

EXECUTIVE PROGRAMME
STUDY MATERIAL

COMPANY LAW

MODULE II - PAPER 4



**THE INSTITUTE OF
Company Secretaries of India**

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

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EXECUTIVE PROGRAMME

COMPANY LAW

In view of increasing emphasis on adherence to norms of good corporate governance, Company Law assumes an added importance in the corporate legislative milieu, as it deals with structure, management, administration and conduct of affairs of Companies. A thorough study of various provisions of the Companies Act is a must for becoming a competent and efficient Company Secretary. In the light of this, the study material has been published to impart thorough knowledge to the students preparing for the Company Law paper of the CS Executive Programme. The purpose of this study material is to develop an understanding of the regulation of registered companies and to provide thorough understanding of the various provisions of the Company Law as well as Schedules and Rules made thereunder including their interpretation through case laws, departmental clarifications etc. Additionally this study material also provides conceptual understanding of the principles of Cooperatives Law.

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

The amendments made upto December, 2011 have been incorporated in this study material. However, it may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the 'Student Company Secretary', Chartered Secretary and other publications for updation of study material. In the event of any doubt, students may contact the Directorate of Academics and Professional Development in the Institute for clarification.

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

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

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EXECUTIVE PROGRAMME
SYLLABUS
FOR
PAPER 4: COMPANY LAW

Level of knowledge : Expert knowledge.

Objective: To develop an understanding of the regulation of companies and to provide thorough knowledge of the various provisions of the Company Law in India as well as Schedules and Rules made thereunder including their interpretation through case laws, departmental circulars, clarifications, notifications, etc.

Detailed contents :

1. Introduction

Nature and form of business enterprise; types of business enterprises; company – definition and nature.

Historical development of corporate concepts; emergence of principles of limited liability and development of Company Law in England and India.

Concept of corporate personality; corporate veil and its lifting.

Working and administration of Company Law.

2. Incorporation and its Consequences

Types of companies and their incorporation; memorandum and articles of association and their alteration; registered office; publication of name; commencement of business; contracts; deeds; common seal; effect of incorporation.

Re-registration and registration of unregistered joint-stock companies.

The doctrine of *ultra-vires*, constructive notice and indoor management.

Promoters - meaning and importance; position, duties and liabilities.

3. Financial Structure

Concept of capital and financing of companies, sources of capital; classes and types of shares; equity with differential rights; issue of shares at par, premium and discount; forfeiture and surrender of shares; bonus issues; rights issues; issue of sweat equity shares; employees stock option scheme; private placement.

Alteration of share capital; reduction of capital; buy-back of shares.

Debt capital - debentures, debenture stock, bonds; new developments in corporate debt financing; debenture trust deed and trustees; conversion of and redemption of debentures.

Securing of debts – creation, modification and satisfaction of charges.

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Prospectus – definition; abridged prospectus; red-herring prospectus; shelf prospectus; information memorandum; contents, registration, misrepresentations and penalties.

Allotment and certificates - contracts to subscribe for shares, debentures and other securities; calls; share certificates and share warrants.

4. Membership, Depositories and Transfer/Transmission

Membership - modes of acquiring membership; rights and privileges of members, register of members; dematerialisation and rematerialisation of securities; transfer and transmission of securities in physical and depository modes; nomination.

5. Management and Control of Companies

Directors – appointment/re-appointment, qualifications, disqualifications, remuneration, vacation of office, retirement, resignation and removal; loans to directors; powers and duties; office or place of profit; role of directors; contracts in which directors are interested.

Managing and whole-time directors and manager.

Company secretary – appointment, role and responsibilities; company secretary as a principal officer.

Meetings of directors and committees - frequency, convening, and proceedings of Board/Committee meetings; tele and video-conferencing of Board/ Committee(s); resolution by circulation; minutes and evidence.

General meetings - kinds of meetings; law, practice and procedure relating to convening and proceedings at general and other meetings – notice, quorum, proxy, voting including voting through electronic means, resolutions, circulation of members' resolution, etc.; postal ballot; recording, signing and inspection of minutes; role of chairman.

Distribution of powers of a company - division of powers between Board and general meetings; acts by directors in excess of authority; monitoring and management.

Sole Selling and Buying Agents - Meaning, appointment and reappointment, removal; powers of Central Government and rules framed for the purpose.

6. Dividend

Profit and ascertainment of divisible profits; declaration and payment of dividend; treatment of unpaid and unclaimed dividend; transfer of unpaid and unclaimed dividend to Investor Education and Protection Fund.

7. Investments, Loans and Deposits

Law relating to making investments in and granting loans to other bodies corporate and giving guarantees and providing security.

Invitation, acceptance, renewal, repayment, default and remedies.

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8. Accounts and Audit

Books of account; financial statements; audit and auditor's report; powers of the Central Government to direct special audit; cost audit.

Auditors - appointment, resignation and removal; qualification and disqualification; rights, duties and liabilities.

9. Board's Report and Disclosures – preparation; disclosures; directors' responsibility statement.

Compliance certificate – need and purpose; issue and signing by practising company secretary; disclosure and filing.

10. Registers and Returns – maintenance, authentication, presentation and inspection of statutory books/registers prescribed under various provisions of the company law and filing of various forms/returns to Registrar of Companies; procedure and penalties for delayed filing, etc.

Annual Return – Nature and significance; contents; filling – preparation and disclosures; signing, certification and filing; maintenance, place of keeping and its inspection.

11. Inspection and Investigation

Inspection of documents, books of account, registers etc; powers of the inspector, seizure of books and documents, inspector's report; power of the Registrar of Companies, investigation into affairs of the company.

12. Majority Rule and Minority Rights

Law relating to majority powers and minority rights.

Shareholder remedies - actions by shareholders; statutory remedies; personal actions; prevention of oppression and mis-management.

13. Compromises and Arrangements – an overview.

14. Societies, Co-operative Societies, Trusts, Producer Companies and Limited Liability Partnerships

Concept, formation, membership, functioning and dissolution.

15. Application of Company Law to Different Sectors such as Banking, Insurance, etc.

16. Offences and Penalties – an overview.

17. Striking off Name of Companies.

Concept.

18. Winding up of Companies

Concept and modes.

19. An Introduction to E-governance

20. Secretarial Standards

LIST OF RECOMMENDED BOOKS

COMPANY LAW

Readings:

1. Dr. Avtar Singh : Company Law; Eastern Book Company, 34, Lalbagh, Lucknow – 226 001
2. A. Ramaiya : Guide to Companies Act; Wadhwa & Company Nagpur.
3. B.K. Sen Gupta : Company Law; Eastern Law House, 54, Ganesh Chunder Avenue, Kolkata (Calcutta) 700013.
4. ICSI Publication : Manual on Capital Issues (in the Light of SEBI Guidelines)
5. Dr. Avadesh Ojha, CS. Amit Baxi : Company & Security Laws Practice Compendium, The Tax Publishers "Kedarnath", 7, Avadh Vihar, Chopasani Road, Jodhpur-342 009.
6. A.K. Majumdar, Dr. G.K. Kapoor : Company Law and Practice; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
7. P.K. Ghosh & V. Balachandran : Company Law and Practice; Sultan Chand & Sons, 23, Daryaganj, New Delhi-110 002.
8. M.C. Kuchhal : Modern Indian Company Law; Shri Mahavir Book Depot, 2603, Nai Sarak, Delhi-110 033.
9. Ashok K. Bagnal : Company Law, Vikas Publishing House Pvt. Ltd., A-122, Sector 4, Noida.

References:

1. Taxmann : Company Law Ready Reckoner; Taxmann Publication (P) Ltd., 59/32, New Rohtak Road, New Delhi-110 005.
2. Palmer : Company Law (Vol. 1); Stevens & Sons Ltd., London.
3. L.C.B. Gower : Principles of Modern Company Law; Stevens & Sons Ltd., London.
5. Bare Act : Corporate Laws; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.

