the statutory meeting of the company. A copy of the statutory report must also be sent along with the notice.

(c) Statutory Report

The Board of Directors is required to prepare a report called the 'statutory report'.

You have learnt that along with the notice convening the meeting, this statutory report should also be sent to each Member. If the statutory report is sent later, it will still be treated as valid if all the members entitled to attend and vote at the meeting agree to it.

Contents of the Statutory Report: According to Section 165(3) of the Companies Act, the statutory report must give the following information

i) The total number of shares allotted, distinguishing those allotted as fully or partly paid up otherwise than in cash, the extent to which they are partly paid up, the consideration for which they have been allotted and the total amount received in cash;

ii) An abstract of receipts and payments of the company up to a date within seven days of the date of the report and the balance of cash in hand;

iii) An account or the estimate of the preliminary expenses of the company (such as legal charges, charges in connection with the preparation of memorandum and articles of association, printing expenses, registration charges) showing separately any commission or discount paid or to be paid on the issue or sale of shares or debentures;

iv) Names, addresses and occupation of the directors, auditors, manager and secretary. Changes, if any, in these respects, since the incorporation, are also required to be given;

v) Particulars of any contract which are to be submitted to the statutory meeting for approval. If any modification or proposed modification of a contract is to be submitted for such approval ,brief particulars of contracts and particulars of modifications or proposed modification should also be given;

vi) The extent to which underwriting contracts have not been carried out, and reasons therefore;

vii) The arrears, if any, due on calls from directors and from the manager; and

viii) The particulars of any commission or brokerage paid, or to be paid, in connection with the issue or sale of shares to any director or to the manager.

The report must be certified as correct by not less than two directors, including the managing director, where there is one. With regard to the shares allotted by the company

and the cash received in respect of such shares and the receipts and payments is also required to be certified as correct by the auditors.

A certified copy of the statutory report must be sent to the Registrar after sending the report to the members. At the commencement of the statutory meeting, the Board of directors shall produce a list of members showing their names, addresses and occupations along with the number of shares held by them. This list shall remain open and accessible to any member of the company during the continuance of the meeting.

The members present at the meeting are free to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice of the matter has been given or not. But only such resolutions can be passed of which notice has been given in accordance with the provisions of the Act. If default is made in filing the statutory report, or in holding, the statutory meeting, and every director arid other officers in default shall be punishable with fine which may extend up to Rs. 500. Further, the members have the right to file a petition to the court for compulsory winding up of the company, if the meeting is not held or the report is not filed with the registrar.

ANNUAL GENERAL MEETING

The annual general meeting of the company is an important means through which the shareholders get the opportunity to exercise their power of control. It is at this meeting that the directors retire and seek re election. The shareholders get an opportunity of reviewing and evaluating the overall performance of the company during a year. The shareholders can place their views before the management and can seek clarifications on matters about which they are not satisfied. Thus, you note that an annual general meeting is very important. Unlike the statutory meeting which is held only once in Meetings UNI winding u the life-time of the company, the annual general meeting is held every year.

Every company, public or private, must in each calendar year, hold in addition to any other meeting a general meeting as its annual general meeting and the notice must specify that it is the annual general meeting.

The holding of an annual general meeting is a statutory requirement. Following are the rules regarding annual general meetings:

i) The first annual general meeting of the company must be held within a period of 18 months from the date of its incorporation, and if such a general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year. For example, a company is incorporated on 5th October, 1989 and holds its first annual general meeting 10th March, 1991 (i.e. within 18 months of incorporation), then it need not hold any other annual general meeting in 1990 and 1991. But from the year 1992 onwards, it must hold such a meeting in every calendar year.

ii) The gap between two annual general meetings must not exceed 15 months. The Registrar may, however, for any special reason extend the above time by a period not exceeding three months.

iii) At least 21 clear days' notice of the meeting in writing must be given to every shareholder, directors and auditors of the company. A shorter notice may also be given if it is agreed to by all the members entitled to vote at the meeting.

iv) The annual general meeting of the company must be called on a working day during business hours either at the registered office of the company or at some other place within the city in which the registered office of the company is situated. Thus, no meeting can be called on a public holiday, for example on 15th August, 2nd October and 26th January. If any day is declared by the Central Government to be a public holiday after the issue of notice convening the annual general meeting: It shall not be deemed to be a public holiday and the meeting could be hold on that day as scheduled.

v) The Board of directors can cancel or postpone the holding of the meeting on the scheduled date, but this power should be exercised by the Board bonafide and for proper reasons. The better course for the Board will be to hold the meeting and then have the matter decided by the meeting.

Consequences of not holding Annual General Meeting

You learnt that holding of the annual general meeting is a statutory requirement. If a company makes a default in hol4ing the annual general meeting in accordance with the provisions of Section 166 of the Companies Act, the following two consequences will follow:

i) Any 'member of the company can apply to the Company Law Board for calling the meeting. On such application, the Company Law Board may order the calling of the or it may issue directions for calling the meeting, which may even include a direction that one person present in person or proxy shall constitute the annual general meeting. A meeting called by the order of the Company Law Board shall be deemed to be annual general meeting of the company.

ii) The company and every officer of the company In default shall be punishable with fine up to Rs. 5,000 and if the default continues, with a further fine up to Rs. 250 for every day after the first day of default during which the default continues.

The Business to be Transacted: According to Section 173 of the Companies Act, at - the annual general meeting ordinary business is to be transacted. Any other business can also be transacted at the annual general meeting, but that will be termed as 'special business'. Thus, the annual general meeting can transact both ordinary and special business. The following ordinary business is generally transacted at every annual general meeting:

i) the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors;

ii) the declaration of dividend;

iii) the appointment of directors in the places of those retiring;" and

iv) the appointment of the auditors and fixing their remuneration.

If any other business (other than those mentioned above) is to be transacted at the Meetings, annual general meeting, it shall be treated as special business. Special business can be transacted at an annual general meeting provided the articles of association do not prohibit it and the notice of the meeting mentions it as special business.

You should note that the ordinary business requires an ordinary resolution, while the special business may be passed by an ordinary resolution or special resolution as required by the Act.

EXTRAORDINARY GENERAL MEETING

All general meetings of a company other than the statutory and annual general meeting are called 'extraordinary meetings'. Extraordinary general meeting is a meeting which is held between two annual general meetings. These meetings are called in emergencies or on special occasions. This meeting is called to discuss some urgent special business which cannot .be postponed till the next annual general meeting, for example, alteration in the memorandum or articles of association, reduction of capital, issue of debentures etc. All business transacted at such meeting is deemed to be special business.

An extraordinary general meeting may be called by

a) Board of directors on its own motion;

b) the Board of directors on the requisition of members; or

c) the requisitionists themselves; or

d) the Company Law Board.

a) By the Board of Directors: Clause 48 of Table A states that "the Board may, whenever it thinks fit, call an extraordinary general meeting. "However, the Board has to pass the resolution for convening such meeting.

b) By the Board on requisition: According to Section 169 of the Act, the Board of directors must call an extraordinary general meeting of the company on the requisition of required number of members. The requisition letter for calling this meeting must be signed-by members holding at least one-tenth of the paid-up 'capital and having a right to vote on the matter of requisition. In the case of a company having no share capital, it must be signed by those members who have at least one-tenth of the total voting power.

The requisition must state the purpose for which the meeting is requisitioned and it must be deposited at the registered office of the company. You should note that only such matter can be taken up at the meeting which is specified in the requisition.

On receipt of a valid requisition, the Board of directors should, within 21 days, move to call a meeting and the meeting must actually be held within 45 days of the date of deposit of the requisition. A notice of21 clear days is necessary for calling the extraordinary general meeting. A duty has been imposed on the management to disclose, in an explanatory statement all material facts relating to every special business to enable the members to form a judgment on the business.

c) By the Requisitionist: If the Board of directors fails to call the meeting with in 21 days and the meeting is not held within 45 days of the deposit of the requisition, the requisitionists may themselves proceed to call the meeting. But the requisitionists must hold the meeting within three months from the deposit of the requisition. Such meeting must, as nearly as possible, be held in the manner as called by the Board of directors. When the requisitionists themselves call a meeting, they may recover the reasonable expenses incurred from the company, and the company may deduct such amount from the amount of remuneration payable to the directors in default.

If the meeting is called by requisitionists, it can only transact the special business for which it has been expressly convened. The resolutions, which are properly passed at such requisitioned meeting, shall be binding upon the company.

d) By the Company Law Board: Under Section 186 of the Act, the Company Law Board is empowered to call, bold or conduct such a meeting, if for any reason it is impracticable to call or conduct an extraordinary general meeting. The term 'impracticable' means not possible to call, bold or conduct the meeting in accordance with the provisions of the Act and Articles, for example, if the meeting cannot be called because of the rivalry of two groups.

The Company Law Board may order for the calling, holding and conducting such a meeting either on-its own motion or on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting. The Company Law Board should use this power sparingly and on being convinced that it is in the larger interest of the company. While calling a meeting, the Company Law Board may give such directions as it thinks fit, including the direction, that one member present in person or by proxy would constitute the quorum.

Like any other general meeting, the notice of the extraordinary general meeting must also be given at least 21 days before the date of the meeting specifying the date, time and place of the meeting. The notice must also specify the special business to be transacted at the meeting. You should note that unlike an annual general meeting, extraordinary general meeting may be held on any day including a public holiday. The meeting may be held at a place other than the registered office of the company or even outside the city in which the registered office is situated,

REQUISITES OF A VALID MEETING

The decisions taken at the general meeting shall be valid and binding only if the meeting itself has been properly called and conducted. Any irregularity in calling or conducting the meeting, shall invalidate the proceedings of the meeting. The company meetings must be conducted in accordance with the rules and regulations laid down in the Act (Section 171 to 186) and the articles of association. The following are the requisites of a valid meeting:

1) Proper Authority:- The meeting shall be valid only when it is called by a proper authority. The proper authority to convene the meeting is the Board of directors. The Board of Directors should pass a resolution at its meeting to call the general meeting, otherwise the notice calling the meeting will become invalid and the proceedings of the company shall not be effective (Harban V. Phillips). Thus, a notice issued by the secretary without the authority of a resolution of the board is patently invalid.

Though the Board of directors is the proper authority to convene a general meeting, but under certain circumstances the meeting maybe called by requisitionists or by the Company Law Board.

2) Proper Notice: 'Notice' means an advance intimation of the meeting so as to enable the person concerned to prepare himself for it. A proper notice should be given to every member, auditors, directors of the company and to every such person who is entitled to attend the meeting. The notice must be clear and should state the purpose for

which the meeting is called. The notice must be in writing and it must be given at least 21 clear days before the date of the meeting.

You should note that deliberate omission to serve notice to one or more members' will invalidate the meeting. But an accidental omission will not render the meeting invalid. Similarly, the non-receipt of the notice will not affect the validity of the meeting. The notice must state the date, time and place of meeting.

3) Quorum: Quorum means the minimum numbers of members whose presence is necessary at the meeting for transacting the business of the company. In the absence of a quorum, no meeting can be held. Any resolution passed at a meeting without quorum shall be invalid.

4) Chairman: Every general meeting of the company should be presided over by a chairman. The chairman has to be there to conduct the meeting in a proper and smooth manner. The articles usually provide the mode of appointment of the chairman of a meeting.

If the articles do not provide otherwise, the members who are personally present at the meeting shall elect one of themselves to act as the chairman of the meeting. The chairman should act bonafide and in the interest of the company, he must act in an impartial manner.

5) Properly Conducted: It is essential that the business at the meeting must be conducted according to rules. Company meetings are held for discussing particular issues relating to the company's working and taking a decision on the same. The matter should be placed in the form of a resolution, it should be discussed thoroughly, amendments to it should be carefully considered and then it should be decided by voting by show of hands or poll.

6) Proper Record: A proper record of the proceedings should be kept in the Minutes Book. Every company is required to maintain minutes of the proceedings of every general meeting and meetings of the Board and its Committees. When the minutes are confirmed and signed by the chairman, they are acceptable in a court of law as evidence of the proceedings.

NOTICE OF MEETINGS

The normal rule for any meeting of shareholders of a public company is that the meeting should be called by giving a notice of not less than 21 clear days.

However, a private company may provide in its articles for a shorter notice. The essentials of a valid notice are:

a) It must clearly state the date, time and place of the meeting as also the purpose of the meeting.

b) The notice must be issued on the authority of a resolution of the Board of directors.

c) The notice should be signed by a person authorized by the Board. Usually, a director of the Board or the company secretary would sign the notice.

d) It must be sent to all persons who are entitled to receive the notice.

The words “clear days notice” indicate that the day of serving the notice and the day of meeting are excluded. Thus in normal practice, 21 clear days would mean 23 days.

Further, if the notice is to be sent by post, another 48 hours are to be added to the 23 days. Thus the notice must be sent at least 25 days before the date of the meeting.

A shorter notice can also be given. In the case of annual general meeting, all the members should consent to the shorter notice and in the case of any other meeting, members holding not less than 95 % of the paid-up share capital or voting rights should consent to it. The consents can be given either before or at the meeting, and has to be given in the prescribed form.

Persons Entitled to Notice

The persons who should be sent the notice of any general meeting are:

a) Every member of the company;

b) Persons entitled to a share in consequence of the death or insolvency of the member;

c) Auditors of the company for the time being;

d) Public trustees in respect of holdings to which Section 153B is applicable.

Further, if the notice pertains to the meeting of a particular class of shareholders, then it should be sent only to the shareholders of that class.

A quorum is the minimum number of persons who must be present in order to constitute a valid meeting, If there is no quorum, the meeting shall not be valid and the business a valid meeting. If the quorum is not present, the meeting shall not be valid and the transacted at such meeting will be invalid. The main pupose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may not be acceptable to the vast majority of members.

Generally, the quorum is fixed by the articles of the company. According to Section 174 of the Companies Act, unless the articles provide for a larger number, five persons personally present (and not by proxy) in the case of a public company and two persons personally present in the case of any other company, shall constitute the quorum for a general meeting of the company.

If within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall Island dissolved (Section 174(3). Is any other case, if there is no quorum within half an hour from the time fixed for holding the meeting, the meeting shall stand adjourned to the same day in the next week, at the same time and place, or to such other day and at such other time and place as the Board may determine.

If at the a4joumed meeting also, there is no quorum within half an hour from the time appointed for holding the meeting, then the members present shall form the quorum. But you must remember that there must be at least two persons to hold the meeting. These provisions are also applicable to private companies, if the articles do not provide otherwise.

According to Article 49 of Table A, the quorum must be present at the time when the meeting begins and proceeds to take up business. It means that the quorum must be present at the beginning of the meeting and it need not be present throughout or at the time of taking votes on any resolution. But as regards the meetings of the Board of directors,, the quorum must be present throughout the meeting. You should note that a quorum is presumed unless it is questioned at the meeting.

11.3 PROXIES

The term 'proxy' is used both for the person who is authorized to act and vote for another at a meeting of the company and the instrument through which such a person is named and authorized to attend the meeting. Section 176 of the Companies Act, states that any member of a company who is entitled to attend and vote at a meeting of the company, is entitled to appoint another person as his proxy to attend and vote instead of himself. Thus, any person may-be appointed as a proxy whether he is a member of the company or not.

Unless the articles provide otherwise: (a) a proxy cannot be appointed in the case of a company having no share capital and (b) a member of a private company cannot appoint more than one proxy to attend on the same occasion.

The instrument appointing a proxy must be in writing and signed by the appointer or his attorney duly authorized in writing and must be stamped. The instrument appointing a proxy should be deposited with the company forty eight hours before the commencement of the meeting. Any provision in the articles of the company requiring the proxy form to be deposited earlier than 48 hours will be invalid.

The proxy has no right to speak at the meeting, but he can put questions in writing and sending the same to the Chairman for answer. For each meeting a separate proxy is required. A proxy can demand a poll and unless the articles otherwise provide a proxy is not allowed to vote except on a poll.