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Journals:

1. Chartered Secretary : ICSI, New Delhi
2. Student Company Secretary : ICSI, New Delhi
3. Corporate Law Adviser : Corporate Law Advisers, Post Bag No. 3, Vasant Vihar, New Delhi.
4. Company Law Journal : L.M. Sharma, Post Box No. 2693, New Delhi – 110 005

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

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29.	Law relating to Co-operatives, Societies and Trusts
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33.	Offences and Penalties
34.	Striking off Name of Companies
35.	Winding Up of Companies
36.	An Introduction to E-Governance
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COMPANY LAW

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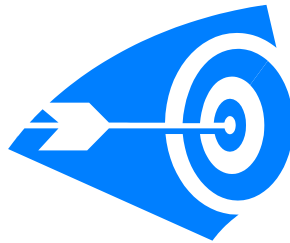
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STUDY I
INTRODUCTION

LEARNING OBJECTIVES



This chapter deals with the company as a form of organization. It explains the nature and characteristics of a company. It also discussed the circumstances in which an association can be described as an illegal association. Further, it laid down the situations in which a corporate veil can be lifted by the court.

At the end of this chapter, students will be able to understand:

- Definition of a company.
- Nature and characteristics of a company.
- History of Company Law in India and England.
- The development of Indian Company Law along with various amendments to it including the Companies (Amendment) Act, 2006.
- Forms and types of business enterprises.
- Distinction between a company and other business enterprises.
- Advantages and disadvantages of corporate form of enterprises.
- Lifting of Corporate Veil.
- Personal liability of directors or members.
- Illegal association.
- Nature of corporate form of organization.

1. COMPANY AS A BUSINESS MEDIUM

Meaning of a Company

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

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

The incorporated company owes its existence either to a special Act of Parliament or to company legislation. The public corporations like Life Insurance Corporation of India and Damodar Valley Corporation have been brought into existence through special Acts of Parliament, whereas companies like Tata Iron and Steel Co. Ltd., Reliance Industries Limited have been formed under the Company's Legislation i.e. Companies Act, 1956. The trading partnership which is governed by Partnership Act is the most apt example of an unincorporated association.

In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. In terms of the Companies Act, 1956 (Act No. 1 of 1956) [hereinafter referred to as the Act] a "company means a company formed and registered under the Companies Act, 1956 or under the previous laws relating to companies" [Section 3(1)(ii)]. In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. However, an association formed not for profit acquires a corporate life and falls within the meaning of a company by reason of a licence under Section 25(1) of the Act.

But a company is not merely a legal institution. It is rather a legal device for the attainment of any social or economic end. It is, therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organisation in the conduct of an enterprise". It is "an intricate, centralised, economic and administrative structure run by professional managers who hire capital from the investor(s)". Lord Justice James has defined a company as "an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his "share".

From the foregoing discussion it is clear that a company has its own corporate and legal personality distinct and separate from that of its members. A brief description of the various attributes is given here to explain the nature and characteristics of the company as a corporate body.

Nature and Characteristics of a Company

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

The most striking characteristics of a company are:

(i) Corporate personality

By incorporation under the Act, the company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different 'person' from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners but they can be its creditors simultaneously as it has a separate legal entity. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. Thus, 'incorporation' is the act of forming a legal corporation as a juristic person. A juristic person is in law also conferred with rights and obligations and is dealt with in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law [*Shiromani Gurdwara Prabandhak Committee v. Shri Sam Nath Dass* AIR 2000 SCW 139].

CASE EXAMPLE 1.1

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

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

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

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

Their Lordships of the House of Lords observed:

“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 statute can lose 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 statute enacts nothing as to the extent or degree of interest which may be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of company.”

CASE EXAMPLE 1.2

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

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

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

CASE EXAMPLE 1.3***New Horizons Ltd. v. Union of India, AIR 1994, Delhi 126***

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

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

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

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

TEST YOUR KNOWLEDGE 1.1**State whether the following statement is “True” or “False”**

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

- True
- False

Correct Answer: True

(ii) Limited Liability

“The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organisation.” The company, being a separate person, is the owner of its assets and bound by its liabilities. The liability of a member as shareholder, extends to contribution to the assets of the company up to the nominal value of the shares held and not paid by him. Members, even as a whole, are neither the owners of the company’s

undertakings, nor liable for its debts. In other words, a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited. For example, if A holds shares of the total nominal value of Rs. 1,000 and has already paid Rs. 500/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than Rs. 500/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent. In the case of a company limited by guarantee, the liability of members is limited to a specified amount mentioned in the memorandum.

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

There are, however, some statutory exceptions to the principle of limited liability. As provided by Section 45 of the Companies Act, 1956, the members become personally liable if the membership falls below prescribed minimum and the business is carried on for more than six months thereafter. It is also provided in the Act vide Section 323 that a limited company may, if so authorised by its articles, alter its memorandum by special resolution so as to render the liability of its directors or of any of its director or manager as unlimited. Further, where in the course of winding up it appears that any business of the company has been carried on with intent to defraud creditors, the Court may declare the persons who were knowingly parties to the transaction as personally liable without limitation of liability for all or any of the debts/liabilities of the company.

(iii) Perpetual Succession

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

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

(iv) Separate Property

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

CASE EXAMPLE 1.4

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

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

(v) Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. When the joint stock companies were established, the object was that their shares should be capable of being easily transferred, [In *Re. Balia and San Francisco Rly.*, (1968) L.R. 3 Q.B. 588]. Section 82 of the Companies Act, 1956 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles. If the articles do not provide anything for the transfer of shares and the Regulations contained in Table “A” in Schedule I to the Companies Act, 1956, are also expressly excluded, the transfer of shares will be governed by the general law relating to transfer of movable property.

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

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

(vi) Common Seal

On incorporation, a company acquires legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The Common Seal acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company is not authentic and has no legal force behind it.

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

TEST YOUR KNOWLEDGE 1.2

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

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

- True
- False

Correct Answer: True

(vii) Capacity to Sue and Be Sued

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

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

(viii) Contractual Rights

A company, being a separate legal entity different from its members, can enter into contracts for the conduct of the business in its own name. A shareholder cannot enforce a contract made by his company; he is neither a party to the contract nor

entitled to the benefit of it, as a company is not a trustee for its shareholders. Likewise, a shareholder cannot be sued on contracts made by his company. The distinction between a company and its members is not confined to the rules of privity, however, it permeates the whole law of contract. Thus, if a director fails to disclose a breach of his duties to his company, and in consequence a shareholder is induced to enter into a contract with the director which he would not have entered into had there been disclosure, the shareholder cannot rescind the contract.

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

(ix) Limitation of Action

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

(x) Separate Management

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

(xi) Voluntary Association for Profit

A company is a voluntary association for profit. It is formed for the accomplishment of some public goals and whatsoever profit is gained is divided among its shareholders or restored for the future expansion of the company. Only a Section 25 company can be formed with no profit motive.

(xii) Termination of Existence

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

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

2. BRIEF HISTORY OF COMPANY LAW IN INDIA AND ENGLAND

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

Background of English Company Law

The history of modern company law in England began in 1844 when the *Joint Stock Companies Act* was passed. The Act provided for the first time that a company could be incorporated by registration without obtaining a Royal Charter or sanction by a special Act of Parliament. The office of the Registrar of Joint Stock Companies was also created. But the Act denied to the members the facility of limited liability. The English Parliament in 1855 passed the Limited Liability Act providing for limited liability to the members of a registered company. The Act of 1844 was superseded by a comprehensive Act of 1856 which marked the beginning of a new era in company law in England. This Act introduced the modern mode of creating companies by means of Memorandum and Articles of Associations.