Every notice of a meeting must clearly state that a member is entitled to appoint a proxy and that the proxy need not be a member. If default shall be punishable with fine up to Rs. 500. But no invitation to appoint any person as proxy be made at the expense of the company and in case any such invitation is issued, the officer in default will be liable to fine to up to Rs. 1,000.

Every member entitled to vote at a meeting of the company is entitled to inspect the proxies deposited at any time during the business hours. You must remember that a proxy is always revocable, but it can be revoked before the proxy has voted. For revoking the proxy, the company must be informed. Death or Insanity of a member appointing the proxy revokes the proxy but proper intimation to the company is necessary. If the member appointing the proxy personally attends and votes at the meeting, the proxy shall stand revoked.

11.4 VOTING

The business of the company is transacted at meeting. A motion becomes a resolution when it is duly passed at the meeting. The shareholders have the right to discuss every proposed resolution and propose amendments therein. After the motion is discussed, it is put to vote. The voting may be (a) by show of hands or (b) by taking a poll.

a) By show of bands: At any general meeting, a resolution put to vote is decided first by show of hands. On a show of hands, each member shall have one vote. Unless the articles otherwise provide, proxies are not entitled to vote in case of such voting. The chairman counts the hands 'for' and 'against' a resolution and declares the result and when it is recorded in the minutes it becomes a conclusive proof of the fact. However, the dissatisfied shareholders may challenge the validity of the passing of the resolution or they may demand a poll.

b) By taking a poll: If there is dissatisfaction about the result of voting by show of hands a poll can be demanded. The chairman on his own motion may demand for the poll. The poll may also be demanded even before the declaration of the result on a show of hands.

In the case of a public company having a share capital, a poll may be demanded by any member present personally or through proxy and holding shares having not less than one tenth of the total voting power or, on which not less then Rs. 50,000 has been paid-up. In the case of a private company having share capital, a poll may be demanded one member personally present or by proxy if seven such members are personally present in the meeting or by two members if more than seven members are present. You should note that as soon as a demand for poll is made, all decisions taken by voting by show of hands stands cancelled.

In a poll, the voting rights of a member are in proportion to his share of the paid-up equity capital of the company. If the articles so provide, members holding shares on which calls are in arrear or in regard to which the company has right of lien, may not be allowed to vote in a poll.

The demand for poll may be withdrawn at any time by the person or persons who made the demand. When more than one resolution is put to vote poll should be taken on each separately. A poll demanded on the question of adjournment of the meeting must be taken immediately and in all other cases, the chairman must take poll within 48 hours of the demand for poll.

The chairman of the meeting shall appoint two scrutinizers to scrutinize the votes given on the poll, and to report thereon to him. Out of the two scrutinizers, at least one shall be the member of the company but be should not be an officer or an employee of the company The result of the poll shall be deemed to be a decision of the, meeting on the resolution on which the poll was taken.

11.5 CHAIRMAN

Chairman is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. A chairman is necessary for conducting a meeting properly. He is the chief authority in the meeting, he is the umpire of debates and he regulates the meeting.

Articles usually provide the mode of appointment of the chairman of a meeting. But if there is nothing in the articles, the members personally present at the meeting shall elect one of the themselves to be the chairman of the meeting. If a poll is demanded on the election of the chairman, it must be taken forthwith and a chairman is elected for the

purposed. Your should not that these provisions as given is Section 175 of the Act are applicable only if there is no provision in the articles.

Regulations 50 to 52 of Table A state the rules regarding the appointment of chairman. The articles usually provide at the general meeting of the company. If there is no such chairman or if be is not present within fifteen minutes of the time fixed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one of their member to be chairman of the meeting. If at any meeting no director is willing to act as chairman or if no director is present within fifteen minutes of the time fixed for holding the meeting, the members present shall choose one of themselves as the chairman.

The chairman has prima facie authority to decide all questions which arise eta meeting and which require decision at the time. He has the power to give his ruling on points of order to expel any unruly member, to adjoum the meeting if it becomes impossible to conduct the meeting smoothly, to regulate the taking of poll, to sign and date the Proceedings of the meeting. If so authorized by the articles, the chairman may give his casting vote to decide the issue where the members are equally divided for arid against the resolution.

The chairman must see to it that the proceedings of the meeting are conducted according to the rules, that proper order is maintained at the meeting, that proper opportunity is given to members to express their views. He should see that the voting is fair and the sense of the meeting is properly ascertained on each and every motion. He must act bonafide at all times and in the interest of the company.

11.6 RESOLUTIONS

Decisions of the members at a general meeting are expressed by way of resolutions At the meetings a definite proposal in the form of a 'motion' is placed, it is discussed thoroughly and finally is put to vote. When the motion is passed by a majority, it is called a resolution. In simple words, resolution means the decision taken at the meeting.

The Companies Act provides for three types of resolutions that may be passed at the general meeting of a company—(i) Ordinary resolution; (ii) Special resolution; and (iii) Resolution requiring .special notice.

1. Ordinary Resolution

An ordinary resolution is one which is passed by a simple majority, that is to say that the votes cast in favour of the resolution exceed the votes cast against the resolution. For example, if at a meeting Where, say, 81 members cast their votes in a manner that 41 cast votes in favour and 40 against the motion, the ordinary resolution is said to be taken as passed. The voting may be either by show of hands or by poll. An ordinary resolution is required to pass the annual accounts, to declare dividend, to appoint auditors to elect directors, to issue shares at a discount etc.

2. Special Resolution

A special resolution is one which is required for transacting special business and is required to be passed by a three majority. The voting may be either by show of hand or by polls. In determining the three- fourths majority, all the votes cast by members, whether personally or by proxy, are considered.

According to Section 189(2) of the Companies Act, a resolution shall be a special when:

(i) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meetings;

(ii) the notice has been duly given of the general meetings; and

(iii) the votes cast by members in favour of the resolution are not less than three times the number of votes cast against the resolution.

The special resolution is necessary to transact important business. The articles of the company may specify purposes for which a special resolution is required. The Companies Act has also expressly required the passing of special resolution on certain matters. The following are some of the instances where special resolutions are necessary:

i)to alter the memorandum of association;

ii) to alter the articles of association;

iii) to create reserve capital;

iv) to reduce capital;

v)to pay interest out of capital;

vi) to allow a director to hold office of profit in the company;

vii) for voluntary winding up of the company.

3. Resolution Requiring Special Notice

A resolution requiring special notice is, in fact, not a type of resolution, but is a kind of ordinary resolution for which a prior notice of intention to move the resolution has to be given to the company". With regard to certain matters, a special notice is required to be given of a resolution to be moved at a meeting of the company. The object is to give members sufficient time to consider the proposed resolution. Where special notice of a resolution is required by the Act or the articles, the notice of the intention to move the resolution must be given to the company at least 14 full days before the date of the meeting. On receipt of such a notice the company must give notice of the resolution to the members at least seven days before the meeting either individually or through an advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles.

According to the Companies Act, a resolution requiring special notice is required to transact the following business:

i) to remove a director before the expiry of his term;

ii) to appoint an auditor in place of the retiring auditor;-

iii) to appoint a new director in place of the removed director;

iv) to pass a resolution that retiring auditors shall not be reappointed.

11.7 MINUTES

The Companies Act, provides that every company must keep the minutes of the meetings containing a fair and correct summary of all proceedings of the meetings. The minutes of a meeting should be recorded within 30 days of the meeting in the books called the minute book should be initialed and last page signed and dated by the chairman of the meeting. The minutes duly signed by the chairman axe presumptive evidence that the meeting was duly called and held and all proceedings duly carried out. The minutes book should be kept in the safe custody so as to avoid any tempering of the same. The minutes of a general meeting should also be signed within 30 days of the meeting, by the chairman of the meeting or any other authorized person. The minutes book relating to the general meeting is open to inspection of any member of the company without charge during business hours at least for 2 hours.

Further, a member company is entitled to be furnished within seven days of his request with a copy of any minutes of the general meeting on payment of such sum as may be prescribed for every 100 words or part thereof.

11.8 SUM-UP

The general meetings of members are of great importance in the working of the company. The members in the gen3eral meetings give the guidelines to the directors for carrying on the business of the company. The meeting of the members is of three types (i) statutory meetings (ii)annual general meeting(iii)extraordinary general meeting.

Unless the articles provide for a larger number, the quorum shall be two members personality present is the case of a public company.

Member of a company having space capital have a statutory right to a point proxies. A proxy need not be a member of the company. A proxy can not speak in the meeting but be can rote at a poll.

The decisions taken in the meeting are taken in the form of resolutions. The reared three types of resonations (i)ordinary(ii) special and (iii) resolution requiring special notice.

11.9 KEY WARDS

Statutory Report: A report containing vital information about the information of the company.

Notice: An intimation in writing about the date, place and time of the meeting.

Quorum : Minimum number of members who must be present at a meeting to transact a business.

Agenda: Matters to be discussed at the meeting.

Chairman : The person who presides over the meetings.

Resolution : When a motion is duty passed, it becomes a resolution or decision.

Proxy: A authority to represent and rote for mother person at a meeting.

Minutes: Written record of the proceedings of a meeting.

11.10 CHECK YOUR PROGRESS

1) Discuss the various types of meetings of a company.
2) Describe the statutory meeting.
3) Discuss resolutions, proxies and minutes.

11.11 REFERENCES

1) N.D. Kapoor, Elements of company Sultan Chand & Sons.
2) M.C. Kuehhal, Modern Indian Company Law, Shrll Mahavir Book Depot.
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11.12 TERMINAL QUESTIONS

1) What are the various types of meetings of a company?
2) Discuss the statutory report. What it must extant.
3) What do you mean by quorum? What happens of there is no quorum at a meeting.
4) Describe proxies and minutes.

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LESSON-12

MODES OF WINDING UP OF COMPANIES

STRUCTURE

12.0 OBJECTIVES

After studying this lesson, you should be able to:

- understand the concept of winding up of a company.
- explain the different modes of companies winding up
- differentiate between various modes of the winding up
- understand the conduct and consequences of a winding up of a company.

12.1 INTRODUCTION

A company is an artificial person created by law and as such it life can be ended only by a legal procedure. Winding up is a means by which a company is dissolved. A company shall cease to exist only when it is dissolved. There are three ways in which a company may cease to exist in the eyes of law, they are:

a) Under a scheme of reconstruction and amalgamation, a company may be dissolved by order of the court without being wound up (Section 394);

b) When the company becomes a defunct company, the Registrar may remove the name from the Register of Companies (Sec. 560);

c) Through winding up process.

In this chapter you will study the different types of winding up, the grounds for winding up and the consequences of winding up.

MEANING OF WINDING UP

The winding u is the process of putting an end to the life of the company. During this process the company ceases to carry on its normal business, the assets of the company are sold and the proceeds are utilized in paying off the debts and liabilities. If any surplus is left, it is paid back to the members in proportion to their contribution to the capital of the company. An administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and distributes the surplus, if any, among the members. Thus, with the winding up, a company ceases to be a going concern, all its operations come to a halt. You should note that the process of winding up begins only alter the court passes the order for winding up and till such an order is passed there is no winding up.

Further, a company may be unable to pay its debts but it cannot be adjudicated insolvent as the law of insolvency does not apply to companies. Only individuals can be declared insolvent, not a body corporate. In such a case, a company can only be wound up.

12.2 WINDING UP AND DISSOLUTION

Winding up and dissolution of the company are not the same thing. A company is not dissolved immediately, on the commencement of winding up proceedings. Winding .up is the prior stage and dissolution is the next. On dissolution, the name of the company is struck off by the Registrar from the Register of Companies i.e. it ceases to exist. While on winding up, the Companies' name is not struck off from the register. The legal entity of a company remains even after the commencement of winding up and it can be sued in a court of law. Dissolution is the final stage of the Company's winding up pa But a company can be dissolved without winding up under certain circumstances such as when it merges with another company.

The main points of difference between winding up and dissolution are as follows:

i) In winding up the assets of the company are sold and the proceeds are utilized in paying off the debts and other liabilities of the company. It is the first stage of terminating the life of a company. While the dissolution is the next stage and after this the company ceases to exist,

ii) The winding up proceedings are carried out by a liquidator of the company while in case of dissolution no such proceedings are carried out.

iii) Creditors can prove their debts in the winding up but not in the dissolution of the-company,

iv) In the cases of winding up it is not always necessary to obtain an order of the court because voluntary winding up may take place, but for dissolution of the company, the order of the court is essential.

From the above discussion it should be clear to you that winding up and dissolution of a company is not the same thing.

12.3 MODES OF WINDING UP

Under Section 425 of the Companies Act, a company may be wound up in any of the following ways:

1) Compulsory winding up by the Court.

2) Voluntary winding up. It may further be:

a) Members Voluntary winding up; or

b) Creditors Voluntary winding up.

3) Voluntary winding up under the supervision of the court. Let us now discuss these modes one by one in detail

COMPULSORY WINDING UP

The winding up of a company by an order of the court is known as compulsory winding up. Section 433 of the Act contains the cases where the Court may order for the winding up of a company on a petition submitted to it.

GROUNDS FOR COMPULSORY WINDING UP

The company may be wound-up by the Court under the following circumstances:

i) Special Resolution by the Company: If the company has passed a special resolution to the effect that the company be wound up by the court. The resolution may be passed for any reason whatsoever. In such cases, the court may order the winding up of the company on a petition submitted to it. But the Court's power is discretionary, that is, it may not pass an order for winding up even if the company has so resolved if such winding up would be detrimental to the interests of the company or public.

This mode of winding up is not very popular as members' voluntary winding up is preferable because there the interference of the court is least.

ii) Default in holding statutory meeting: You know that a public company must hold the statutory meeting within six months of obtaining the certificate to commence business and file the statutory report with the registrar. If the company makes any default in holding the statutory meeting or in filing the report with the registrar, the court may order the winding up on a petition of the registrar or of a contributory. If a petition is filed by any other person, e.g. a creditor, it must then be presented before the .expiry of fourteen days after the last day on which the statutory meeting ought to have been held [Sec. 439 (7)]. However, the court is not bound to order for winding upon this ground. It may instead order the company to file the statutory report or hold the statutory meeting.

iii) Failure to commence business: If the company fails to commence business within one year of its incorporation, or suspends its business for a whole year, the court may order the winding up of the company only when it is satisfied that the company has no intention of carrying on business or is unable to carry on its business. Where the delay in commencing the business or suspension of business is due to temporary reasons and there are reasonable prospects of the company starting business within a reasonable time, the court shall not pass the winding up order.

Sometimes, a company may have a number of business units. In such a case an interesting question may arise as to whether the -suspension of any one business, unit is a valid ground for winding up of the company? The matter is to be decided by the Court. Even if the business in all the units has been suspended, the court may not order winding up if it is satisfied that there are chances of the company resuming its business.

iv) Reduction in membership: If the number of members is reduced, in the case of a public company, below seven and in the case of a private company, below two, the court may order the winding up of the company.

v) Inability to debts: Inability to pay debts means that the company is not in a position to honour its monetary commitments i.e. its existing assets are not' sufficient to discharge its existing liabilities. In such a situation, the court may order the winding up of the company.

According to Section 434 of the Companies Act, a company shall be deemed to be unable to its debts in the following circumstances:

a) If a creditor to whom the company is indebted for a sum exceeding Rs. 500 has served a demand notice on the company requiring the company to pay the sum due and the company has for three weeks thereafter neglected to pay or otherwise satisfy him. For calculating the period of three weeks the days on which the demand notice is dispatched and served should be excluded; or

b) If a creditor has obtained a decree from the court for the payment of his debts by the company, and the company fails to satisfy in full this decree in favour of a creditor; or

c) If the court is satisfied that the company is unable to pay its debts taking into account the company's contingent and prospective liabilities. This means the commercial insolvency of the company, a situation where the company is unable to meet its current liabilities. The mere fact that the company is incurring losses or running in continuous losses does not mean that it is-unable to pay its debts. Also the excess of liabilities over assets alone does not mean that the company is unable to pay its debts.