The first enactment to bear the title "Companies Act" was the Companies Act, 1862. By these Acts some of the modern provisions of a company were clearly laid down. Firstly, two documents, namely, (a) the Memorandum of association, and (b) the Articles of association formed the integral part for the formation of a limited liability company. Secondly, a company could be formed with liability limited by guarantee. Thirdly, any alteration in the object clause of the memorandum of association was prohibited. Provisions for winding-up were also introduced. Thus, the basic structure of the company as we know had taken shape. Sir Francis Palmer described this Act as the "*magna carta* of co-operative enterprises".

The Companies (Memorandum and Association) Act, 1890 made relaxation with regard to change in the object clause under the leave of the Court obtained on the basis of special resolution passed by the members in general meeting. Then the liability of the directors of a company was introduced by the Directors' Liability Act, 1890, and the compulsory audit of the company's accounts was enforced under the Companies Act, 1900.

The concept of private company was introduced for the first time in the Companies Act, 1908. The earlier ones were called public companies. Two subsequent Acts were passed in 1908 and in 1929 to consolidate the earlier Acts. The Companies Act, 1948 which was the Principal Act in force in England then was based on the report of a Committee under Lord Cohen. The Act introduced *inter alia* another new form of company known as exempt private company.

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

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

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

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

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

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

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

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

The U.K. company law has further been amended and has been substituted by U.K. Companies Act, 2006 (which received Royal Assent on November 8, 2006). The

Act has been brought into force in stages and circumscribes enhanced duties of directors, simpler regime for private companies, increased use of e-communication, enhanced auditor liabilities etc.

TEST YOUR KNOWLEDGE 1.3

What are the principles behind amendment of UK Companies Act in the year 2006.

- (a) Insider dealing was made a criminal offence.
- (b) Simpler regime for private companies.
- (c) Increased use of e-communication.
- (d) Dealings between the Directors and their companies became greatly restricted.

Correct answer: b and c

Development of Indian Company Law

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

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

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

The Companies Act, 1956 has undergone changes by amendments in 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1971, 1977, 1985, 1988, 1996, 1999,

2000, 2002 (Amendment), 2002 (Second Amendment), and 2006. The Companies Act, 1956 was also amended by enactment of Depositories Act, 1996.

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

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

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

The Companies Act was amended twice in 1966. These amendments consisted of four sections only.

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

The Companies (Amendment) Act, 1974 which came into force from February 1, 1975 had introduced some important and major changes in the Companies Act, 1956.

The object of the Amendment Act was to inject an element of public interest in the working of the corporate sector. The important changes introduced by the Amendment Act of 1974 are given below:

1. Deemed to be public limited companies.
2. Acceptance of deposits from the public to be in accordance with the Rules.
3. Maintenance of a separate account for unclaimed dividend by public limited companies.
4. Control over foreign-owned companies brought within the purview of the Act.
5. Appointment of Company Law Board benches in metropolitan cities.
6. Power to prohibit the appointment of a sole-selling agent by Central Government.
7. Appointment of a whole-time secretary.

The Companies (Amendment) Act of 1977 brought about certain changes in Sections 58A, 220, 293, 620 and 634A. The amended Section 58A empowered the Central Government to grant extension of time or to exempt any company in deserving cases from all or any of the provisions of Section 58A. Section 293 empowered a company to make donations for charitable purposes upto 5 per cent of

its average net profit or upto Rs. 25,000 whichever was higher. This section as amended by the Act of 1977 raised the ceiling to Rs. 50,000.

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

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

In order to give effect to the recommendations of the Committee on Subordinate Legislations (Seventh Lok Sabha) that the Company Law Board should be empowered to reassess compensation on appeal from the order of the prescribed authority assessing the compensation payable under an order of amalgamation under Section 396, and that the order of amalgamation itself may provide for the continuation of any pending legal proceeding by or against the transferee company on the lines of the existing provisions of Section 394 of the Act under which the High Court orders amalgamation, Section 396 of the Act was amended.

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

It was for the first time that the Companies Act provided that every public company of a certain size shall have a managing or whole-time director. The companies were also given freedom to fix the managerial remuneration on the basis of certain limits.

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

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

The concept of company secretary in practice was introduced for the first time in the Companies Act. A practising secretary has been authorised to file declaration of compliance under Sections 33 and 149. Every listed company is required to file annual return under Section 161 which must also be signed by a practising secretary apart from other signatories. In the absence of a company secretary, the practising secretary may also certify that the requirements of Schedule XIII have been complied with.

The amended Act, among other things, also set up an independent Company Law Board to exercise such judicial and quasi-judicial functions, earlier being exercised either by the Court or the Central Government.

It also dispensed with the requirement of getting Government approval for managerial appointments and remuneration subject to the fulfillment of certain statutory guidelines which were incorporated in the Act itself.

It delinked the rates of depreciation from the rates specified under the Income-tax Act and laid down rates of depreciation in the Act itself to reflect the true and fair view of the state of affairs of the company.

3. AMENDMENTS MADE TO THE COMPANIES ACT BY THE DEPOSITORIES ACT, 1996

- (1) Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company. [Section 41(3)]
- (2) Section 83 was repealed, as requirement of distinguishing each share in a company by an appropriate number is no more mandatory. However, section 83 was reintroduced by the Depositories Related Laws (Amendment) Act, 1997.
- (3) Stamping of transfer instruments is not required where both the transferor and transferee are entered as beneficial owners in the records of a depository. [Section 111(13)]
- (4) Power of company to refuse to register transfer of shares would apply to a private company only. [Section 111(14)]
- (5) The securities of a company other than a private company have been made freely transferable. The transfer has to be effected immediately by the company/depository. However, if it is provided that the transfer is in contravention of SEBI Act/SICA the aggrieved party can move to CLB to determine if the alleged contravention has taken place. [Section 111A]
- (6) The register of members shall indicate the shares held by a member in demat mode but such shares need not be distinguished by a distinct number. [Section 150(1)(b)].
- (7) The register of debentureholders shall indicate the debentures held by a holder in demat form but such debentures need not be distinguished by distinct numbers.
- (8) The company is required to indicate in the offer document that an investor has the option to subscribe for securities in the demat mode.
- (9) Sections 153, 153A, 153B, 187B, 187C and 372 of the Companies Act made inapplicable to the securities held in a depository on behalf of the beneficial owners.

4. THE COMPANIES (AMENDMENT) ACT, 1999—SALIENT FEATURES

- The Infrastructure Development Finance Company Limited recognised as one of the Public Financial Institutions.
- Companies allowed to buy-back their own securities.
- Companies enabled to issue Sweat Equity shares.
- Facility for nomination provided for the benefit of share/debenture/deposit holders.
- An Investor Education and Protection Fund proposed to be established.
- National Advisory Committee on Accounting Standards for companies proposed to be established.
- Companies freed from obtaining prior approval of Central Government for their intercorporate investment/lending proposals.

5. THE COMPANIES (AMENDMENT) ACT, 2000—SALIENT FEATURES

The major provisions of this Amendment Act, in brief, are as under:

- (1) Private Companies and Public Companies to have a minimum paid-up capital of Rupees one lakh and five lakh respectively. This is also applicable to existing companies.
- (2) Change of place of registered office from the jurisdiction of one Registrar of Companies to another Registrar of Companies within the same state requires confirmation from the Regional Director.
- (3) Provisions relating to deemed public companies (Section 43A companies) became inoperative and a new sub-section (2A) relating to conversion of a public company to a private company on or after the commencement of Companies (Amendment) Act, 2000 inserted in the Companies Act, 1956.
- (4) SEBI entrusted with powers with regard to issue and transfer of securities and non-payment of dividend by listed public companies.
- (5) Certain measures included for protecting the interest of small depositors in a company.
- (6) Preferential offer/Private placement of securities to 50 (fifty) persons or more treated as public issue. This shall not apply to a preferential offer made by public financial institutions and NBFCs.
- (7) Provisions for issuing equity share capital with differential rights as to dividend, voting or otherwise included in the Act.
- (8) Provisions relating to 'shelf-prospectus' and information memorandum included in the Act.
- (9) Every listed company making initial public offer of any security for a sum of Rupees ten crores or more will have to issue the same only in a dematerialised form.
- (10) Specific provisions for appointment of Debenture Trustees, liability of the company to create security and debenture redemption reserve included in the Act.
- (11) Provisions for appointment of Public Trustees by the Central Government deleted with a view to enable the Trusts to directly exercise their voting power. Similarly, provisions relating to declaration of beneficial interest by registered holders also deleted.
- (12) With a view to ensuring good corporate governance, voting through postal ballot for important items (as may be notified) were prescribed.
- (13) The period for disbursing dividend including interim dividend reduced to thirty (30) days from the date of declaration of dividend. The amount of dividend declared to be deposited in a separate bank account within five days from the date of declaration of such dividend.
- (14) Board of directors' report to include a Directors' Responsibility Statement to highlight the accountability of directors with a view to ensure good corporate governance.
- (15) Private companies to be excluded in reckoning the number of companies which an auditor can audit.