The court may order winding up on this ground only when:

i) the debt owned by the company is undisputed, for a definite sum and is payable immediately;

ii) the creditors' right to the debt is clear and undisputed, and

iii) the company has neglected to pay without sufficient cause or excuse.

Where the sole purpose of the petition is to put pressure on the company for the repayment of a debt, the court shall not pass an order for winding up.

vi) Just and equitable: Where the court is satisfied, on the facts and circumstances of the case, that it is just and equitable for the company to be wound up, it may pass an order for the winding up of the company. Under this clause, the court has very wide discretionary powers. What is 'Just-and equitable' depends upon the facts and circumstances of each case.

Some of the instances under which the court has ordered winding up on the ground of being 'just and equitable' are as under:

i) When the main object of the company has failed or has become substantially impossible to be carried out.

ii) When there is a complete deadlock in the management of the company, for example, where two directors holding equal voting rights become so hostile they would not talk with each other, it amounts to deadlock in the management.

iii) When shareholders holding majority voting power adopt an oppressive attitude towards minority shareholders,

iv) When the object for which the company was formed is fraudulent or Illegal or it becomes illegal subsequently,

v) When the business cannot be carried on except at a loss, i.e. where there is no reasonable hope of running business at profit

vi) When it is only a 'bubble' company and it has no property or business to carry on.

vii) When there has been gross mismanagement and misuse of funds by the directors of a private company or complete lack of confidence in the management.

You should, however, note that relief under just and equitable clause is in the nature of last resort when other remedies are not effective enough to protect the general interest by the company.

2. Who can File a Petition?

According to Section 439 of the Companies Act, a petition for compulsory winding up may be filed by anyone of the following:.

i) By the Company: A petition can be filed by the company itself for winding up when a special resolution to this effect has been passed in the general meeting of the company. Therefore, the directors or the managing director cannot file such a petition of their own.

ii) By the creditors: A creditor can file a petition to the court, if he can prove that the company could not pay his debt of Rs. 500 or more within three weeks of making the demand. The term creditor includes a secured creditor, a debenture holder, a prospective creditor and any Central or State Government or local authority to whom any tax etc. is due. A secured creditor holding ample security will fail to obtain the winding up order, if the petition is not supported by other creditors. The creditors' petition will not be taken up if the claim of the creditors has become time barred under the Limitation Act.

iii) By contributories: The term 'contributory' means a person who is liable to contribute to the assets of the company in the event of its being wound up. A contributory is entitled to presents petition for winding up even though 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 members after paying off the liabilities.

Any contributory may present a petition for winding up where the ground for winding up is that the number of members is reduced below the statutory limit. But a petition on any other ground can be presented only by the a) original allottee or who has acquired shares through transmission orb) by the person who has been the registered

holder of the shares for at least six months during the eighteen months immediately preceding the petition.

iv) By the Registrar: After obtaining the previous sanction of the Central Government, the Registrar can file the petition for winding up of the company on the following grounds:

a) if default is made in holding the statutory meeting or filing the statutory report;

b) if the company fails to commence business within one year of its incorporation or suspends the business for a whole year;

c) if the number of members falls below the statutory limit;

d) if the company is unable to pay its debts;

e) if the court considers it just and equitable.

The registrar can present the petition on the ground that the company is unable to pay its debts, only if it appears to him from the balance sheet of the company or from a special auditors' or Inspectors' report that the company is unable to pay its debts.

v) By any person authorized by the Central Government: If the business of the company is being conducted to defraud its creditors, or members or any other person, as disclosed by the report of inspectors appointed to investigate the aft the Central Government may authorize any person to file a petition for winding up of the company-. Usually, the registrar is to present the petition.

3. COMMENCEMENT OF WINDING UP

When a winding up order is issued by the court against a company, the winding up does not commence from the date of the order but it commences from an earlier date. According to Section 441 of the Companies Act, the winding-up of a company by court shall be deemed to commence at the time when the petition for winding up is presented. But where before the presentation of a petition for winding up, if a company has passed a special resolution for winding up, then the winding up shall be deemed to have commenced at the time of passing of the resolution.

If a winding up order has been made on more than one petition/the winding up shall commence from the date of the presentation of the earliest petition.

Sometimes, legal proceedings might be pending against the company. Before passing the winding up order, the court may, on an application made by the company or any creditor or any contributory, issue orders staying further proceedings on such terms as it thinks fit. In case a suit or proceeding is pending in the Supreme Court or in any High Court, the application for stay is to be made in the concerned court in which the suit or proceeding is pending.

Power of Court on hearing petition: According to Section 443 of the Companies Act, on hearing up a winding up petition, the Court may:

a) dismiss it, with or without costs; or

b) adjourn the hearing conditionally or unconditionally; or

c) make any interim order that it thinks fit; or

d) make an order for winding-up the company with or without costs, or any other that it thinks fit.

4. CONSEQUENCES OF THE WINDING UP ORDER

i) After the court has made the winding up order, it must immediately sent information to the official liquidator and the Registrar,

ii) The petitioner and the company is required to file with the Registrar a certified copy of the order within thirty days of the making of the order. The Registrar will then notify in the Official Gazettee that such an order has been made,

iii) The winding up order shall be deemed to be a notice of discharge to the officers and employees of the company, except when the business of the company is continued,

iv) No suit or other legal proceeding against the company could be commenced or proceeded with after the making of a winding up order, except with the leave of the court and subject to such terms and conditions as the court may impose.

v) The winding up order operates in favour of all the creditors and all the contributors, as if it had been made on a joint petition of creditors and contributories.

vi) The powers of the Board of Directors will terminate and the same will now vest in the official liquidator. The official liquidator, shall by virtue of his office, become the liquidator of the company,

vii) All debts, including those payable at some future date, become payable immediately,

viii) The Court Issuing up the winding order shall have the right to dispose off any new or pending suit against the company. Any suit or proceeding lying pending in another court shall also be transferred to the court which has issued the winding up orders,

ix) All the property of the company shall be under the custody and control of the liquidator.

5. CONDUCT OP WINDING UP

The winding up proceedings are conducted by the official liquidator and his powers are subject to the control of the Court. He may. also apply to" the court for directions in any particular matter in winding up.

The company is required to submit within 21 days of the order of winding up or within such time not exceeding 3 months as extended by the court, a Statement of Affairs containing particulars regarding the assets of the company, its debts and liabilities, particulars of creditors along with details of security, if any, and particulars of debts due to the company. This statement is required to be verified by affidavit of one or more directors of the company and also by the Manager, Secretary or Chief Officer of the company.

The official liquidator shall submit a preliminary report to the court based on the Statement of Affairs.

Once assets of the company are realized and contribution from the contributories have been received the liabilities of the company are to be discharged. According to the

provisions of the Act, overriding preferential payments are to be made first, then the preferential payments and then the other creditors. Any surplus after discharging alt debts and liabilities will be distributed amongst the contributories pro rata.

A 'contributory' means every person Liable to contribute to the assets of the company in the event of it being wound up and includes holders of fully paid shares, though the liability of a contributory extends only up to the amount remaining unpaid on the shares held by him.

The liquidator is required to present an account of his receipts and payments to the court twice a year and also file with the Court a duly audited statement with respect to the proceedings and position of the liquidation every year.

When the affairs of the company have been completely wound up or when the court is of the opinion that the liquidator cannot proceed with the winding up for want of funds and assets or for any other reason, the court shall make an order of dissolution of the company.

The dissolution puts an end to the existence of the company, and the Registrar strikes off the name of the company from the Registrar of Companies. The company stands dissolved from the date on which the order is made by the court.

VOLUNTARY WINDING UP

You have learnt about the winding up of a company by an order of the court. The company can also be wound up without the intervention of the court, and this is termed as 'voluntary winding up'. The voluntary winding up means winding up, without the intervention of the court, by members or creditors themselves. in voluntary winding up, the members and creditors are left free to settle their affairs without going to the court, although they may apply to the court for directions or orders, if and when necessary.

Section 484 of the Companies Act specifies the circumstances in which the company may be wound up voluntarily.

These are:

1) By passing an ordinary resolution in the following cases:

a) where the period, if any, fixed for the duration of the company by the articles has expired; or

b) where the articles provide that the company is to be dissolved on the occurrence of any event and if that event has' occurred.

2) By passing a special resolution that the company be wound up voluntarily. When a special resolution is passed by the members to wind up the company, it is not necessary to give any reasons for doing so. When a company passes a special resolution for voluntary winding up, it must within 14 days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette, and also in some newspaper circulating in the district where the registered office on the company is situated.

You should note that a voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed (Section 486).

Voluntary winding up of the company is of two types, namely:

a) Members 'voluntary winding up, and

b) Creditors 'voluntary winding up.

Let us now discuss them one by one in detail.

(a) Members' Voluntary Winding Up

The members' voluntary winding up is possible only in case when the company is solvent and is in a position to pay all its debts in full. Members' voluntary winding up is possible in cases where a declaration of solvency is made by the company and is delivered to the Registrar for registration.

Declaration of Solvency: Where it is proposed to wind up a company voluntarily, the Declaration of solvency is to be made by all the directors (if there are only two directors) or by the majority of the directors (if there are more than two directors). The declaration must be made at the meeting of the Board and must be verified by an affidavit.

The declaration must state that the directors have made a full inquiry into the affairs of the company and that they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of winding it.

The declaration shall be effective only if it is made within five weeks immediately before the date of the passing of the resolution for winding up the company and is delivered to the Registrar for registration before that date. The declaration must be accompanied by a copy of the report of the auditors of the company on the profit and loss account and the balance sheet of the company and also a statement of the assets and liabilities as at the latest practicable date immediately before the making of the declaration.

Conduct of Winding Up

The company in a general meeting, shall appoint one or more liquidators and fix his remuneration and liquidator so appointed will take charge only after his remuneration is fixed. The company is required to give notice to the Registrar of the appointment of the liquidator within 10 days of such appointment.

The powers of the Board of Directors shall cease on the appointment of a liquidator except when the company or the liquidator sanctions their continuance.

If the company is unable to pay or in the opinion of the liquidator will not be able to pay its debts in full within the period stated in the declaration of solvency, the liquidator should immediately call a meeting of the creditors and place before them a statement of the assets and liabilities of the company. In such cases, the winding up will proceed in the manner of creditors' winding up.

If the liquidation continues for more than One year, the liquidator should call a meeting of the shareholders at the end of each year and place before them an account of his acts and dealings and the progress of winding up during the year. Where the company in liquidation proposes to sell its business or property to another company, the liquidator may receive shares or other interest in the other company (transferee) as consideration for

distribution among the members of the company (transferor company) but he can do so only on the authority of a special resolution of the company. If any member of the transferor company does not agree to the special resolution, he may require the liquidator either to abstain from carrying the resolution or to purchase his interest at an agreed price.

Final Meeting and Dissolution

When the affairs of the company are fully wound up i.e. when all the assets have been. disposed off and realized and all debts and liabilities have been discharged, the liquidator shall call a general meeting of the company and lay before it the accounts of winding up to show how the winding up has been conducted and the property of the company dealt with. This is the final meeting of the company.

A copy of these accounts is to be sent to the official liquidator and the Registrar within one week after the meeting. The official liquidator would then scrutinize the books and papers of the company and shall report to the court. If the report of the official liquidator shows that the affairs of the company were conducted properly, then the company shall be deemed to be dissolved from the date of submission of report to the court.

If the report reveals that the winding up affairs were conducted in a manner prejudicial to the members' interest or public interest, the court shall direct the official liquidator to make further investigations, after which, the court may either dissolve the company or make any other order, as it deems fit.

(b) Creditors Voluntary Winding Up

This type of winding up takes place when the company is not in a position to pay its debts in full and where a declaration of solvency has not been made. In this type of winding up, since the interest of the creditors is involved, they are given the powers to control and supervise the winding up of the company.

The various statutory provisions governing such a winding up may be discussed under the following heads:

Meeting of Creditors

The company must call a meeting of the creditors to be held either on the same day on which the meeting of the company is to be held or on the day following the day when the members meeting is held to pass a resolution for voluntary winding up. The Board of Directors shall lay before the creditors a full statement of the position of the affairs of the company together with a list of the creditors of the company arid the estimated amount of their claims.

Appointment of Liquidator

The creditors and the members, at their respective meetings, may nominate a person to be the liquidator. Where the members have not nominated any person, the nominee of the creditors, shall be the liquidator. Where different persons have been nominated by the creditors and members, the creditors' nominee shall be the liquidator.

Committee of Inspection (COI)

The creditors at the meeting may appoint a committee of inspection consisting of not more than five persons to which the company may also appoint five members. Incase

of any difference of opinion as to the nominees to the Committee of Inspection, the court shall settle the matter.

The remuneration of the liquidator shall be fixed by the COI or the Creditors, failing which, it shall be determined by the court.

The Boards' powers shall cease on the appointment of the liquidator. However, the COI, or if there is no such committee, the creditors in general meeting may sanction the continuance of the Board's powers.

The liquidation would proceed in the same manner as in the case of members' voluntary winding up. In addition to the final meeting of the members, a meeting of the creditors shall also be called before the company is dissolved.

General Provisions with respect to Member's Voluntary Winding up and Creditors' Voluntary Winding up

Statement of Affairs

The Board of Directors is required to submit a statement as to the affairs of the company, to the liquidator which should state the following particulars and is to be verified by one or more directors and manager, or secretary or other Chief Officer of the company:

i) assets of the company—cash and bank balances and negotiable securities to be stated separately.

ii) debts and liabilities of the company,

iii) names and addresses of creditors indicating the amount of secured and unsecured debts,

iv) debts due to the company, persons from whom they are due and the amount likely to be realized. v) Such other information as may be required.

Liquidator's Power

The liquidator has the same powers as that of the official liquidator in compulsory winding up. Whereas the official liquidator requires the sanction of the court in certain cases, the liquidator in case of menders' voluntary winding up would require the sanction of the members/company and in case of creditors' voluntary winding up, of the court of the committee of inspection or the creditors.

In addition, the liquidator would also have the power of the court to settle the list of contributories, making calls and calling general meetings of the company. You should, however, note that the exercise of powers by the liquidator shall be subject to the control of the court.

Conduct of Winding Up

The Court has the power to remove a liquidator and appoint the official liquidator or any other person as the liquidator in place of the removed liquidator. You should note that a body corporate is not qualified for appointment as a liquidator of a company in a voluntary winding up.

The liquidator shall within 30 days after his appointment, publish the Official Gazette and deliver to the Registrar for registration a notice of his appointment in the form prescribed.

The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of the company.

In a voluntary winding up, the liquidator is an agent of the company and not a trustee for shareholders or creditors. He is the custodian of the property of the company.

His functions include taking into custody the property of the company, selling the same, instituting and defending suits in the name and on behalf of the company, keeping proper books and recording proceedings at meetings and to have them audited, calling meetings of the committee of inspection, members and creditors. As an agent of the company, an individual shareholder or creditor cannot sue him for delaying payments etc. except in cases of deliberate misconduct. In any case, the suitable remedy is to seek a court order in reference to his conduct

Consequences of Voluntary Winding Up

You know that the voluntary winding up commences from the date of the passing of the resolution to that effect. This date is important because it helps in determining the liability of past members. The consequences of voluntary winding up can be summarized following:

i) From the commencement of voluntary winding up, the company ceases to carry on its business, except so far as may be required for the beneficial winding up thereof. It means that the corporate entity of the company shall continue until the dissolution of the company.

ii) With the appointment of liquidator, all the powers of the Board of Directors, managing or whole-time director shall come to an end. But with the approval of the general meeting, or the liquidator or the creditors or the committee of inspection, the directors etc. may continue to exercise their powers.

iii) Voluntary winding up does not always mean a notice of discharge to its employees, e.g., if it is done to effect amalgamation. But winding up on grounds of insolvency will mean discharge of its employees.

iv) After the order has been made, no suitor other legal proceeding can be commenced or if pending at the date of the winding up order can be proceeded with against the company except with the leave of the court.

v) Any transfer of shares in the company and any alteration in the status of the members of the company made after the commencement of the winding up shall be void unless it is done with the sanction of the liquidator.

vi) Every notice, invoice, order, business letter issued by or on behalf of the company or liquidator of the company bearing the name of the company shall contain a statement that the company is being wound up.

12.4 DISTINCTION BETWEEN MEMBERS AND CREDITORS' VOLUNTARY WINDING UP

From the following table, you can very well understand the main points of difference between members' and creditors voluntary winding up:

MEMBERS' VOLUNTARY WINDING UP	CREDITORS' VOLUNTARY WINDING UP
1) This takes place only when the company is in a position to pay its debts.	1) This takes place only in cases when the company is not in a position to pay its debts.
2) The directors must file a declaration of solvency' with the registrar.	2) The directors are not required to file any such declaration.
3) Only the general meeting of members is called.	3) A meeting of creditors must be called immediately after the meeting of the members.
4) The liquidator is appointed by the members.	4) If the creditors and the company nominate different persons as liquidator, the person nominated by creditors shall be the liquidator.
5) There is no committee of inspection.	5) A committee of inspection is usually appointed to assist the liquidator.
6) The liquidator can exercise-powers with the sanction of special resolution of the company.	6) The liquidator can exercise powers with the sanction of the court, or committee of inspection or of a meeting of creditors.
7) Winding up proceedings are controlled by members.	7) Winding up proceedings are controlled by creditors.
8) Meeting of members is called on the completion of winding up proceedings.	8) Meeting of members and creditors is called on the completion of winding up proceedings

12.5 WINDING UP UNDER SUPERVISION OF THE COURT

A company can be wound up without the intervention of the court, but voluntary winding up, may be under the supervision of the court. At any time after the company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up shall continue but subject to the supervision of the court. When the voluntary winding up is in progress and if any creditor or contributory or the liquidator is not satisfied, they may apply to the court for winding up under the supervision of the court. Such an order is passed by the Court on any of the following grounds:

a) the liquidator is partial or negligent in collecting the assets; or

b) the majority is playing fraud with the minority; or

c) the rules regarding winding up of a company have not been fully complied with.

In such cases, the court may make an order that the winding up of the company shall continue subject to the supervision of the court and on such terms conditions as it thinks fit. The most important effect of the supervision order is that is gives the court then necessary jurisdiction over its and legal proceedings as in the case of compulsory winding up under order of e court.

Generally, the liquidator appointed in voluntary winding up is allowed to continue, but the court may appoint one or more additional liquidators. The court may remove any liquidator so appointed and fill any vacancy occasioned by the removal or by death, or resignation. The court may also a point remove a liquidator on an application made the Registrar in this behalf. The liquidator so appointed shall have the same powers and duties as in the case of appointment of liquidators in a voluntary winding up.

The court will have all the powers as it has in the case of compulsory winding up such as, staying of suits and other legal proceedings, making calls etc., though the winding up remains a voluntary winding up.

16 Section 527 of the Companies Act empowers the court to an order for compulsory winding up, in case of need, superseding the order of winding up under its supervision. In case of winding up under the supervision of the court, when the affairs of the company have been completely wound up and the liquidator has submitted his report to the court recommending dissolution, the court shall pass an order dissolving the company. The company is treated as having been dissolved from the date of the order of the court.

12.6 SUM UP

Winding up is the process which a company is dissolved and its properties are administered for the benefit of its creditors and members. It involves realization of a company's arrets, payment of its literalities and return of money back to the members in proportion is the contribution made by them to the capital of the company. A company may be down up in one of the following ways;

1) Winding up by Court.

2) Voluntary Winding up.

3) Voluntary Winding up under the supervision of the court.

Thus winding up ultimately leads to the dissolution of the company. In between winding up and dissolution the legal entity of the company remains and it can be sned in a court of law.

12.7 KEY WORDS

Winding up : A process by which the life of the company comes to an end.

Dissolution : The company oases to exit.

Liquidator: A person who helps the court to complete the liquidation proceedings.

12.8 CHECK YOUR PROGRESS

1) Explain the term winding up.

2) Discuss the compulsory winding up.

3) Explain the consequences of a winding up order.

12.9 REFERENCES

1) N.D. Kapoor, Elements of company Sultan Chand & Sons.

2) M.C. Kuehhal, Modern Indian Company Law, Shrll Mahavir Book Depot.

3) Ashok K. Bagrial, Company Law, Vikas Publishing House.

12.10 TERMINAL QUESTIONS

1) Define winding up, enumerate different modes of winding up of a company.

2) Explain the circumstances when the court will consider winding up of the company to be just and equitable.

3) When and how can a company be voluntarily wound up? State briefly the consequents of such winding up.

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LESSON-13

RESTRICTIVE AND UNFAIR TRADE PRACTICES

STRUCTURE

13.0 OBJECTIVES

After studying this lesson, you should be able to :

- explain the term restrictive trade practices.
- Describe whether a particular restraint is preventive, restrictive or distortive.
- Differentiate between monopolistic and restrictive trade practices.

13.1 INTRODUCTION

The term 'restrictive trade practice' as defined under Section 2(c) means a trade practice which has or may have the effect of preventing, distorting or restricting competition in any manner and in particular:

(i) Which tends to obstruct the flow of capital or resources into the steam of production; or

(ii) Which tends to bring about manipulation of prices or conditions of delivery or to effect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions.

In above definition of restrictive trade practice, one may notice that the definition has two parts — the first part is generic and the second part particularizes certain practices.

According to the first part of the definition, a restrictive trade practice means a trade practice which has or may have the effect of preventing, restricting or distorting competition in any manner. According to this part of the definition it is only where a trade practice has the effect, actual or probable, of restricting, lessening or destroying competition that it is liable to be regarded as a restrictive trade practice. If a trade practice merely regulates and thereby promotes competition, it would not fall within the definition of restrictive trade practice, even though it may be, to some extent, in restraint of trade.

The second part of the definition particularizes two trade practices, viz.,

(i) Any trade practice which tends to obstruct the flow of capital or resources into the stream of production; and

(ii) Any trade practice which tends to bring about manipulation of prices, or conditions of delivery or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions.

Let us now look into the aforesaid two parts of the definition of restrictive trade practice.

13.2 PREVENTING, RESTRICTING OR DISTORTING COMPETITION

To determine whether a particular restraint is preventive, restrictive or distortive of competition or not, the Supreme Court in TELCO's case laid down the following three tests:

(i) What facts are peculiar to the business to which the restraint is applied?

(ii) What was the condition before and after imposition of the restraint?

(iii) What is the nature of restraint and what is its actual and probable effect?

Obstruction of Flow of Capital or Resources into the Stream of Production

Trade Practices which tend to bring about manipulation of prices or conditions of delivery so as to impose unjustified costs or restrictions

DISTINCTION BETWEEN MONOPOLISTIC AND RESTRICTIVE TRADE PRACTICES

In Registrar of Restrictive Trade Agreements vs. Gramophone Company of India Ltd. The MRTP Commission observed that a monopolistic trade practice may not necessarily also be restrictive trade practice. However, on reading of the two definitions one might find that the two are similar.

The following points of distinction may be noticed:

1. Authority to pass Orders. Although the Central Government can make a reference to the Commission both in respect of a restrictive trade practice under Section 10(b) as well as under Section 3191), the Commission alone can pass an order under Section 37 in respect of a restrictive trade practice and it is the Central Government alone which can make an order in respect of a monopolistic trade practice Section 31(3).

2. Who may refer? The reference in case of a restrictive trade practice can be made by a registered consumer's association, a trade association or any consumer. It may also be made by the Central Government or State Government or the DGIR. Even the MRTP Commission may initiate an enquiry upon its own knowledge and information (suo moto). The reference in relation to monopolistic trade practice on the other hand, cannot be made by any of a trade association or a registered consumer's association or a consumer.

3. Scope of Orders. The powers of the Central Government in dealing with monopolistic trade practices include issuing order regulating production, supply, distribution or control, prohibiting any act, practice or commercial policy, fixing standards, declaring any agreement unlawful and even requiring any party to an agreement to determine the same. On the other hand, the scope of the orders which Commission can pass after making enquiry into a restrictive trade practice is limited to a negative order of enjoining upon the person including in the restrictive trade practice to cease and desist from the alleged practice and to award compensation.

4. Presumption of public interest. In the case of restrictive trade practice, the presumption that it operates against public interest is rebuttable in terms of one or more circumstances enumerated in Section 38 (1) and the balancing test provided is warranted to be continued because of, say, it is being beneficial to the consumers or users of goods or for preserving competition and fair dealing in trade or business, are not tenable. Unlike a restrictive trade practice, the monopolistic trade practice is violative of public interest.

13.3 Registrable Agreement Relating to Restrictive Trade Practices

In the above discussion, we noticed that every restrictive trade practice or agreement is not necessary bad and, therefore, actionable. It may sometimes be even in the public interest. However, Section 33 of the Act (as amended by the 1984 Amendment Act) states that every agreement falling within one or more of the following categories that shall be deemed, for the purposes of this Act, to be an agreement relating to restrictive trade practices and shall be subject to registration, namely:

(a) Refusal to Deal, i.e., any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

(b) Tie-up Sales and Full-Line Forcing, i.e., any agreement requiring a purchaser of goods, as a condition of such popularly known as trying arrangement. An agreement by a party to sell one product but only on the condition that the buyer also purchases a different product constitutes a typing arrangement. Thus, where a manufacture of pressure cookers required 'the purchasers of pressure cookers, as a condition of such purchases, to purchase containers/separators along with the pressure cookers, it was held to be a restrictive trade practice.

(c) Exclusive Dealing, i.e., any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person. The type of exclusive dealing envisaged under clause (o) of Section 31 (1) is the one that flows from bilateral agreements. In effect, the prohibition, under this clause, on the purchaser is in relation to dealing in competing goods of the seller. This practice may be resorted to through any one or more of the

devices like (a) requiring the purchaser of goods to purchase exclusively from the seller (which would include a commitment by a purchaser to buy his entire requirements of the goods from a single seller); (b) requiring the seller to sell only such part of the goods as is in excess of the requirements of the buyer; (c) seller agreeing not to sell to other buyers or to sell to buyer (other than those who agree to buy exclusively from the seller) only on terms and conditions which will favour exclusive buyer; or a buyer agreeing to buy from another on the condition that the latter would also buy from the former (reciprocal arrangement)

(d) Concert in Prices and Terms and Conditions of Purchase or Sale i.e., An agreement to purchase or sell goods or to tender for the sale or purchase of goods only at prices or on terms or conditions agreed upon between the seller or purchaser. Almost every type of agreement relating to restrictive trade practice, so long as it is sought to be given effect by means of an agreement between sellers or by means of an agreement between purchasers, may be covered under this clause. Thus, all arrangements or understandings between manufactures or suppliers of goods which tend to obstruct competition may come within the purview of this clause. Almost all types of cartels are covered by this clause.

(e) Discriminatory Dealings i.e., any agreement to grant or allow concessions or benefits, including allowance, discount, rebates or credit in connections with, or by reasons of dealings. The clause envisages granting of concessions or benefits including the allowing of discounts or rebates on a discriminatory basis.

(f) Re — sale Price Maintenance, i.e., any agreement to sell goods on condition that the prices to be charged on re-sale to the purchaser shall be the prices stipulated by the sellers unless it is clearly stated that the price lower than those prices may be charged.. 'Re-sale price maintenance' can be restored to either individually or collectively, 'Individual re-sale price maintenance' is the practice by a supplier of prescribing and taking action to enforce retail or wholesale prices for the re-sale of goods. 'Collective restrictive price maintenance' is an arrangement among suppliers of goods to prescribe wholesale or retail prices for the re-sale of their goods by buyer.

(g) Territorial Restriction/Restriction or Withholding of Output or Supply, i.e., any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area of market for the disposal of the goods. This clause refers to two type of trade practices, viz., (a) limiting, restriction or withholding the supply of goods, and (b) allocation of area or market.

(h) Controlling Manufacturing Process, i.e. any agreement not to employ or restrict the employment of any method, machinery or process in the manufacture of goods. There are different ways, direct and indirect, for eliminating competition. The imposition of restriction on the deployment of any machine or the use of any manufacturing process, for production of goods is a direct way to achieve this purpose. Such restriction can be put by an entrepreneur, who has a dominant say and/or share in the market for goods of any particular description, and who either provides his technical knowledge to other, or avails of the production facilities of other smaller units engaged in the same line of activity. Such arrangement are, however, too conspicuous and are rarely resorted to openly.

(i) Boycott i.e. any agreement for the exclusion from any trade association of any person carrying on or intending to carry on, in good faith the trade in relation to which the trade association is formed. The object of such an agreement is to restrict the membership of the association to a few persons for mutually sharing the benefits which may arise from the membership. The practice of boycott is not widely prevalent in India. Not many cases of this nature have come up, for inquiry, before the Commission.

(j) Agreement Having the Effect of Eliminating Competition/Competitors, i.e., any agreement to sell goods at such prices as would have the effect of eliminating competition or competitors. All cases of collective price fixing, price agreements which have the effect of reducing the extent of the market or eliminating certain competitors, are covered by this clause. Thus, any agreement to sell at a price lower than the customary profit maximizing consideration would dictate, for the purpose of driving a competitor out of business or crippling his competitive power shall be restrictive under clause (f).

Exempted Agreements

Sub-section 3 of section 33 speaks of the 'Exempted Agreement' Accordingly, any agreement falling within Section 33 shall not be registrable. If :

(i) It is expressly authorized by or under any law for the time being in force; or

(ii) Has the approval of the Central Government; or

(iii) If the Government is a party to such agreement.

The assumption underlying the aforesaid exemption is that any agreement which is authorized under any law or by Government (Central or State) cannot be prejudicial to public interest.

13.4 DEFINITION OF UNDER TRADE PRACTICE

The chapter of original MRTP Act dealing with restrictive trade practice was supplement by the amendment of 1984 by adding part B to it. This part is design to deal with unfair trade practice. The same set of provisions has also been included in section 2(1)(r) of the consumer protection Act, 1986.

Section 36-A explains what "unfair trade practice" means for the purposes of the Act. The main purpose of the provisions is to afford some measure of protection to-the ultimate consumers of goods or users of services. The consumer must get but he is told he is getting. Where, by any method whatsoever, a relief is created in the minds of consumers as to some quality or utility of goods or services, and the goods actually fail short of those standards, this will be unfair to consumers. As a part of the statutory framework of the consumer protection programme, such a method has been regarded by the act as an unfair trade practice. Such methods are listed in the section. The section says that where the methods stated in the section are adopted for the purpose of promoting the sale, use or supply of any goods or for the provision of any services and thereby some loss or injury is caused to the consumers of such goods or services, it is an unfair trade practice, whether the purpose- is achieved by eliminating or restricting competition or otherwise. This is so because the primary theme of provisions is to protect the consumer from the business community. The provisions became necessary because the provisions of the Contract Act, 1872 relating to fraud and Misrepresentation and those of the Sale of Goods Act, 1930 relating to Condition and warranties have not been able to give adequate

protection to consumers against deceptive trade practices. This is true primarily because of the high cost and long delays of litigation.