- (16) A holder of security which carries voting rights in a company to be disqualified for appointment as an auditor of the said company.
- (17) Auditors to report 'in thick type or in italics' their observations which have an adverse effect on the functioning of the company.
- (18) A public company having a paid-up share capital of five crore rupees or more and one thousand or more small shareholders may appoint at least one director elected by small shareholders (holding shares of nominal value of Rs. 20,000 or less) on the Board of the said company.
- (19) No person can hold office of director in more than 15 (fifteen) companies at a time.
- (20) Every public company having paid up capital of not less than rupees five crores shall constitute 'Audit Committee' of the Board.
- (21) For the purpose of managerial remuneration the amount of depreciation to be the same as provided in Profit and Loss Account of the Company.
- (22) Companies with paid-up share capital of Rs. 10 lakhs or more and which are not required to have wholetime secretary in their employment required to file a Compliance Certificate from a Secretary in whole-time practice with Registrar of Companies. A copy of such certificate shall also be attached with Directors' Report.
- (23) Certain new expressions defined in the Act e.g. abridged prospectus, shelf prospectus, depository, information memorandum, dividend etc.
- (24) As a thumb rule, penal provisions (fiscal penalties) contained under various sections of the Companies Act, 1956 were increased ten fold.

6. COMPANIES (AMENDMENT) ACT, 2002 AND COMPANIES (SECOND AMENDMENT) ACT, 2002 — SALIENT FEATURES

- 1. New Part IXA consisting of Section 581A to 581ZT relating to Producer Companies inserted vide Companies (Amendment) Act, 2002 effective from 6.2.2003.
- 2. The existing Company Law Board is proposed to be dissolved and in its place a National Company Law Tribunal (Tribunal) is to be constituted.
- 3. Substantial enhancement in the number of members of the Tribunal. Similarly, the number of Benches would also increase.
- 4. The Tribunal will consist of a President and Judicial and Technical Members. The maximum number of members should not exceed sixty-two. The actual number will be decided by the Central Government, as it may deem fit. The appointments will be done by the Government, by notification in the *Official Gazette*.
- 5. Setting up of National Company Law Appellate Tribunal (Appellate Tribunal). Appeals against the orders of the Tribunal can be filed with the Appellate Tribunal. Further appeal against the orders of the Appellate Tribunal would lie to the Supreme Court.
- 6. The Board for Industrial and Financial Reconstruction is to be abolished and SICA will be repealed.

7. Transfer of all the powers from the BIFR to the Tribunal.
8. Transfer of certain powers of the High Court to the Tribunal.
9. Greater role for professionals in the administration of Company Law.
10. The Amendment Act seeks to transfer powers relating to winding up, mergers and amalgamations from the Court to the Tribunal.
11. The definition of a "sick industrial company" to be changed and it shall mean an industrial company which has:
 - (i) the accumulated losses in any financial year equal to fifty per cent or more of its average net worth during four years immediately preceding such financial years; or
 - (ii) failed to repay its debts within any three consecutive quarters on demand for its repayment by a creditor or creditors of such company.
12. The Amendment Act has introduced a new provision for imposition of cess. Under Sections 441A to 441G, every company will be required to pay cess at such rate as may be decided by the Central Government. The amount so collected is proposed to be utilised for the revival and the rehabilitation of sick industrial companies. The amount will be first credited into the Consolidated Fund of India. Later, as may be approved by the Parliament, the amount so approved will be credited to a specially created Fund. Assistance to sick industrial companies will be provided out of the said Fund. The power to distribute the amount out of the said fund is vested in the Tribunal.
13. Several powers that were earlier exercised by the Company Law Board are to be transferred to the Central Government, including granting of approval for shifting of registered office from one State to another State, extension of time for filing of charges, permission for holding Annual General Meeting, etc.

7. THE COMPANIES (AMENDMENT) ACT, 2006

The Companies (Amendment) Bill, 2006 was introduced and passed by the Parliament in May, 2006. The Bill received President's assent on 29th May 2006. Section 4 of the Act, which proposed to insert new Sections 610B, 610C, 610D and 610E was made effective from 16th September 2006 [vide S.O.No.1529E dated 14.9.2006]. Sections 2 and 3 of the Act pertaining to Director Identification Number (DIN) have been made effective from 1st November 2006 [vide GSR 648(E) dated 19.10.2006].

Salient features of the provisions of Companies (Amendment) Act, 2006 are as follows:

Director Identification Number (DIN)

- Director Identification Number (DIN) to be obtained by all existing directors and every other person, intending to become a director.
- DIN to be allotted by the Central Government within one month from the receipt of application for allotment of DIN.

- Individuals prohibited to apply, obtain or possess more than one DIN.
- Every existing Director to intimate his DIN to the company or all companies wherein he is a director, within one month of receipt of DIN.
- Intimation of DIN, to the Registrar or any other officer or other specified authority by every company, within one week of the receipt of intimation by the Director. Intimation to be given in prescribed form and manner.
- DIN to be quoted by every person or company while furnishing any return, information or particulars required to be furnished under the Act, if such return etc. relate to the director or contain any reference of the director.

Filing of applications, documents inspection etc. through electronic form

- The applications, balance sheet, prospectus, return, declaration, memorandum and articles of association, particulars of charges or any other particulars or document required to be filed or delivered under this Act or rules made thereunder, are to be filed through electronic form and authenticated in a manner specified in the rules.
- The document, notice, any communication or intimation, required to be served or delivered under the Act, should be served or delivered through the electronic form and authenticated in manner specified in the rules.
- The applications, balance sheet, prospectus, return, register, memorandum and articles of association, particulars of charges or any other document and return filed under the Act or rules made thereunder shall be maintained by Registrar in electronic form and registered or authenticated in manner specified in the Rules.
- The inspection of the MOA, AOA, register, index, balance-sheet, return or any other document maintained in the electronic form, which is otherwise available for such inspection under the Act or rules made thereunder, may be made by any person through electronic form as may be specified in the rules.
- Fees, charges or other sums, payable under the Act or rules made thereunder, shall be paid electronically and in such manner as may be specified in the rules.
- Registrar shall register change of registered office, alteration of MOA or AOA, prospectus, issue certificate of incorporation or certificate of commencement of business, register such document, issue such certificate, record notice, receive such communication required to be registered or issued or recorded or received, as the case may be, under this Act or rules made thereunder by electronic form, in the manner as may be specified in the rules.

Providing of value added services through electronic form

- Central Government may provide such value added services through the electronic form and levy such fees as may be prescribed.

Application of provisions of Information Technology Act, 2000

- All the provisions of Information Technology Act, 2000 relating to the

electronic records (including the manner and format in which the electronic records shall be filed), in so far as they are not inconsistent with this Act, shall apply to the records in electronic form.

8. HIGHLIGHTS OF THE COMPANIES BILL, 2011

[Introduced in Lok Sabha on 14th December 2011(Bill no. 121 of 2011)]

- The Bill has 470 clauses and 7 schedules as against 658 Sections and 15 schedules in the existing Companies Act, 1956.
- The entire bill has been divided into 29 chapters.
- Following chapters have been introduced, viz.
 - Registered Valuers
 - Government companies
 - Companies to furnish information or statistics
 - Nidhis
 - National Company Law Tribunal & Appellate Tribunal
 - Special Courts
- The Bill empowers Central Government to make rules, etc. through delegated legislation after having detailed consultative process
- The Bill provides for self-regulatory process and stringent compliance regime.

9. COMPANY AS DISTINGUISHED FROM OTHER BUSINESS ENTERPRISES

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

Distinction between Company and Partnership

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

- (1) A company is a distinct legal person. A partnership firm is not distinct from the several persons who compose it.
- (2) In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals comprising it.
- (3) Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.
- (4) Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business. A member of a company has no such power.

- (5) A partner cannot contract with his firm, whereas a member of a company can.
- (6) A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.
- (7) Restrictions on a partner's authority contained in the partnership contract do not bind outsiders; whereas such restrictions incorporated in the Articles are effective, because the public are bound to acquaint themselves with them.
- (8) A partner's liability is always unlimited whereas that of shareholder may be limited either by shares or a guarantee.
- (9) A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.
- (10) A company may have any number of members except in the case of a private company which cannot have more than fifty members (excluding past and present employee members). In a public company there must not be less than seven persons and in a private company not less than two. On the other hand, a partnership firm cannot have more than 20 members in any business and 10 in the case of banking business.
- (11) A company is legally required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.
- (12) A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement.

Distinction between Company and Hindu Joint Family Business

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

Distinction between Company and Corporation

Generally speaking, an association of persons incorporated according to the relevant law and clothed with legal personality separate from the persons constituting it is known as a corporation. The word 'corporation' or words 'body corporate' is/are

both used in the Companies Act, 1956. Definition of the same which is reproduced below is contained in Clause (7) of Section 2 of the Act:

“Body corporate” or “corporation” includes a company incorporated outside India but does not include—

- (a) a corporation sole;
- (b) a co-operative society registered under any law relating to co-operative societies; and
- (c) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.”

The expression “corporation” or “body corporate” is wider than the word ‘company’.

A corporation sole is a single individual constituted as a corporation in respect of some office held by him or function performed by him. The Crown or a Bishop under the English law are examples of this type of corporation. It may be noted that though a corporation sole is excluded from the definition for the purposes of the Companies Act, it continues to be a legal person capable of holding property and becoming a member of a company.

A society registered under the Societies Registration Act has been held by the Supreme Court in *Board of Trustees v. State of Delhi*, A.I.R. 1962 S.C. 458, not to come within the term ‘body corporate’ under the Companies Act, though it is a legal person capable of holding property and becoming a member of a company.

An industrial society formed under Industrial and Provident Societies Acts is not a “Company”. [*Great Northern Railway Co. v. Coal Co-operative Society*, (1896) 1 Ch. 187].

In *Board of Trustees, Ayurvedic and Unani Tibbia College, Delhi v. State of Delhi*, A.I.R. 1962 S.C. 458, the Supreme Court laid down the essence of a corporation. It consists of (1) lawful authority of incorporation, (2) the persons to be incorporated, (3) a name by which the persons are incorporated, (4) a place, and (5) words sufficient in law to show incorporation. No particular words are necessary for the creation of a corporation. Any expression showing an intention to incorporate will be sufficient. It was held in that case that the old Board of Trustees of the Ayurvedic and Unani Tibbia College of Delhi on being registered under the Societies Registration Act, 1860 did not become a corporation within the meaning of Entry 44 of list I of the Seventh Schedule of the Constitution. It remained and continued to be an unincorporated society though under the several provisions of the Societies Registration Act, 1860 it had certain privileges, some of them being analogous to those of corporations.

In view of the said decision it has been decided that such a society should not be deemed to be a “body corporate” within the meaning of Section 2(7) of the Companies Act, 1956, although such a society can be treated as a ‘person’ having separate legal entity apart from the members constituting it and thereby capable of becoming a member of a company under Section 41(2) of the Act. The expression ‘body corporate’ occurring in various provisions of the Companies Act viz. Sections 295, 303, 372 etc. should therefore be interpreted so as to exclude a society

registered under the Societies Registration Act from the scope of the expression 'body corporate' (Circular No. 8/48/2(7)/63-PR dated November 24, 1962).

Distinction between company and Limited Liability Partnership (LLP)

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

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

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

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

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

A basic difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act, 1956) whereas for an LLP it would be by a contractual agreement between partners.

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

10. ADVANTAGES OF CORPORATE FORM OF ENTERPRISE

Kindly see the nature and characteristics of a company as given earlier in the chapter.

11. DISADVANTAGES OF CORPORATE FORM OF ENTERPRISE

There are, however, certain disadvantages and inconveniences in Incorporation. Some of these disadvantages are:

1. **Formalities and expenses:** Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money. Even after the company is incorporated, its affairs and working must be conducted strictly in

accordance with legal provisions. Thus various returns and documents are required to be filed with the Registrar of Companies, some periodically and some on the happening of an event. Certain books and registers are compulsorily required to be maintained by a company. Approval and sanction of the Company Law Board, the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities.

2. **Corporate disclosures:** Notwithstanding the elaborate legal framework designed to ensure maximum disclosure of corporate information, the members of a company comparatively have restricted accessibility to its internal management and day-to-day administration of corporate working.
3. **Separation of control from ownership:** Members of a company do not have an effective and intimate control over its working as one can have in other forms of business organisation, say, a partnership firm. This is particularly so in big companies in which the number of members is too large to exercise any effective control over its day-to-day affairs.
4. **Greater social responsibility:** Having regard to the enormous powers wielded by the companies and the impact they have on the society, the companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated.
5. **Greater tax burden in certain cases:** In certain circumstances, the tax burden on a company is more than that on other forms of business organization including partnership firms.
6. **Detailed winding-up procedure:** The Act provides elaborate and detailed procedure for winding-up of companies which is more expensive and time consuming than that which is applicable to other forms of business organisation.

TEST YOUR KNOWLEDGE 1.4

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

The tax burden on a company is less than that on other forms of business organization including partnership firms.

- True
- False

Correct answer: False

12. CONCEPT OF CORPORATE PERSONALITY

By the provision of law, a corporation is clothed with a distinct personality, yet in reality it is an association of persons who are in fact, in a way, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its own, it can only act through natural persons.

Lifting of or piercing through the corporate veil

It means the company has a separate legal entity from the persons constituting its members.

Indeed, the theory of corporate entity is still the basic principle on which the whole law of corporations is based. But as the separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as "lifting of or piercing through the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company

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

However, the shareholders cannot ask for lifting veil for their purposes. This was upheld in *Premlata Bhatia v. Union of India* (2004) 58 CL 217 (Delhi) wherein the premises of a shop were allotted on a licence to the individual licence. She set up a wholly owned private company and transferred the premises to that company with the Government consent. She could not remove the illegality by saying that she and her company were virtually the same person.

Statutory Recognition of Lifting of Corporate Veil

The Companies Act, 1956 itself contains some provisions (Sections 45, 147, 212, 247 and 542) which lift the corporate veil to reach the real forces of action. Taxation Laws have also made deep inroads to crack the corporate shell for efficient administration of tax laws. For the purpose of Wealth Tax and Estate Duty Legislation, new statutory formulae have been enacted for shares of private companies which substantially disregard the separate corporate entity and proceed on the basis that the ownership of such corporate property belongs to the shareholders. In terms of Income-tax Law, directors of private companies have been made personally liable for the tax liabilities of such companies. The face of the corporation is examined in order to pay regard to the economic realities behind the legal facade.