The practices mentioned in the section are grouped on five categories:

1. False representation

The practice of making any statement, whether oral or written or by verbal representation which:

(i) falsely suggests that the goods are of a particular standard grade, composition, style or model;

(ii) falsely suggests that the services are of a pa standard or quality or grade;

(iii) falsely suggests any rebuilt, second land, renovated or reconditioned or old goods as new goods;

(iv) represents that the goods or services has sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;

(v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

(vi) makes a false or misleading representation concerning the need for or usefulness of any goods or services;

(vii) gives a wan or guarantee as to the durability, performance or efficacy of the goods which is not based upon adequate or proper test; the burden of proof will lie upon him to show that the goods were adequately and properly tested;

(viii) makes to the public a representation on a form that looks like a guarantee or warranty, or a promise to replace, maintain or repair the goods until they achieve a specified result, and the representation is materially misleading or there is no reasonable prospect that the guarantee, etc., contained in the representation shall be carried out;

(ix) materially misleads the public about the prices at which such goods or services are available in the market;

(x) gives false of representation or statement to the public may be by any method. It will be enough if the statement comes to the knowledge of a buyer of those goods, etc. The Explanation appended to sub-section (1), therefore, says that the representation may appear on the article, or on its wrapper or container, or on anything attached to, inserted in or accompanying the articles, or on anything on which the article is mounted. An advertisement for sale of holidays resorts held out promises as to appreciation both in terms of value and rent and offered “free holiday forever” comparing them with commercial complexes like those in Connaught Place. The promises and comparisons were found to be false, the Commission prohibited any further portrayal of the advertisement. The claim of another advertiser as to a cure for leukoderma was restrained because the treatment offered was neither medically sound, nor the clinic was being attended by a “world -renowned doctor”, as representative. An advertisement offering high rate of interest and secured investment without proof of supporting facts. as to final base, etc.., has been restrained. An institute was organized by some private persons under the

name “Indian Institute of Management Studies” offered courses leading to “Diplomas” can be conferred only by an Authority created by law.

Tracing the need for the provisions relating to protection of the consumer against unfair trade practices in *Lakhanpal National Ltd v M R T P Commission,* the Supreme Court observed:

The Act (MRTP), as it originally stood, did not contain any provision for protection of consumers against false or misleading advertisements for other similar or unfair trade practices. By providing for measure against restrictive and monopolistic trade practices, it was perhaps assumed that the consumers also, as result, will get a fair deal. However, experience indicated otherwise, and following the recommendations of a committee, it was considered necessary to amend the Act. In the fast changing world of today, advertising goods is a well recognized marketing strategy. The consumer also needs it, as the articles which they require for their daily life are of a great variety and the knowledge of an ordinary man is imperfect. If the manufacturers make available, by proper publicity, necessary details about the products, they come as a great help to the man in the street. Unfortunately, some of the advertisements make exaggerated and sometimes baseless representation about the quality standard and performance, with the object of attracting purchasers. It was, therefore, considered necessary to have statutory regulations insisting that, while advertising, the sellers must speak the truth Accordingly, Sections 36-A to 36-E on part B were inserted in chapter V of the Act by an amendment in 1984.

Referring to the definition of “unfair trade practice” the court said:

The definition of ‘unfair trade practice’ in Section 36-A is not inclusive or flexible, but specific and limited in its contents. The object is to bring honesty and truth in the relationship between the manufacturer and the consumer. When a problem arises as to whether a particular act can be condemned as, an unfair trade practice or not, the key to the solution would be examine whether it contain a false statement and is misleading and further what is the effect of such a representation ... on the common man ? Does it lead a reasonable person in the position of a buyer to a wrong conclusion? The issue cannot be resolved by merely examining whether the representation is correct or incorrect in the literal sense. A representation containing a statement apparently correct in the technical sense may have the effect of misleading the buyer by using tricky language [on the other hand], a statement which may be inaccurate in the technical [or] literal sense can convey the truth and sometimes more effectively than a literally correct statement. It is, therefore necessary to examine whether the representation contains or carries the possibility of misleading the buyer: [would] a reasonable man, on reading the advertisement from a belief different from what truth is? The position [would] have to be viewed objectively in an impersonal manne. It is stated in Halsbury’s LOW of England, that a representation will be deemed to be false, if it is false in substance and in fact; and the test by which the representation is to be judged to see whether the discrepancy between the fact as represented and the actual fact is such as would be considered material by a reasonable represented. “Another way of stating the rule is to say that substantial falsity is, on the one hand necessary, and, on the other, adequate, to establish a misrepresentation” and “that where the entire representation is a faithful picture or transcript of the essential facts, on falsity is established, and even though there may have been any number of inaccuracies in unimportant details. Conversely, if the general impression conversely is

false, the most punctilious and scrupulous accuracy in immaterial minutiae will not render the representation true.

The facts of the case were that a producer of batteries in collaboration with a Japanese firm, by name, "Mitsushita Ltd" [referred to as M Ltd], advertised his batteries as being produced in collaboration with "National" and "Panasonic". That was not the name of the collaborator, but those brand names of its products the collaborator was known in India as a worthy producer. In other words, instead of the name of the collaborator, the collaboration was represented to be with the products of the collaborator. The Supreme Court was not able to see anything wrong in it. SHARMA J said: "Where the reference is being made to the standard or the quality, it is not material whether the manufacturing company is indicated by its correct name or by its description with reference to its product. We, therefore, hold that the erroneous description of the manufacturing company in the advertisements in question does not attract Section 36-A although we would hasten to add that it would be more proper for the appellant company to give the full facts by referring to Mitsushita Ltd by its correct name and further stating that its products are known by the names "National" and "Panasonic".

Representation about a video cassette that it was the exact copy of the film as certified by the Board, whereas portion of the film were blocked or deleted to accommodate advertisements, amounted to an unfair trade practice, the representation being not true.

A warranty which is not false or misleading does not amount to an unfair trade practice merely by reason of the fact that the supplier has committed a breach of it.

2. False offer of bargain price

The second category is in clause (2). It includes the publication of an advertisement on a news paper or otherwise by which goods or services is offered at a bargain price when in fact this is not the intention or they are not intended to be offered at that price for a reasonable period or reasonable quantity. The bargain price for the purposes of this provision means the price stated in the advertisement in such manner as suggests that it is lesser than the ordinary price or a price which the person coming across the advertisement would believe to be better than the price at which such goods are ordinarily sold. An announcement for sale of textiles at throw away prices, which were not verifiable because neither the quality of the goods was mentioned nor their prices, has been held by the Commission to be unfair.

An advertisement of off-season discount of fans calculated in reference to future and not present prices has been held to be unfair.

In determining which cases to select for formal action, the Federal Trade Commission (U S A) places a high priority on those matters which relate to the basic necessities of life, and to situations in which the impact of false and misleading advertising, or other unfair and deceptive practices, falls with cruelest impact upon those least able to survive the consequences the elderly and the poor. Often the type of false adverting attacked by the F T C is designed to make prospective purchasers believe they will be getting a "good deal" in term of price of they buy the product in question. For example, a seller of goods was ordered to refrain from advertising his product for sale by use of a price comparison in which its actual price was compared to a higher "regular"

price or a manufacturer's list price. The Commission ruled that it was deceptive to refer to "regular price" unless the defendant had usually sold the items at that price recently in the regular course of business. Also it was held deceptive to refer to the "manufacturer's list Price" when that list price was not the ordinary and customary retail sales price of the items in the locality... In ordering enforcement of the Commission's cease and desist order the court or Appeal said... "We do not understand the commission to hold that use of the term 'manufacturer's price list' is unlawful per se; rather it is unlawful only if it is not the usual and customary retail price in the area."

3. Schemes offering gifts, etc.

The third category of unfair trade practice includes in its fold the offering of any gifts, prizes or other items along with the goods when the real intention is different or giving impression that something is being offered free of prise along with the goods when in fact the price is wholly or partly covered by the price of the article sold, or some prizes are offered to the buyers by the conduct of some lottery or chance game when the real aim is promotion of sales or business.

A firm was restrained from issuing any misleading advertisement or giving publicity by any other media to its gift scheme being implemented through a coupon book which could bring a benefit up to Rs. 5,000/- to the purchases. In a case before the U.S. Supreme Court, certain representation appeared in advertisements which stated in various ways that for every can of respondent's paint purchased by a buyer, the respondent would give him a 'free' can of equal quality and quantity. The court did not want to make a departure from the commission's policy regarding the use of the commercially exploitable word 'free'. Justice Brennan said:

Initial efforts to define the term 'free' in decisions were followed by 'Guides against defective pricing'. These inform businessmen that they might advertise an article as 'free' even though the purchase of another article was required, so long as the term of the offer were clearly stated, the price of the article required to be purchased was not increased, and its quantity and quality were not diminished. With the specific reference 'two for the price of one offers', the guides required that either the sales price for two the advertiser's "usual and customary retail price for the single article in the recent regular course of hi business' or where the advertiser have not previously sold the articles, the price for two be the "usual and customary" price for one in the relevant trade areas. These, of course, were guides, not fixed rules as such, and were designed to inform businessman of the factor which would guide the commission's decisions. Upholding the decision of the commission that the advertisement complied with the guideline in appearance only, the court said:

In sum, the commission found that Mary Carter had no history of selling single cans of paint, it was marketing twins, and in allocating but is in fact the price of two cans to one can, yet calling one 'free', Mary Carter misrepresented.

The commission has also restrained but is called "bait and switch" promotion. In this method a product is advertise at law price only as a bait to capture the interest of consumer and then switch his attention to another product which the advertiser really desired to sell from the beginning the monopolies and Restrictive trade practices commission restrained a prize scheme which was designed to boost the sale of cycles during the rainy seasons then sales would otherwise be sluggish. The commission advised

the producer that instead of baiting customer like that he should have given them the benefit of price reduction. The commission was of the view that though apparently the scheme was to confer a benefit upon some customer who would be selected by chance; it was injurious to the interest of consumer as a whole inasmuch as it would deprive them of the benefit of competition which is offered by an affluent market. A scheme offering loans to applicants, who received no loans, in fact, whom no loan was granted, but paid heavy application charges and finally settled for refund of half of their application money, was restrained by the commission.

A firm was restrained from floating a scheme of free distribution coffee shakers with coffee packs when it was found that the cost was partly recovered through constant price increase, and the number of shakers delivered to the market was not equal to coffee packs. A company announced a price scheme. Shortly before the launching of the scheme, the price structure applicable to sale of its detergent powder was revised upwards. The monopolies commission held that the company was guilty of an unfair trade practice. The company contended that the increase in price was due to other factors, such as increase in the prices of raw material and was not connected with the price scheme. The Supreme Court returned the matter to the monopolies commission for decision on merits after considering the company's connection. .

4. Non Compliance of prescribed Standards

The fourth category of unfair trade practices include cases where goods are sold for use by the consumers knowing or having reasons to believe that they do not comply with standards prescribed by some competent authority. The prescribed standard may relate to performance, composition, contents, design, construction, finishing or packing as are necessary to prevent or reduce the risk of injury to the person using the goods.

It has been held by the MRTP Commission in Food Specialties Ltd., Re, following its on earlier decision in Director General of Investigation & Registration V Foods Specialties Ltd. That the sale of a package containing contents of quantity less than but is mentioned on the container may amount to a contravention of the standards of weights and measure (packaged commodities) Act, but the implementation of that Act is not within the jurisdiction of the MRTPC unless there is an unfair trade practice within the meaning this clause. This is so because non-compliance of prescribed standards must carry a risk of injury to the consumer. Short quantity causes loss but not any injury Hence it is not an unfair trade practice.

5. Hoarding, destruction or refusal

The fifth and the last category of unfair trade practices includes cases of hoarding, destruction of or refusal to sell, goods or services. Clause (5) says that a practice will be unfair if it permits the hoarding or destruction of goods, or refusal to sell the goods or to provide any services of such conduct of intended to raise or has the effect of raising the cost of those or other similar goods or services.

LOSS OR DAMAGE

It is not necessary for restraining an unfair trade practice that the complainant should have suffered some loss, 'damage or prejudice. Such consequences can be compensated in addition to the cease and desist order.

13.5 INQUIRY BY COMMISSION

The Commission can start an inquiry into an alleged unfair trade practice in the following cases:

(i) on receiving a complaint by any trade or consumers' association having a membership of at least 25 persons or from 25 or more consumers; the complaint should state the facts;

(ii) on receiving a reference from the Central or any State' Government;

(iii) on receiving an application from the Central or any State Government;

(iv) upon its own knowledge or information.

Where a complaint is made by consumers or a consumers' organization, the Commission is required by Section 36-C, before proceeding against anybody, to ask the Director General to conduct a preliminary investigation about the complaint so as to satisfy itself that the complaint is genuine and really deserves to be inquired into.

POWERS OF THE COMMISSION

Where upon an inquiry the commission finds that the practice on question is prejudicial to public interest or to the interest of any consumer or consumers generally, the Commission can pass orders of the following kind

(1) that the practice shall be repeated;

(2) that he agreements connected with an unfair trade practice shall be void or shall stand nullified the order may also take care of the consequential matters.

The commission has the alternative power to ask the person concerned that he should so moderate his dealings and no longer to cause prejudice to public or consumer interest. The Commission may set a time-limit for compliance of its orders. If the orders are not carried out, the Commission may exercise its other power under the section.

The orders of the commission cannot deal with any trade practice which has been authorized by any law for the time being in force. Subject to this exception, however, the commission and Director General will have the same power in reference to an: unfair trade practice as they have in respect of restrictive trade practices. The Commission does not have the power to ask a party whose advertisement was stayed to seek approval to advance before any further advertisement was launched.

POWERS TO AWARD COMPENSATION

The power to award compensation has also been conferred by the amendment of 1984. Before this amendment, where any 'violation of the Act caused damage, such as damage caused by a restrictive trade practice, a separate suit has to be filed to recover compensation to the same. Now the Commission itself can award compensation in such cases, though the right to file a separate suit for the purpose is not taken away.

The section says that where any monopolistic, restrictive or unfair trade practice has caused damaged to any Government, or trader or consumer, an application may be made asking for compensation and the Commission may 'award such compensation as it may think appropriate. Where any such loss or damage is caused to a number of persons having the same interest, compensation can be claimed, with the permission of' the commission, by any of them on behalf of all of them. For this purpose, provision of Rule 8 of Order 1 of the first schedule of the First Schedule of the Procedure Code, 1908 wilt

become applicable. The commission' inquires into the allegation in the' application and may then pass a decree for compensation. Where the applicant has already obtained a decree from a civil court for the same loss or damage, the amount of that decree shall be set off against the decree passed by the Commission and the decree shall be executable for the balance.

The defendant advertised that its toothpaste had 102% anti bacterial superiority over other leading toothpastes. The Commission ordered inquiry into the claim and appointed an expert panel for the purpose and till then the advertiser was told not to make any such claim. A writ petition against the order was not allowed. The Supreme Court refused to interfere in this order.

An advertisement of a toothpaste by commending it as capable of giving protection like a "Suraksha Chakra" w not restrained.

ENFORCEMENT OF ORDERS

Temporary injunctions issued by the Commission under Section 12-A and .a decree for compensation under Section 1 are enforceable in the same manner as if it were a decree passed by a civil court. If the Commission finds that it is not able to execute its orders it may refer them to the civil court having jurisdiction over the undertaking or the persons against whom the order is passed.

13.6 SUM UP

A Restrictive trade practices means a trade practice which has or may have the effect of preventing, restricting or distorting competition in any manner. Every restrictive trade practice or agreement is not necessary bad and therefore actionable. It may sometimes be even in the public interest.

13.7 Restriction Trade Practices

Trade practice which has or may have the effect of preventing, restricting or distorting competition in any manner.

13.8 CHECK YOUR PROGRESS

1) Explain restrictive trade practice.
2) Differentiate between monopolistic and restrictive trade practices.

13.9 REFERENCES

1) Maheshwari & Maheshwari, A Manual of Business Law, MPH.
2) Ashok K. Bagarial, Company Law, Vikas Publications.
3) Pathak, Legal Aspects of Business, TMH.

13.9 TERMINAL QUESTIONS

1) Describe restrictive trade practices in detail.
2) Discuss registrable agreement relating to restrictive trade practices
3) Define and discuss unfair trade practices.

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LESSON-14

THE CONSUMER PROTECTION ACT

STRUCTURE

14.0 Objectives

After studying this lesson, you should be able to :

- Define consumer protection act in respect to consumer protection.
- Describe the characteristics of consumer protection Act.
- Know how the consumer protection councils are established.
- Describe The nation of commission composition.

14.1 INTRODUCTION

The Consumer Protection Act, as its Preamble says, is the Act to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer's councils and other authorities for the settlement of consumers' disputes and for matters connected therewith. The Act applies to all goods and services unless specifically exempted by the Central Government.

DEFINITIONS IN RESPECT TO CONSUMER PROTECTION ACT, 1986

(1) Appropriate Authority

In this Act, unless the context otherwise requires,- 2 'appropriate laboratory' means a laboratory or organization —

(i) recognized by the Central Government;

(ii) recognized by a State Government, subject to such guidelines as may be prescribed by the Central Government in this behalf or (iii) any such laboratory or organization established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect.

(2) Branch Office

'Branch office" means -

(i) any establishment described as a branch by the opposite party; or

(ii) any establishment carrying on either the same or substantially the same activity as that carried on by the head, office of the establishment.

(3) Complainant

"Complainant" means —

(i) a consumer; or

(ii) any voluntary consumer association registered under the Companies Act, 1956 (1 of 1956) or under any other law for the time being in force; or

(iii) the Central Government or any State Government; or

(iv) one or more consumers, where there are numerous consumers having the same interest;

(v) in case of death of a consumer, his legal heir or representative; who or which makes a complaint.

(4) Complaint

'Complaint' means any allegation in writing made by a complainant that

(i) an unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;

(ii) the goods bought by him or agreed to be bought by him suffer from, one or more defects;

(iii) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

(iv) a trader or the service provider, as The case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price —

(a) fixed by or under any law for the time being in force;

(b) displayed on the goods or any package containing such goods;

(c) displayed on the price list exhibited by him by or under any law for the time being in force;

(d) agreed between the parties.

(v) If goods which will be hazardous to life and safety when used, are being offered for sale to the public —

(a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;

(b) if the trader could have known with due diligence that the goods so offered are unsafe to the public;

(vi) services which are hazardous or likely to be hazardous to life and safety. of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety.

(5) Consumer

Consumer' means any person who, —

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person but does not include a person who avails of such services for any commercial purpose.

Explanation: For the purposes of this clause, "commercial purpose" does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment.

(6) Consumer Dispute

'Consumer dispute' means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

(7) Defect

'Defect' means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under, any law for the time being in force or 'under any contract, express or implied, or as is claimed' by the trader in any manner whatsoever in relation to any goods.

(8) Deficiency

'Deficiency' means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

(9) District Forum

'District forum' means a Consumer Disputes Redressal Forum established under clause (a) of section 9.

(10) Goods

'Goods' means goods as defined in the Sale of Goods Act, 1930 (3of 1930).

(11) Manufacturer

'Manufacturer' means a person who —

(i) makes or manufactures any goods or parts thereof; or

(ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others; or

(iii) puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer.

(12) Member

'Member includes the President and a member of the National Commission or a State Commission or a District Forum, as the case may be.

(13) National Commission

'National Commission' means the National Consumer Disputes Redressal Commission established under clause (c) of section 9.

(14) Notification

'Notification' means a notification published in the Official Gazette.

(15) Person

'Person' includes —

(i) a firm whether registered or not;

(ii) a Hindu undivided family;

(iii) a co-operative society;.

(iv) every other association of persons whether registered under the Societies Registration Act, 1860 (21 of 1860) or not.

(16) Prescribed

'Prescribed' means prescribed by rules made by the State Government, or as the case may be, by the Central Government under this Act.

(17) Regulation

'Regulation' means the regulations made by the National Commission under this Act.

(18) Restrictive Trade Practice

'Restrictive trade practice' means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include —

(a) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price;

(b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services.

(19) Service

'Service' means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service. -

(20) Trader

'Trader' in relation to any goods means a person who sells of distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in packaged form, includes the packer thereof.

14.2 SCOPE OF THE ACT

The Act covers all the sectors whether private, public or co-operative and the provisions in the Act are compensatory in nature. It ensures the following rights to the consumers:

- The right to be protected against the marketing of goods which are hazardous to life and property.
- The right to be informed about the quality, quantity, potency, purity, standard and price of goods so as to protect the consumer against unfair trade practices.
- The right to be assured, wherever possible, access to a variety of goods at competitive prices.
- The right to be heard and to be assured that consumer's interest will receive due consideration at appropriate forums.
- The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers.
- The right to consumer education.

The Act envisages establishment of Consumer Protection Councils at the Central and State levels whose main object will be to promote 'and protect the rights of the consumers.

PROVISIONS OF THE CONSUMER PROTECTION ACT

The Act provides speedy and inexpensive redressal of consumer grievances and for the purpose envisages three-tier quasi-judicial machinery at the national, state and district levels. At the national level, there is National Consumer Disputes Redressal Commission (known as National Commission); at the State level there are Consumer

Disputes Redressal Commissions (known as State Commissions) and at the. district level there are Consumer Disputes Redressal Forums (known as District Forums). The provisions of this Act are in addition to and not in derogation of the provisions of any other laws for the time being in force.

The Act, as amended in 1993, has laid down that a complaint can be made to the court designated as the consumer forum) in case an unfair trade practice is committed, the goods bought suffer from defects, the services hired or awaited suffer from any deficiency, excessive pricing or the sale of any hazardous goods. The complaint can be made by any consumer or any consumer organization.

14.3 CHARACTERISTICS OF CONSUMER PROTECTION ACT

Important features of Consumer Protection act are as under:

1. With the enactment of this Act, India has become first country in the world to provide legal protection to the interests of consumers.

2. This Act provides for quick and easy justice.

3. This Act applies on all goods and services unless the Central Government excludes some particular goods or service from this Act.

4. Provisions of this Act are of compensatory nature, and not of punishing nature.

5. This Act is secular in nature.

6. Three-tier judiciary system has been framed under this Act: District Consumer Forum, State Commission and National Commission.

7. Consumers are not required to engage any advocate; they can plead their case themselves.

8. This Act applies in all the areas and all institutions, whether in private sector or in public sector.

9. This Act is a comprehensive Act to protect the interests of consumers against their exploitation by manufacturers and suppliers.

10. No court fee is to be paid under this Act. No stamp is required on application, however, certain fees is to be paid on appeal against an order and in case of laboratory test.

LIMITATIONS OF LEGISLATIVE MEASURES

In a country where most of the people are illiterate and live below poverty line, it is too ambitious to expect adequate knowledge of legislative provisions, and their rights on the part of the consumers. The businessmen and industrialists, on the other hand, are always seriously engaged in finding out some loopholes or other, in the consumer protection legislation that has been enacted to augment their profits in an undesirable manner.

Further, mere enactment of any amount of legislation to protect the interests of the consumers by itself cannot serve the purpose. The machinery that is available at present for the redressal of the grievances of the consumers is available mostly in urban areas. In

rural areas, there is virtually no mechanism for consumer protection. Even in some of the urban areas, it is not so much effective as it should be due to various reasons.

The crying need of the hour is the organization of the consumers into powerful unions at various levels to protect their rights and privileges and safeguard themselves against the exploitation of the fraudulent businessmen and industrialists. Self-help is the best help. This realization must dawn on every consumer in the country. It is only then that the consumers in our country can find salvation from their problems. Legislation is no panacea for all the problems of consumers. They have to help themselves.

To sum up, it is not the legislation alone that we can depend upon for safeguarding the interests of the consumers. There should be more awareness, education, understanding and realization of the rights and privileges on the part of the consumers and more than anything else, a strong organization that will really help in building up a more effective consumerism in our country.

WHO CAN FILE A COMPLAINT UNDER CONSUMER ACT?

Under Consumer Protection Act; 1986, following persons can file their complaints:

(a) Central government,

(b) A consumer,

(c) State government,

(d) A group of consumers having same interest and same complaint (such complaint may be filed by any of these persons);

(e) A voluntary consumer association (provided if such association is registered under Indian Companies Act, 1956 or Societies Registration Act, 1960 or under any other law in force.)

(f) Legal Heir of a consumer after his death.

14.4 CONSUMER PROTECTION COUNCILS

(1) The Central Consumer Protection Council

The Central Government shall, by notification', establish with effect from such date as it may specify in such notification, a Council to be known as the Central Consumer Protection Council hereinafter referred to as the Central Council. The Central Council shall consist of the following members, namely:

(a) the Minister in-charge of the consumer affairs in the Central Government, who shall be its Chairman and

(b) such number of other official or non-official members representing" such interests as may be prescribed.

Procedure for meetings of the Central Council: The Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year.

The Central Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

Objects of the Central Council: The objects of the Central Council shall be to promote and protect the rights of the consumers such as, —

(a) the right to be protected against the marketing of goods and services which are hazardous to life and property;

(b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices;

(c) the right to be assured, wherever possible, access to a variety of goods and services at competitive prices;

(d) the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate form;

(e) the right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and the right to consumer education.

(2) The State Consumer Protection Councils

The State Government shall, by notification, establish with effect from such date as it may Specify in such notification, a Council to be known as the Consumer Protection Council for ... (hereinafter referred to as the State Council).

The State Council shall consist of the following members, namely:

(a) the Minister in charge of consumer affairs in the State Government who shall be its Chairman;

(b) such number of other official or non-official members representing such interests as may be prescribed by the State Government.

(c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

(d) the State Council shall meet as and when necessary but not less than two meetings shall be held every year.

(e) the State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

Objects of the State Council: The objects of every State Council 'shall be to promote and protect within the State the rights of the consumers be laid down in clauses (a) to (f) of section 6.

(3) The District Consumer Protection Council

The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification. The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following members, namely:

(a) the Collector of the district (by whatever name called), who shall be its Chairman; and

(b) such number of other official and non-official members representing such interests as may be prescribed by the State Government.

(c) The District Consumer Protection Council shall meet as and when necessary but not less than two meetings shall be held every year.

(d) The District Consumer Protection Council shall meet at such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. Objects of the District Council: The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to (f) of section 6.

PERSONS AGAINST WHOM COMPLAINT CAN BE FILED

Under the provisions of Consumer Protections Act, a Consumer can file his, complaint against following persons:

1. Trader

A trader means a person who sells or distributes any goods for sale. This term includes the manufacturer and packer of goods also.

2. Manufacturer

Manufacturer means a person who:

(i) produces and manufacturers any goods or parts thereof, or,

(ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others and claims the product to be the goods manufactured by himself, or,

(iii) puts or causes to be put his own mark on any goods manufactured by any other manufacturer and claims such goods to be manufactured by himself

It is Important in this respect that if a manufacturer dispatches any goods or part thereof to a branch office or a dealer, such branch office or dealer shall not be deemed to be the manufacturer even if the parts so dispatched are assembled at such branch office or dealer

Example: Lancer Ltd dispatched 10 cars to Jam Motors (a dealer) Out of these, one car was having some manufacturing defects Jam Motors charged some more prices for two cars from two customers In this case, the car having manufacturing defects will be the liability of manufacturer and charging higher price will be the liability of dealer (Jain Motors).

3. Supplier of Services

Service under this act means only such service which is commercial in nature and is rendered against payment. It includes the service of any description which is made available to potential users and includes the provision of facilities in connection with such services. A customer can file complaint against any person or organization who has

supplied such service, weather it is government or private organization, Municipal Corporation, loc authority; development authority etc. It includes the following persons and organizations (a complaint can be filed against any of them also):

(a) Advocates and Chartered Accountants

(b) Supply of Water

(c) Travel Agencies

(d)Finance Companies

(e) Supply of Electrical or Other Energy

(f) Educational Institutions

(g) Banquet Halls

(h) Transport Companies

(i) Entertainment and Amusement

(j) Telephone Department

(k) Post and Telegraph Department

(l) Insurance Companies

(m) Private Doctors and Nursing Homes

(n) Housing Construction

(o) Banking Companies

(p) Advertising and Courier Agencies

(q) Boarding or Lodging or both

(r) Supply of Gas.

14.5 THE NATIONAL COMMISSION COMPOSITION

The National Commission shall consist of:

(1) A person who is or has been a Judge of the Supreme Court, to be appointed by the Central Government, who shall be its President. However, no appointment under this Clause shall be made except after consultation, with the Chief Justice of India;

(2) Not less than 4 and not more than such number of members, as may be prescribed and one of whom shall be a woman who shall have the following qualifications, namely:

(a) Be not less than 35 years of age;

(b) Possess a bachelor's degree from a recognized university; and

(c) Be persons of ability, integrity and 'standing and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy industry, public affairs or administration.

However, not more than 50 percent of the members shall be from amongst the persons having a judicial background.

The, expression "persons having a judicial background" shall mean persons having knowledge and experience for at least a period of 10 years as a presiding officer at the district level court or any tribunal at equivalent level.

Every appointment referred to above shall be made by the Central Government on the recommendation of a Selection Committee consisting of the following namely:

(a) A person who is a judge of the Supreme Court to be nominated by the Chief Justice of India. — Chairman

(b) The Secretary in the Department of Legal Affairs in the Government of India. — Member

(c) Secretary of the Department dealing with Consumer Affairs in the Government of India. —Member

The jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof.

A Bench may be constituted by the President with one or more members as the President may deem fit.

Every member of the National Commission shall hold office for a term of 5 years or up to the age of 70 years, whichever is earlier. However a member shall be eligible for reappointment for another term of 5 years or up to the age 70 years, whichever is earlier, subject to the condition that he fulfils the qualifications and other conditions for appointment and such re-appointment is made on the basis of the recommendation of the Selection Committee.

The salary or honorarium and other allowances payable to, and the terms and conditions of service of the members of the National Commission shall he prescribed by the Central Government.

Place of the National Commission: The office of the National Commission shall be located in the Union Territory of Delhi (Rule 5 of the Consumer Protection Rules, 1957).

Jurisdiction: Subject to the other provisions of this act, the National Commission shall have jurisdiction

(1) To entertain (i) complaints where tire value of the goods or services and compensation, if any, claimed exceeds one crore and (ii) appeals against the orders of any State Commission; and

(2) To call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission (i) has exercised a jurisdiction not vested in it by law, or (ii) has failed to exercise a jurisdiction so vested, or (iii) has acted in the exercise of its jurisdiction illegally or with material irregularity.

Appeal: Any person, aggrieved by an Order made by the National Commission in exercise of its powers, may prefer an appeal against such order to the Supreme Court within a period of 30 days from the date of the order. The Supreme Court may entertain

an appeal after the expiry of this period of 30 days if it is satisfied that there was sufficient cause for not filing the appeal within that-period. Further, no appeal by a person, who is required to pay any amount in terms of an order of the National Commission, shall be entertained by the Supreme Court unless that person has deposited in the prescribed manner 50 percent of that amount or rupees Rs. 50,000, whichever is less.

Finality of orders: Every order of a District Forum, the State Commission or the National Commission shall, if no appeal has been preferred against such order under the provisions of this Act, be final.

ESTABLISHMENT OF CONSUMER DISPUTES REDRESSAL AGENCIES

There shall be established for the purposes of this Act, the following agencies, namely:

(a) a Consumer Disputes Redressal 'Forum to be known as the 'District Forum' established by the State Government in each district of the State by notification provided that the State Government may, if it deems fit, establish more than one District Forum in a district;

(b) a Consumer Disputes Redressal Commission to be known as the 'State Commission' established by the State Government in the State by notification; and

(c) a National Consumer Disputes Redressal Commission established by the Central Government by notification.

14.6 SUM UP

The consumer protection Act, is the Act to provide for better protection of the interests of consumers. To fulfill the interests of consumers it makes provisions for the establishment of Consumers councils and other authorities for the settlement of consumers disputes and for matters connected there with. The Act applies to all goods and services unless specifically exempted by the Central Government. The Act covers all the sectors whether private, public or co-operatives and the provisions in the Act are compensatory in nature. Under Consumer Protection Act, 1986, Central Government, a consumer, state Government, a group of consumers, a voluntary consumer association and legal heir of a consumer can file their complaints.

14.7 KEY WORDS

Consumer: Means any person who buys any goods for a consideration which have been paid or party paid.

Trader: Means a person who sells or distributes any goods for sale.

14.8 CHECK YOUR PROGRESS

1) Outline the provisions of the consumer protection Act.

2) Describe the characteristics of consumer protection Act.