Lifting of Corporate Veil under Judicial Interpretation

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

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

CASE EXAMPLE 1.5**In *Jones v. Lipman*, (1962) 1 W.L.R. 832**

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

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

CASE EXAMPLE 1.6**In *Re. R.G. Films Ltd.* (1953) 1 All E.R. 615**

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

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

CASE EXAMPLE 1.7**In *Connors Bros. v. Connors* (1940) 4 All E.R. 179**

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

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

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

CASE EXAMPLE 1.8**Re.: Sir Dinshaw Manakjee Petit, A.I.R. 1927 Bombay 371**

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

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

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

CASE EXAMPLE 1.9

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

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

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

CASE EXAMPLE 1.10

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

In this case, the petitioner had alleged that the State of Bihar had not paid salaries to its employees in PSUs etc. for long periods resulting in starvation deaths. But the

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

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

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

Lifting the Corporate Veil of Small Scale Industry

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

Use of Corporate Veil for Hiding Criminal Activities

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

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

TEST YOUR KNOWLEDGE 1.5

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

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

Correct answer: a, b c and d

13. PERSONAL LIABILITY OF DIRECTORS OR MEMBERS

Notwithstanding the cardinal principles of “limited liability” and “corporate personality”, the Companies Act, 1956 has specifically provided that in certain cases the advantages of distinct entity and limited liability may not be allowed to be enjoyed. Such cases are:

- (i) **Reduction of Membership** : Where the number of members falls below the statutory minimum (seven in the case of a public company and two in the case of a private company), and the company carries on business for more than 6 months while the number is so reduced, every person who is a member of the company during the time the company so carries on business after those six months and is aware of that fact, shall be severally liable for the payment of company's debts contracted during that time. Thus, in this case, the privilege of limited liability is lost by the shareholders (Section 45).
- (ii) **Mis-description of Name**: Where an officer of a company signs on behalf of the company any contract, bill of exchange, hundi, promissory note, cheque, or order for money or goods, such person shall be personally liable to the holder if the name of the company is not mentioned (Section 147).

CASE EXAMPLE 1.11***Hendon v. Adelman & Others, 1973 New L.J. 637***

In this case, the directors were held personally liable for a cheque signed by them in the name of a company stating the company's name as “LR Agencies Ltd.” whereas the real name of the company was “L & R Agencies Ltd.”.

- (iii) **Subsidiary Company**: A holding company is required to disclose to its members the accounts of its subsidiaries (Sections 212 and 214). Though in the eyes of law, a subsidiary is a separate legal person, under certain circumstances, the court may not treat the subsidiary company as an independent entity.

CASE EXAMPLE 1.12***In Merchandise Transport Limited v. British Transport Commission [1982] 2 QB 173***

A transport company wanted to obtain licences for its vehicles, but it could not do so if it made the application in its own name. It, therefore, formed a subsidiary company and the application for licences was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary. Held, the parent and the subsidiary company were one commercial unit and the application for licences was rejected.

- (iv) **Fraudulent Conduct:** Where in the course of winding-up of a company it appears that any business of the company has been carried on with an intent to defraud creditors of the company or any other person, or for any fraudulent purpose, those who were knowingly parties to such conduct of business may, at the discretion of the court, be made personally liable without any limitation as to liability for all or any debts or other liabilities of the company (Section 542).

CASE EXAMPLE 1.13

Delhi Development Authority v. Skipper Constructions Co. P. Ltd., (1997) 89 Com. Cases. 362 (SC)

A large number of persons were deceived by a company in a scheme of booking plots-flats which was operated with utter dishonesty and fraud towards persons coming into the scheme. Persons playing such frauds, though in the name of a company, can be held personally liable. The fact that they have been punished for contempt of court does not absolve them from liability.

- (v) **Failure to return Application Money:** In case of first allotment of shares in a public company, if minimum subscription has not been received or the company has not obtained certificate of commencement of business, the directors shall be personally liable to pay money with interest, if application money is not repaid within 130 days (unless they prove their ignorance) [Section 69(5)].
- (vi) **Misrepresentation in Prospectus:** In case of misrepresentation in a prospectus, every director, promoter, and every other person who authorises issue of such prospectus incurs liability towards those who subscribe for share on the faith of untrue statement (Section 62).
- (vii) **Non-Payment of Tax:** When any private company is wound-up, any tax assessed on the company whether before or in course of liquidation in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally liable for payment of tax.

CASE EXAMPLE 1.14

India Waste Energy Development Ltd. v. Govt. of NCT of Delhi (2003) 114 Com Cases 82 (Del)

A company transferred its business to another company which was not taxable, but the company was carrying on some other business also which was taxable. The company remained liable to pay the tax applicable to such business and lifting of corporate veil was permitted even in the absence of any statutory provision in this regard.

- (viii) **Ultra vires Acts:** Directors of a company will be personally liable for all those

acts which they have done on behalf of a company if they are *ultra vires* the company.

14. ILLEGAL ASSOCIATION

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

By virtue of Section 11 of the Companies Act, no company, association or partnership consisting of more than 20 persons (10 in the case of banking business) can be formed for the purpose of carrying on any business for gain, unless it is registered as a company under the Companies Act, or is formed in pursuance of some other Indian Law, or is a Joint Hindu Family carrying on business for gain.

Section 11 of the Act does not apply to the case of a single joint family carrying on any business whatever may be the number of its members. But if two or more joint hindu family firms carry on business together and the combined number of members exceed 20, then their association will become illegal. In computing the number, minor members of joint families are to be ignored. If by reason of minor members of such joint families on attaining majority, the number of persons exceeds the statutory limit, it will *ipso facto* become an illegal association.

In CASE EXAMPLE 1.15

Babu Lal v. Laxmi Bharat Trading Co., A.I.R. 1966 Raj. 14 (D.B.)

In this case, an unregistered association consisting of 115 members was alleged to be formed at the instance of Government to help it in distribution of grain among public. It was established from evidence that an element of acquisition of gain was present in its formation. It was, therefore, held that it was an illegal association and came within the purview of Section 11 of the Act.

Associations, like charitable, religious or scientific, which are not formed for the purpose of acquisition of gain are excluded from the scope of the section. [*Inland Revenue Commissioners v. Korean Syndicate*, (1920) K.B. 598]. Foreign companies are also excluded from the scope of this section. On discovery of illegality of an association, the members may choose either to register it under the Act or to dissolve it immediately. In the absence of any such steps, they continue to be in the association on paying of the penalty under this section. To protect the interest of the outsiders this public mischief of unregistered large trading association is suppressed by this section. It is with this end in view, an illegal association formed by combination of two or more joint families ought to be governed by the provisions of the section.

The effect of non-registration of an association which falls within the terms of Section 11 is that such association is illegal and has no existence in the eyes of law. The law does not recognize it, so no relief can be granted either to the association or to any of its members, as the contractual relationship on which it is founded is illegal (*Badri Prasad v. Nagarmal*, A.I.R. 1959 S.C. 559).

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

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

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

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

Under Sub-sections (4) and (5) of Section 11, every member of an illegal association is:

- (i) personally liable for all liabilities incurred in carrying on such business, and
- (ii) punishable with fine up to Rs. 10,000.

TEST YOUR KNOWLEDGE 1.6

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

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

Correct answer: a, b and c

15. OTHER ISSUES WITH REGARD TO COMPANY FORM OF ORGANISATION

Company as a person

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

CASE EXAMPLE 1.16***Union Bank of India v. Khader International Construction and Other* [(2001) 42 CLA 296 SC]**

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

Nationality and Residence of a Company

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

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

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

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

Company as a Citizen

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

CASE EXAMPLE 1.17**In *R.C. Cooper v. Union of India*, AIR 1970 SC 564**

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

CASE EXAMPLE 1.18***Bennet Coleman Co. v. Union of India*, AIR 1973 SC 106**

In this case, the Supreme Court stated that:

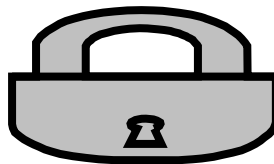
“It is now clear that the Fundamental Rights of shareholders as citizens are not lost when they associate to form a company. When their Fundamental Rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders' rights are equally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

LESSON ROUND-UP

- The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together.
- In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. A company has a separate legal entity from the persons constituting it.
- The main characteristics of company are corporate personality, limited liability, perpetual succession, separate property, transferability of shares, common seal, capacity to sue and be sued, contractual rights, limitation of action, separate management, termination of existence etc.
- Company Law in India has been modelled on the English Acts.
- The Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations.
- Major amendments to Companies Act, 1956 have been made by Depositories Act, 1996, the Companies (Amendment) Acts, 1988, 1999, 2000, 2002 & 2006 apart from various other Amendments Acts.