14.9 REFERENCES

1) Maheshwari & Maheshwari, A Manual of Business Law, MPH.

2) N.D. Kapoor, Bhacat Bhushan, Rajini Abbi, Essentials of poutiness Law, Saltan Chand & Sons.

14.10 TERMINAL QUESTIONS

1) Explain the precisions of the consumer provision Act.

2) Discuss the characteristics of consumer protection Act.

3) Discuss the composition of National Commission.

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LESSON-15

COMPETITION ACT

STRUCTURE

15.0 OBJECTIVES

After studying this lesson, you should be able to:-

- Understand the scope and application of the competition Act.
- State the regulations relating to combinations
- Explain the provisions relating to establishment, composition, process and duties, faction of competition commission of India.

15.1 INTRODUCTION

In the pursuit of globalization, India has responded by opening up its economy, removing controls and resorting to liberalization. For this it was necessary that Indian markets should be geared to face competition within the country and from foreign countries. The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) became obsolete in certain respects in the light of international economic development relating to competition laws. A need was felt to shift focus from curbing monopolies to promoting competition. Accordingly, the Competition Act, 2002 was enacted and the MRTP Act, 1969 was repealed, as a consequence of which the Monopolies and Restrictive Trade Practices Commission (MRTPC) established under that Act was also dissolved. -

The Preamble of the Competition Act, 2002 states that the Act has the following objectives:

(i) to provide for the establishment of a Competition Commission of India (CCI) to prevent practices having adverse effect on competition, and also to undertake competition advocacy for creating awareness and imparting training on competition and related issues;

(ii) to promote and sustain competition in market;

(iii) to protect the interests of consumers;

(iv) to ensure freedom of trade carried on by other participants in markets in India.

The Competition Act, 2002 applies to the whole of India except the State of Jammu and Kashmir. The Act is being brought into force in stages. Different provisions of the Act were enforced from different dates. The Act has been amended in 2007 and 2009.

DEFINITIONS

The various expressions used in the Act have been defined as follows:

Acquisition [Sec. 2(a)]. it means acquiring or agreeing to acquire, directly or indirectly:

(a) the shares, voting rights or assets of any enterprise; or

(b) control over management or control over assets of any enterprise.

Agreement [Sec. 2(b)]. It includes any arrangement, or understanding or action in concert, irrespective of whether such arrangement, understanding or action is formally made in writing or is intended to be legally enforceable.

Appellate Tribunal [Sec. 2(ba)]. It means the Competition Appellate Tribunal established under Section 53A(l) of this Act.

Cartel [Sec. 2(c)]. It means an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.

Chairperson [Sec. 2(d)]. It means the Chairperson of the Commission appointed under Section 9 of this Act.

Commission [Sec. 2(e)] it means the Competition Commission of India established under Section 7(1) of tins Act

Consumer [Sec. 2(f)]. It includes any person who buys arty goods for a consideration, paid or promised or part!; paid and partly promised or under any system of deferred payment, whether for resale or any commercial purpose or for personal use It also includes any user of such goods, who uses them with the approval of the person who bought the goods.

It also includes the person who hires or avails of any services for commercial purpose or for personal use, for a consideration which is paid or promised or under any system of deferred payment. The beneficiary of such services, who avail the service with the approval of the hiring person, shall also be included m the definition of consumer

Director General [Sec. 2(g)] it means the Director General appointed under Section 16(1) of this Act and includes any Additional, Joint, Deputy or Assistant Director General appointed under that section.

Enterprise [Sec. 2(h) it means a person or a department of the Government, who, either directly or through one or more of its units or divisions or subsidiaries, whether located at same place or different places, is and has been engaged in any activity relating to—

(a) production, storage, supply, distribution, acquisition or control of articles or goods; or

(b) the provision of services of any kind; or

(c the investment or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate.

However, it shall not include any activity of the Government relating to the sovereign functions of the Government, including all activities carried on by the departments of Central Government dealing with atomic energy, currency, defence and space.

As per the explanation added to the Section: (a) The word "activity" includes profession or occupation; (b) "Article" includes a new article and "Service" includes a new service; (c) "Unit" or "division" of an enterprise includes:

(i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods; -.

(ii) any branch or office established for the provision of any service.

Goods [Sec. 2(i)]. It means goods as defined in the Sale of Goods Act, 1930 and includes—

(a) products manufactured, processed or mined;

(b) debentures, stocks and shares after allotments;

(c) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Member [Sec. 2 It means a Member of the Commission appointed under Section 9(1) and includes the Chairperson.

Person [Sec. 2(1)]. It includes:

(i) an individual;

(ii) a Hindu Undivided Family;

(iii) a Company;

(iv) a firm;

(v) an association of persons or a body of individuals, whether incorporated or not, in India or outside India;

(vi) any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956;

(vii) any body corporate incorporated by or under the laws of a country outside India;

(viii) a co-operative society registered under any law relating to the cooperative societies;

(ix) a local authority;

(x) every artificial juridical person, not falling within any of the preceding sub-clauses.

Practice [Sec. 2(m)]. It includes any practice relating to the carrying on of any trade by a person or an enterprise.

Price [Sec. 2(o)]. Price in relation to the sale of any goods or to the performance of any services, includes every valuable consideration, be it direct, indirect or deferred. It also includes any consideration which in effect relates to the sale of any goods or to the performance of any services, although ostensibly relating to any other matter or thing.

Public Financial Institution [Sec. (2) (p)]. It means a public financial institution specified under Section 4A of the Companies Act, 1956 and includes a State Financial, Industrial or Investment Corporation.

Relevant market [Sec. 2(r)]. It means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets.

Relevant geographic market [Sec. 2(s)]. It means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas.

Relevant product market [Sec. 2(t)]. It means a market comprising of all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of the characteristics of the products or services, their prices and intended use.

Service [Sec. 2(u)]. It means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial matters such as banking, communication, education, financing, insurance, chit funds, real estate, transport, storage, material treatment, processing, supply of electrical or other energy, boarding, lodging, entertainment, amusement, construction, repair, conveying of news or information and advertising.

Shares [Sec. 2(v)]. It means shares in the share capital of a company carrying voting rights and includes—

(i) any security which entitles the holder to receive shares with voting rights;

(ii) stock except where a distinction between stock and share is expressed or implied.

Statutory Authority [Sec. 2(w)]. It means any authority, board, corporation, council, institute, university or any other body corporate, established by or under any Central, State or Provincial Act for the purposes of regulating production or supply of goods or provision of any services or markets there for, or any other matter connected or incidental thereto.

Trade [Sec. 2(x)]. It means any trade, business, industry, profession or occupation relating to the production, supply, distribution, storage or control of goods and includes the provision of any services.

15.2 PROVISIONS

PROHTHITION OF CERTAIN AGREEMENTS, ABUSE OF DOMINANT POSITION, AND REGULATION OF COMBINATIONS

The provisions regarding prohibition of anti-competitive agreements, prohibition of abuse of dominant position and regulation of combinations are contained in Sections 3 to 6. These provisions constitute the core of the law relating to competition. We shall now discuss these provisions.

Prohibition of Anti-competitive Agreements (Sec. 3)

No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any agreement entered into in contravention of the aforesaid prohibition shall be void.

Agreements having adverse effect on competition.

Any (i) agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or (ii) practice carried on by any association of persons, including cartels, which are engaged in identical or similar trade of goods or provision of services, shall be presumed to have an appreciable adverse effect on competition, when the agreement or the practice:

(a) directly or indirectly determines purchase or sale prices;

(b) limits or controls production, supply, markets, technical development, investment or provision of services;

(c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;

(d) directly or indirectly results in bid rigging or collusive bidding.

However, any agreement entered into by way of joint ventures, if such agreement increases efficiency in production, supply, distribution, storage, acquisition and control of goods or provision of services, will be outside the purview of this Section.

The term “bid rigging” referred to above means any agreement between the enterprises or persons referred to above, engaged in identical or similar production or trading of goods or services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process of bidding.

Furthermore, any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, shall be void if such agreement causes or likely to cause appreciable adverse effect on competition. The Section specifies the following such agreements which shall be void:

(a) Tie-in arrangements. it includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.

(b) Exclusive supply agreement. It means any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

(c) Exclusive distribution agreement. It includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of goods.

(d) Refusal to deal. It covers any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

(e) Resale price maintenance. It includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the sellers, unless it is clearly stated that prices lower than those prices may be charged.

Exemption. The provisions of Section 3 do not apply to the following rights:

(1) The right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under:

(a the Copyright Act, 1957.

(b) the Patents Act, 1970;

(c) the Trade Marks Act, 1999;

(d) the Geographical Indications of Goods (Registration and Protection) Act, 1999;

(e) the Designs Act, 2000;

(f) the Semi-conductor Integrated Circuits Layout Design Act, 2000;

(2) The right of any person to expert goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

Prohibition of Abuse of Dominant Position (Sec. 4)

No enterprise or group shall abuse its dominant position. "Dominant position' means a position of strength, enjoyed by an enterprise, in the relevant market in India, which enables it to—

(i) operate independently of competitive forces prevailing in the relevant market; or

(ii) affect its competitors or consumers or the relevant market in its favour.

There shall be an abuse of dominant position, if an enterprise or a group—

(a) directly or indirectly, imposes unfair or discriminatory—

(i) condition in purchase or sale of goods or services; or

(ii) price in purchase or sate (including predatory price) of goods or service.

But the above referred unfair or discriminatory condition or price shall not include such discriminatory conditions or prices which may be adopted to meet the competition; or

(b) limits or restricts—

(i) production of goods or provision of services or market there for; or

(ii) technical or scientific development relating to goods or services to the prejudice of consumers; or

(c) indulges in practice or practices resulting in denial of market access in any mariner, or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(e) uses its dominant position 'none relevant market to e into or protect other relevant market As per the c:xplanation added to the Section:

(a) The expression "predatory price" means the sale of goods or provision of services, at a price which is below the cost of their production, as may be determined by the regulations, with a view to reduce competition or eliminate the competitors.

(b) The word group shall have the same meaning as assigned to in clause (b) of the *Explanation* to Section 5 (discussed later).

Combinations (Sec. 5)

The acquisition of one or more enterprises by one or more persons or mergers or amalgamation of enterprises shall be called Combination' of such enterprises and persons or enterprises, under the following situations:

(a) *Acquisition of control, shares, assets and voting rights.* Any acquisition, where the parties to the acquisition, being the acquirer and the enterprise, jointly have,—

(i) either, in India, the assets of the value of more than `1,000 crores or turnover of more than `3,000 crores; or

(ii) in India or outside India, in aggregate, the assets of the value of more than US 500 million, including at least `500 crores in India, or turnover of more than US $ 1,500 million, including at least `1 ,500 crores in India.

(iii) the group to which the enterprises shall belong after acquisition shall jointly have—

(A) either in India, the assets of the value of more than `4,000 crores or turnover of more than `12,000 crores; or

(B) in India or outside India, in aggregate, the assets of value of more then US $ 2 billion, including at least `500 crores in India, or turnover of more than US $ 6 billion including at least `1,500 crores in India; or

(b) *Acquisition of control over production distribution or trading of similar or identical goods or services.* Any acquisition of control or a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or service, if—

(i) the enterprises after acquisition jointly have-—

(A) either in India, the assets of the value of more than ` 1,000 crores or turnover of more than `3,000 crores, or

(B) in India or outside India, in aggregate, the assets of the value of more than US $500 million, including at least `500 crores in India, or turnover of more than US $1,500 million, including at least `1,530 crores in India; or

(ii) the group to which the enterprise after acquisition belong to, shall jointly have—

(a) either in India, the assets of' the value of more than `4,000 crores or turnover or than `12,000 crores; or

(b) in India or outside India, in aggregate assets of the value of more than US $ 2 billion, including at least `500 crores in India or turnover of more than US $ 6 billion, including at least `1,500 crores in India.

(c) *Merger or amalgamation.* Any merger or amalgamation in which—

(i) the enterprise after merger or amalgamation, have—-

(A) either in India, the assets of the value of more than 1,000 crores or turnover of more than 3,000crores;or

(B) in India or outside India, in aggregate, the assets of the value of more than US $500 million, including at least `500 crores in India, or turnover of more than US $1,500 million, including at least `1,500 crores in India;

(ii) the group to which the enterprise belongs after merger or amalgamation would have—

(A) either in India, the assets of the value of more than `4,000 crores or turnover of more than `12,000 crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than US $ 2 billion, including at least `500 crores in India, or turnover of the value of more than US $ 6 billion, including at least `1 ,500 crores in India.

As per the Explanation inserted in this Section 5:

(a) The word "control" includes controlling the affairs or management by one or more enterprises or groups, either jointly or singly, over another enterprise or group.

(b) The expression "group" means two or more enterprises, which directly or indirectly, are in a position to—

(i) exercise 26% or more of the voting rights in the other enterprise; or

(ii) appoint more than 50% of the members of the Board of Directors in the other enterprise; or

(iii) control the management or affairs of the other enterprise.

(c) The "value of assets" shall be determined by taking the book value of the assets shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls. It shall be reduced by any depreciation but shall include the brand value, value of goodwill, value of copyright, patent or collective mark, registered trade mark, registered user, registered proprietor, homonymous geo graphical indication, geographical indications, design or layout-design or similar other commercial rights, if any.

Regulation of Combinations (Sec: 6)

No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

Any person or enterprise, who proposes to enter into a combination shall give notice to the Competition Commission of India, in the prescribed form alongwith prescribed fees, disclosing the details of the proposed combination within 30 days of—

(a) approval of the proposal for merger or amalgamation by the Board of Directors of the enterprises concerned;

(b) execution of any agreement or document for acquisition or acquiring of control.

The Commission, after receipt of notice of combination from the enterprises involved shall deal with such notice in accordance with its powers with regard to investigation of combinations as provided by Sections 29—31. However, no combination shall come into effect until 210 days have passed from the day on which the notice has been given to the Commission or the Commission has passed orders under Section 31, whichever is earlier.

The provisions of the Section shall not apply to share subscription or financing facility or any acquisition by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any condition in a loan or investment agreement.

The above institutions are required to file, within 7 days from the date of the acquisition, with the Commission, the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

Explanation: The expression "foreign institutional investor" and "venture capital fluid" shall have the same meaning as assigned to them in the Income Tax Act, 1961.

15.3 SUM UP

The competition Act, 2002, applies of the whole of India except the state of Jammu & Kashmir. The Act being brought into force in stages. Different provision of the Act were enforced from different dates. The Act has been amended in 2007 and 2009.

The provision regarding the prohibition of anti-competitive agreements,, prohibition of abuse or dominant position and regulation of combination sere contained in Section 3 156.

15.4 KEY WORDS

Acquistion : Directly or indirectly acquiring to acquire a hares, voting rights or arrests of any enter price.

Goods: Products manufactured, processed or mined, depentures, stooks and shares.

15.5 CHECK YOUR PROGRESS

1) Explain the provision of the competition Act.

2) Define combination

3) What do you understand by consumer?

15.6 REFERENCE

1) N.D. Kapoor, Bharat Bhashan, Rajini Abbi, Elements of Business Law, Sultan Chand & Sons.

2) Maheshwari & Maheshwari, A Manual of Business Law, HPH.

15.7 TERMINAL QUESTIONS

1) Explain the meaning of dorminant position.

2) Describe the paramenters of competition Law, as contained in Competition Act, 2002.

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LESSON-16

COMPANIES ARRANGEMENTS AND RESTRUCTURING

STRUCTURE

16.0 OBJECTIVES

After reading this lesson, you should be able to :

- Define compromise and arrangement
- Distinguish between reconstruction, merger and amalgemation
- Explain the procedure of amalgamation and merger.

16.1 INTRODUCTION

In the simplest words, the term 'compromise' means a settlement or adjustment of disputed claims between the parties by mutual concessions. Thus, compromise is a term which implies the existence of a dispute because there can be no compromise unless there is some dispute. For reaching to a compromise, parties try to find out a settlement of disputed claims which is for the common benefit of them.

Thus, when a company has a dispute with a member or a class of members or with a creditor or a class of creditors, a scheme of compromise may be drawn up.

Term 'arrangement' has wider connotation. It means readjustment or rearrangement or reorganization of rights or liabilities of parties **without existence of any dispute between them**. Any scheme, other than a scheme by way of compromise or reconstruction, which affects the rights of the creditors and the members of the company or any class of them, would fall within the term 'arrangement' [*Bank of India Ltd v. Ahmadabad Mfg & Callco Printing Co Ltd* (1972) 42 Comp Cases 211 Born].

Thus, where no dispute exists, arrangement may take place. The rights or liabilities of a member or a class of members or a creditor or a class of creditors may be readjusted under any arrangement.

The Companies Act, 2013 states that arrangement includes a reorganization of the company's share capital by consolidation of shares of different classes or by the division of shares into shares of different classes or by both of those methods [Explanation to Sec. 230(1)].

COMPROMISE/ARRANGEMENT WITH CREDITORS/MEMBERS

A compromise or arrangement may be proposed between the following:

(a) Between a company and its creditors or any class of them.

(b) Between a company and its members or any class of them [Sec. 230(1)].

Procedure of Compromise/Arrangement

The procedure of compromise or arrangement involves the following steps [Sec. 230]:

1. Application to Tribunal: The application for compromise or arrangement may be made to the Tribunal by any of the following:

(i) By the company.

(ii) By any creditor.

(iii) By any member of the company.

(iv) By the liquidator, in case the company is being wound up.

2. Disclosure by Affidavit to Tribunal: The applicant (the company or any other person shall disclose the following particulars 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 75 per cent of the secured creditors in value.

(d) A creditor's responsibility statement in the prescribed form.

(e) A statement stating the safeguards for the protection of other secured and unsecured creditors.

(f) Report by the auditor that the find 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.

(g) Where the company proposes to adopt the corporate debt restructuring guidelines specified by the RBI, a statement to that effect.

(h) 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.

3. Tribunal's Order for Meeting: On receipt of application proposing compromise or arrangement, the Tribunal may order a meeting of the creditors or class of creditors 6 the members or class of members, as the case may be. The meeting shall be called, held and conducted in such manner as the Tribunal directs.

However, **the Tribunal may dispense with calling of a meeting of creditor or class of creditors** where such creditors or class of creditors having at least 90 per cent value agree and confirm by way of affidavit to the scheme of compromise or arrangement.

4. Notice of Meeting to the Members, Creditors and Debenture-Holders: A notice of such meeting shall be sent to all the creditors and the members or class of creditors or members and the debenture-holders of the company. The notice shall be sent individually at the address registered with the company which shall be accompanied by the following:

(i) A statement disclosing the details of the compromise or arrangement.

(ii) A copy of the valuation report, if any.

(iii) An explanation of effect of the compromise and arrangement on creditors, key managerial personnel, promoters and non-promoter members and the debenture-holders.

(v) A statement of such other matters as may be prescribed.

(iv) An explanation of effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees.

The notice shall also include a statement 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.

5. Publication of Notice: Such notice and other documents shall also be placed on the website of the company, if any. In case of a listed company, these documents shall be sent to the SEBI where the securities of the companies are listed, for

placing on their website. The notice shall also be published in newspapers in such manner as may be prescribed.

Where 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.

6. **Notice to Regulators and Seeking their Representations:** The notice along with all the documents shall also be sent to all those regulatory authorities which are likely to be affected by the compromise or arrangement. These shall include (i) the Central Government; (ii) the income-tax authorities: (iii) the RBI; (iv) the SEBI; (v) the Registrar; (vi) the respective stock exchanges; (vii) the Official Liquidator; (viii) the Competition Commission of India, if necessary; and (ix) such other sectoral regulators or authorities.

   The notice shall require that representations, if any, to be made by them shall be made **within a period of 30 days** from the date of receipt of such notice. If they fail to do so, it shall be presumed that they have no representations to make on the proposals.

7. **Objection to the Proposed Scheme:** Any objection to the proposed scheme of compromise or arrangement may be made only by the following persons:

   (i) By persons holding not less than 10 per cent of the shareholding.

   (ii) By persons having outstanding debt amounting to not less than 5 per cent of the total outstanding debt as per the latest audited financial statement.

8. **Approval of the Scheme:** Where no creditor(s) or member(s) makes any objection to the scheme or where any objection made by them is satisfied, the scheme is put to vote for its approval. If of persons representing three-fourth in value of the creditors or class of creditors or members or class of members, as the case may be, agree to the scheme of compromise or arrangement, it is deemed to have been approved by them. The creditors/ members may vote on such motion of approval in person or by proxy or by postal ballot.

9. **Sanction to Scheme by Tribunal:** The Tribunal may sanction the scheme if majority of persons representing three-fourth in value of the creditors, or class of creditors or members or class of members, as the case may be, have agreed to it. The order sanctioning the scheme shall contain matters as specified under Section 230 (7) (given later). The Tribunal before making such order shall ensure that certain other requirements of law have been complied with.

10. **Sanctioned Scheme is Binding:** If such compromise or arrangement is sanctioned by the Tribunal, 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. In case of a company being wound up, the scheme shall be binding on the liquidator and the contributories of the company.

11. **Filing Order to Registrar:** The order of the Tribunal shall be filed with the Registrar by the company within a period of 30 days of the receipt of the order [Sec. 230(1) to (9)]

Matters to be provided in Tribunal's Order

The order of the Tribunal sanctioning a scheme of compromise or arrangement shall provide (as indicated in point 9 above) for **all or any of the following matters:**

(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 as per the provisions of (Section 48) of this Act.

(d) If the compromise or arrangement is agreed to by the creditors, any proceedings pending before the Board for Industrial and Financial Reconstruction Corporation 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 [Sec. 230 (7)].

Requirements for Sanction to Scheme by Tribunal

The Tribunal may sanction the scheme if it satisfied that the following requirements (as indicated in point 9 above) have been complied with:

(a) The **affidavit filed** by the company or any p (stated in point 2 above) making application for compromise or arrangement discloses all the facts and information required [230(2)].

(b) The scheme has been **approved by majority of persons representing three-fourth in value** of the creditors, or class of creditors or members or class of member as the case may be [23 0(6)].

(c) The company's auditor has filed with the Tribunal a certificate to the effect that the accounting treatment proposed in the **scheme is in conformity with the accounting standards** prescribed under (Section 133) the Act [to Sec. 230(7)].

(d) Where (he scheme of compromise or arrangement involves any **buy-back of securities it is in accordance with** the provisions of (Section 68) of this Act [230 (10)].

Before sanctioning the scheme the Tribunal also has to assure itself that the scheme is fair, just and reasonable. Moreover, the Tribunal must also ensure that the scheme is not Contrary to the law and public interest.

It may be noted that if a compromise or arrangement is sanctioned by the Tribunal, the same shall be binding on the company, all the creditors or members or class or class of creditors or members, as the case may be. In case of a company being wound up, such scheme shall be binding on the liquidator and the contributories of the company [230(6)].

Tribunal's Power to Enforce and Supervise Scheme

Where the Tribunal makes an order sanctioning a compromise or an arrangement, it shall have the following powers:

(a) Power to **supervise the implementation** of the compromise or arrangement.

(b) Power to **give necessary directions** in regard to any matter in the compromise or arrangement at the time of making the order or at any time thereafter.

(c) Power to make necessary modifications in the compromise or arrangement at the time of making the order or at any time thereafter.

These directions may be given or modifications may be made **for the proper implementation of the compromise or arrangement** [231(1)].

Winding up Order: Sometimes, the Tribunal is satisfied that (i) the sanctioned compromise or arrangement cannot be. implemented satisfactorily with, or without modifications, and (ii) the company is unable to pay its debts as per the scheme. In such a case, the Tribunal may make an order for winding up the company. Such an order shall be deemed to be an order made (under Section 273) for winding up of the company by the order of the Tribunal [231(2)].

Compromise/Arrangement Involving Takeover Offer

Any compromise or arrangement may include a takeover offer made in the prescribed manner. But in case of listed companies, takeover offer shall be as per the SEBI Regulations.

Application by Aggrieved Party: Any aggrieved party by the order of Tribunal may make an application to the Tribunal against the takeover offer involving any unlisted company but not any listed company. The Tribunal may, on application, pass such order as it may deem fit [Sec 230(11) and its proviso].

16.2 RECONSTRUCTION, MERGER AND AMALGAMATION

Reconstruction

Reconstruction of a company takes place when 'a company's business and undertaking are transferred to another company which is usually a newly formed company for that purpose. The new company substantially carries on the same business and the same persons are interested in it as in case, of the old company. Thus reconstruction implies the carrying on of the business of the old company in some altered form. A reconstruction may serve the following purposes:

(i) To alter the objects of the company radically. By reconstruction almost new objects may be adopted.

(ii) To make material alteration in the rights of a class of shareholders or creditors.

Merger

Merger means the merger of assets and liabilities of any company or companies into another existing company. Thus, merger takes place when any company transfers all its assets and liabilities to any other existing company. The transferor company is absorbed into that existing company. The transferor company loses its existence and the transferee

company survives. However, all the undertakings and plants of the transferor company may continue to operate independently with the absorbing or transferee company.

Thus, a merger means a merger by absorption of assets and liabilities. The Act explains in these words: In a scheme where 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 [to Sec. 232].

There is no particular meaning in the word 'reconstruction' or in the word, 'amalgamation'. It has to be found out from the scheme read as a whole whether it is a case of reconstruction or a case of amalgamation [Inland Steam Navigation Workers' v. Rivers Steam Navigation Co Ltd (1968) 38 Comp Cases 99 Cal].

Amalgamation

Amalgamation takes place when two or more, companies form a new company and their existence in it. In other words, two or more companies are blended with a new company. All blended companies lose their existence in favour of the new company. All the blended companies transfer their assets and liabilities to a new blending company.

Amalgamation is also called a merger by formation of a new company. The explains it in these words: 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 transferred to a new company, it is a merger by formation of a new company i.e. amalgamation [Explanation to Sec. 232].

Demerger

Demerger of a company means sub-dividing the company into smaller companies or splitting up of the company into more than one company. It also means separating one or more part of a company and constituting them into separate companies. The provisions of compromise or arrangement given in Section 230 allows for demerger of a company.

Demerger is undertaken basically for two reasons. The first one as an exercise in corporate restructuring and the second one is to give effect to a kind of family partitions in case of family owned/controlled companies to give effect to informal family partitions.

Where demerger is an exercise of corporate restructuring the undertaking sought to be demerged is transferred from a transferor company to an existing transferee company. But where demerger is an exercise in family partition the different 'undertakings' of a company is transferred to a newly incorporated transferee companies to facilitate family partitions.

Difference between Merger and Amalgamation

Though both merger and amalgamation differ in the method of their formation, but there is no difference between their objectives. A merger ends the identity of the merging companies. The identity of absorbing company remains intact. On the other hand, in case

of amalgamation, identity of all the companies came to end and their assets and liabilities are transferred to a newly formed company.

16.3 MALGAMATION INVOLVING SALE OF UNDERTAKING

The following are the provisions and steps that a company shall comply with/take in case of reinstitution, merger or amalgamation (involving transfer of assets and liabilities to another company) of a company:

1. **Conditions for Order for Meeting:** Sometimes, 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 member or creditor or any class of them. In such a case, if the following facts are shown to the Tribunal by the applicants, it may **order a meeting of the creditors or the members or class of creditors or members:**

   (a) That the proposed compromise or arrangement involves a scheme for reconstruction of the company or merger or amalgamation of two or more companies.

   (b) That as a result of the scheme, the whole or any part of the undertaking, property or liabilities of any company (transferor company) is to be transferred to another company (transferee company) or is proposed to be divided among and transferred to two or more companies.

2. **Holding Meeting of Members or Creditors:** The meeting shall 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 (indicated in points 4 to 8 under the procedure for compromise or arrangement)) shall apply *mutatis mutandis* [Sec. 232(1)].

3. **Circulating the Documents for Members/Creditors' Meeting:** When an order has been made by the Tribunal, 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: -

   (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 the 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 6 months before the first meeting of the company summoned for the purposes of approving the scheme [Sec. 232(2)].

4. **Sanction of Scheme by Tribunal:** The Tribunal, after satisfying itself that the specified procedure has been complied with, may, by order, sanction the

compromise or arrangement or by a subsequent order, make provision for the following matters:

(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. However, the Tribunal may after recording the reasons in writing for the same decide 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.

However, 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 dissent from the compromise or arrangement.

(f) Where share capital is held by any non-resident shareholder (under the foreign 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 trans1 of the employees of the transferor company to the transferee company

(h) Where the transtctionig company s a listed company and the transferee company is an unlisted company the transferee company shall remain an unlisted company until it becomes a listed company.

Sometimes the trancfer or company is a listed company and the transferee company is an unlisted company and the shareholders of the transferor company decide to opt out of the transferee company. In such a case, provision shall be made for payment of the value shares held by them and other benefit in accordance with a pre-determined price formii1a or after a valuation is made. The arrangements under this provision may be made by the Tribunal.

However, the amount of payment or valuation under this clause for any share shall not be Less than what has been specified by the *SEBI Regulations.*

(i) Where the transferor company is dissolved, the fee if any, paid by the transferor company on its authorized capital shall be set-off against any fees payable by the transferee company on its authorized capital subsequent to the amalgamation.

(ii) Such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out [232(3)].

5. **Auditors Certificate as to Conformity with the 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) of this Act [to Sec. 232(3)1.;

6. **Transfer of Property or Liabilities:** Sometimes, an order provides for the transfer of any property or liabilities. In such a case, that property shall be transferred to the transferee: company and the liabilities shall become the liabilities of the transferee company. Moreover, if the order so directs, any property which is subject to charge shall be freed from the charge.

7. **Filing Copy of Order with the Registrar:** 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 30 days of the receipt of certified copy of the order [232(5)].

8. **Effective Date of the Scheme:** The scheme shall clearly indicate an appointed date from which it shall he effective. The scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date [Sec. 23 2(6)].

9. **Filing Annual Certified Statement:** Every company in relation to which the order is made shall, until the completion of the scheme, file a statement in the prescribed form and within the prescribed time with the Registrar every year. It shall be duly certified by a CA or a CWA or a CS in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not [232(7)].

10. **Punishment:** If a transferor company or a transferee company contravenes the above provisions the default company shall be punishable with fine which shall not be less than 1 lakh but which may extend to 25 lakh. Moreover, every officer of such 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 less than l lakh hut which may extend to 3 lakh, or with both [232(8)].

16.4 SUM UP

When a company has a dispute with a member or class of members or with a creditor or class of creditors a scheme of compromise is drawn up. Arrangement means readjustment or rearrangement or reorganization of rights or liabilities of parties without existence of any dispute between them. Reconstruction of a company takes place when a company's business and undertaking are transferred to another company. Which is usually a newly formed company. Merger takes place when any company transfers all its assists and liabilities is any other existing company. Amalgamation takes place when two or more companies for a new company. Demerge means separating one or more parts of a company and constituting the min to speedy companies.

16.5 KEY WORDS

Re-construction: Carrying on of the business of the old company in some altered form.

Merger: Means merger of assets and liabilities of any company with another existing company.

Demerger : Splitting up of the company in to more has one company.

16.6 CHECK YOUR PROGRESS

1) Define arrangement and list the steps in volved in it.

2) Describe reconstruction, an algemention and merger.

3) Explain the procedure of amalgamation.

16.7 REFERENCES

1) N.D. Kapoor, Business Law, New Age.

2) Gulshan, Business Law, Excel.

3) Sarvanaved and Mahapatra, HPH.

16.8 TERMINAL QUESTIONS

1) List the steps involved in compromise and arrangement.

2) Distinguish between reconstruction, merger and amalgamation.

3) Describe the procedure of amalgamation/merger involving transfer of undertaking or liabilities of a company to another company.

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