- Business enterprises can be broadly divided into two broad categories, namely, one which is non-corporate in form and the other which has a corporate character. Enterprises which fall in the former category are sole proprietorship, partnerships and Hindu Undivided Family and business organization which comprises the latter category are companies and co-operative undertakings.
- As compared to other types of business associations, an incorporated company has the advantage of corporate personality, limited liability, perpetual succession, transferable shares, separate property, capacity to sue, flexibility and autonomy.
- There are, however, certain disadvantages and inconveniences in incorporation. Some of these disadvantages are formalities and expenses, corporate disclosures, separation of control from ownership, greater social responsibility, greater tax burden in certain cases, detailed winding-up procedure.
- Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court may breakthrough the corporate shell and applies the principle of what is known as “lifting of or piercing through the corporate veil”. The situations in which a corporate veil can be lifted are as follows:
 - Where the corporate veil has been used for commission of fraud.
 - Where a corporate façade is really only an agency instrumentality.
 - Where the corporate veil conflicts with public policy.
 - For determining the character or status of the company, the Court may ignore the concept of separate legal entity.
 - Where the veil has been used for evasion of taxes and duties.
 - Avoidance of welfare legislation.
 - Where the company has abused its corporate personality for an unjust and inequitable purpose.
- In order to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them did not know with whom they were contracting, the law has put a ceiling on the number of persons constituting an association or partnership. If the ceiling exceeds 20 (10 in the case of banking business) then such association or partnership has to register itself either under the Companies Act, 1956 or some other Indian Statute.
- The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India. Though it has established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.

SELF-TEST QUESTIONS



1. Advice on the following:
 - (a) Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?

- (b) The members of a private limited company consist of 'A' and 'B' who are also its directors. On 4th August, 2000 'A' left India for a foreign business tour and on 28th August, 2000 he died abroad. On 1st September, 2000 'B' purchased on credit Rs. 10,000 worth of goods from 'C' on behalf of the company. 'C' now proposes to make 'B' personally liable for the payment of the debt. Is 'B' liable?
2. (a) What types of associations are prohibited by the Companies Act, and what are the disabilities of such associations?
- (b) What is a body corporate? What do you understand by corporate veil and when is it disregarded?
- (c) "Members of a Limited Company may nevertheless have unlimited liability." Comment.
3. State the consequences in each of the following cases giving reasons for your answers:
- (a) A Private Company has 60 members in total of which 10 are the employees of the company. 5 of these employees leave the employment of the company.
- (b) A private firm has 20 partners, including a private company which is having 30 shareholders.
4. "The fundamental attribute of corporate personality is that the company is a legal entity distinct from the members." Elucidate the above statement.
5. Discuss briefly the history of Company Law in India. Also discuss how far Company Law in India has been influenced by the English Company Law.
6. What are the advantages of an incorporated company compared to partnership firms and unincorporated companies?
7. What is the maximum number of persons who may lawfully form:
- (a) a banking partnership.
- (b) a partnership other than a banking partnership?
8. Write short notes on:
- (a) Perpetual succession
- (b) Transferability of shares
- (c) Limited liability
- (d) Corporate personality
- (e) One man company.
9. A company transferred all the shares of another company held by it to its newly incorporated wholly-owned public limited subsidiary investment company.

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

Are the workmen of holding company entitled to get the dividend income of

subsidiary company included in holding company's profit and loss account for the purpose of getting higher rate of bonus?

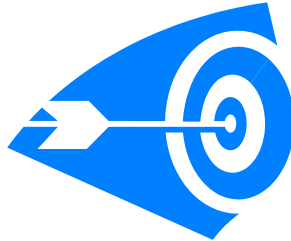
10. Examine the following and say whether they are correct or wrong:
- (a) A company being an artificial person cannot own property and cannot sue or be sued.
 - (b) Members are the owners of the company's undertaking.
 - (c) The term "body corporate" connotes a wider meaning than the term "company".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

INCORPORATION AND ITS CONSEQUENCES-I

TYPES OF COMPANIES

LEARNING OBJECTIVES



In the previous chapter, we have learnt about the concept of company. This chapter explains various types of companies, viz. private companies, public companies, producer companies. It classifies companies from the point of view of incorporation and liability and also as associations not for profit, government companies, foreign companies, holding and subsidiary companies, investment companies, etc. It also gives a brief insight into statutory corporations along with their characteristics. At the end of the lesson, students should be able to understand:

- Meaning of a private company, its privileges and exemptions and its special obligations.
- Consequences of infringement of the articles of private companies.
- Meaning of a public company, companies limited by shares, companies limited by guarantee, unlimited company, associations not for profit.
- Definition of Government companies and audit in Government companies.
- Foreign companies, holding and subsidiary companies, determination of holding – subsidiary relationship and shareholding.
- Distinction between investment companies, producer companies, finance companies and public financial institutions.
- Statutory corporations, their characteristics and their growth in India.
- Which corporations are state?
- Chartered companies in U.K.

1. INTRODUCTION

The Companies Act, 1956 provides for the kinds of companies that can be promoted and registered under the Act. The three basic types of companies which may be registered under the Act are:

- (a) Private Companies;
- (b) Public Companies; and
- (c) Producer Companies.

Classification of Companies

- (i) **Classification on the basis of Incorporation:** There are three ways in which companies may be incorporated.
 - (a) **Chartered Companies:** A company created by the grant of a charter by the Crown is called a Chartered Company and is regulated by that Charter. The East India Company and the Chartered Bank are examples of Chartered Companies.
 - (b) **Statutory Companies:** These are constituted by special Act of Parliament or State Legislature. The provisions of the Companies Act, 1956 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.
 - (c) **Registered Companies:** The companies which are incorporated under the Companies Act, 1956 by getting themselves registered with ROC fall under this category.
- (ii) **Classification on the basis of Liability:** Under this category there are three types of companies:
 - (a) **Unlimited Companies:** In this type of company, the members are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited. Such companies may or may not have share capital. They may be either a public company or private company.
 - (b) **Companies limited by guarantee:** A company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount.
 - (c) **Companies limited by shares:** A company that has the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. For example, a shareholder who has paid ₹ 75 on a share of face value ₹ 100, can be called upon to pay the balance of ₹ 25 only. Companies limited by shares are by far the most common and may be either public or private.
- (iii) **Other Forms of Companies**
 - (a) Associations not for profit having licence under Section 25 of the Act;
 - (b) Government Companies;
 - (c) Foreign Companies;
 - (d) Holding and Subsidiary Companies;
 - (e) Investment Companies; and
 - (f) Producer Companies.

2. PRIVATE COMPANY

By virtue of Section 3(1)(iii), a private company means a company, which has a

minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed, and by its articles:

- (a) restricts the right to transfer its shares, if any;
- (b) limits the number of its members to fifty not including—
 - (i) persons who, are in the employment of the company; and
 - (ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased;
- (c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company; and
- (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

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

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

The aforesaid definition of private limited company specifies the restrictions, limitations and prohibitions, which must be expressly provided in the articles of association of a private limited company. Section 26 of the Companies Act, provides that a private limited company must necessarily have articles of its own. Section 27(3) provides that in the case of a private company having share capital, the articles must contain the matters specified in sub-clauses (a), (b) and (c) of clause (iii) of Sub-section (1) of Section 3 of the Act and in the case of any other private company, the articles must contain provisions relating to matters specified in sub-clause (b) and (c) of clause (iii) of Sub-section (1) of Section 3.

The Articles of Association of a private company should contain one more prohibition for any invitation or acceptance of deposits from persons other than its members, directors or their relatives. It must be borne in mind that an invitation is not prohibited but invitation to the public is prohibited. If a company invites a selected few people e.g. employees, friends or relatives of directors, then it will not be invitation to public.

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

Section 12 of the Act stipulates that any two or more persons associated for any lawful purpose may, by subscribing their names to a Memorandum of Association and otherwise complying with the requirements of the Act in respect of registration, form an incorporated company, with or without limited liability. Section 252 further lays down that a private company shall have at least two directors. The only two members may also be the only two directors of a private company.

A private company which is a subsidiary company of a public company has come under the scope of a public company from the commencement of the Companies (Amendment) Act, 2000, as per the amended definition of the term "Public Company" under Section 3 of the Act.

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

The number of members of the private company is limited to 50.

- True
- False

Correct answer: True

Privileges and Exemptions of Private Company

The Companies Act, 1956, confers certain privileges on private companies. Such companies are also exempted from complying with quite a few provisions of the Act. The basic rationale behind this is that since the private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies.

The private limited companies lose the privileges and exemptions the moment they cease to be private companies. A private limited company, which is a subsidiary of a public limited company, is a public company in accordance with the amended definition of public company under Section 3 of the Act. Similarly, if a private company which was a deemed public company under the provisions of Section 43A of the Act on or before 13-12-2000 decides to become a private company, it has to take steps provided in Sub-section (2A) of Section 43A of the Act. All the provisions of Section 43A except Sub-section (2A) have become inoperative on and from 13-12-2000.

The privileges and exemptions enjoyed by a private company or its advantages over a public company are as follows:

<i>Section</i>	<i>Nature of exemptions/privileges</i>
70(3)	Statement in lieu of prospectus need not be delivered to the Registrar before allotting shares.
77(2)	Financial assistance can be given for purchase of or subscribing for its own shares or shares in its holding company.
81(3)(a)	Further shares can be issued without passing special resolution or obtaining Central Government's approval and without offering the same necessarily to existing shareholders.
90(2)	Provisions as to kinds of share capital (Section 85), further issue of share capital (Section 86), voting rights (Section 87), termination of disproportionate excessive rights (Section 89) are not applicable to Private Companies.

<i>Section</i>	<i>Nature of exemptions/privileges</i>
149(7)	Business can be commenced immediately on incorporation without obtaining a certificate of commencement from Registrar.
165(10)	It is not necessary to hold a statutory meeting and to send statutory report to shareholders or file the same with Registrar.
170(1)	Articles of private company may provide for regulations relating to general meetings without being subject to the provisions of Sections 171 to 186.
192A	Provisions regarding postal ballot are not applicable to private companies and no requirement of small shareholders representative.
198(1)	Any amount of managerial remuneration can be paid to a director of a private company and the same is not restricted to any particular proportion of the net profits.
204(6)	Private company can appoint a firm or body corporate to an office or place of profit under the company.
220(1)(a)	No person other than a member can inspect or obtain copies of profit and loss account of the private company.
224(1B)	A person who is in full-time employment elsewhere, or a firm may be appointed or reappointed as auditors of the private company, if such a person or firm is, at the date of appointment or reappointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies.
252(1)	Small shareholder's representative need not be present on the Board.
252(2)	Private company need not have more than two directors.
255(1)	A proportion of directors need not retire every year.
257(2)	Statutory notice is not required for a person to stand for election as a director.
259	Central Government's sanction is not required to effect increase in the number of directors beyond 12 or the number fixed by Articles of association.
262	Private companies need not follow the proceeding in this section for filling casual vacancies in the office of directors.
263(1)	In passing resolution for election of directors, all directors can be appointed by a single resolution.
264(3)	Consent to act as director need not be filed with Registrar.

<i>Section</i>	<i>Nature of exemptions/privileges</i>
266(5)	Restriction on appointment or advertisement of director as regards consent and qualification of shares does not apply.
268	Central Government's sanction is not required to modify any provision relating to appointment of managing, whole-time or non-rotating directors.
269(2)	Central Government's approval is not required for appointment of managing or whole-time director or manager.
273	Directors of a private company need not possess any share qualification in terms of Section 270.
274(1)(g)	The prohibition against a person, disqualified under this section, does not apply to a person, who is a director of a private company. Also additional grounds for disqualification may be specified by way of articles.
275 to 279	Restrictive provisions regarding total number of directorships which a person may hold do not include directorships held in private company which are not subsidiary of public company.
283(3)	Additional grounds for vacation of office may be provided in the Articles.
292A	Audit Committee need not be constituted.
293(1)	Certain restrictions on powers of Board of directors do not apply.
295(2)	Prohibition against loans to directors does not apply.
300(2)	Prohibition against participation in Board meetings by interested director does not apply.
303(1)	Date of birth of director need not be entered in the register of directors.
309(9)	There is no restriction on remuneration payable to directors.
310	Any change in remuneration of directors also does not require Government's approval.
311	Any increase in the remuneration not being sitting fees beyond specified limit of directors on appointment or reappointment does not require Central Government's approval.
316(1)	A private company may appoint a person as its managing director even if he is already a managing director or manager of one or more companies without complying with Section 316.

<i>Section</i>	<i>Nature of exemptions/privileges</i>
317(4) & 388	Managing director can be appointed for more than five years at a time.
349, 350 & 355	Provisions relating to method of determination of net profits and ascertainment of depreciation do not apply
372A	There is no restriction on making of loans or investments or giving guarantee, etc. (applicable to a private company which is not a subsidiary of a public company)
388A	Provisions of Sections 386 and 387, which restrict the number of companies of which a person can be appointed as manager, remuneration of the manager, etc., and also provisions of Sections 269, 310, 311, 312 and 317 do not apply.
409(3)	Central Government cannot exercise its power to prevent change in Board of directors which is likely to affect the company prejudicially.
416(1)	Person can enter into contract on behalf of company as undisclosed principal and need not give intimation to the other directors.

Special Obligations of a Private Company

In addition to the restrictions imposed on Private Companies as contained in Section 3(1)(iii) of the Companies Act, a private company owes certain special obligations as compared to a public company, which are as follows :

1. A private company, while filing its annual return with the Registrar of Companies as required by Section 159, must also send with this return a certificate stating that the company has not, since the date of last return issued any invitation to the public to subscribe for its shares or debentures of the company and that where the annual return discloses the fact that the number of members of the company exceeds fifty, the excess comprises wholly of persons who under sub-clause (b) of clause (iii) of Sub-section (1) of Section 3 are not to be included in reckoning the number of fifty — [Section 161(2)(b)].
2. Unless the articles otherwise provide, a member of a private company cannot appoint more than one proxy to attend and vote at a meeting of the company — [Section 176(1)(b)].

Consequences of Infringement of the Articles of Private Companies

Section 43 lays down that if a private company commits a default in complying with any of the compulsory provisions required to be contained in its articles as required under Section 3(1)(iii) [as enumerated earlier], it shall cease to be a private company and the Act will apply to the company as if it were not a private company.

The proviso to Section 43, however, states that if the infringement of any of the four conditions contained in the articles was accidental or due to inadvertence or due to some other sufficient cause, and if the Company Law Board is satisfied that it is just and equitable to grant relief it may relieve the company from the above consequences, on such terms and conditions as seem just and expedient to the Company Law Board, on the application of the company or of any other interested person.

The consequences which arise on account of infringing the minimum number of members in the case of private company are as under:

- (a) Section 45: Several liability of members: Under Section 45, the members of a private company will lose the indemnity of limited liability if, in the normal circumstances, their number falls below 2 and the company carries on business for a period of more than 6 months from the date of such reduction.
- (b) Section 433(d): Compulsory Winding up: This section states that the reduction of members below 2 in the case of private company is a valid ground for compulsory winding up.
- (c) Section 439(4)(a): Contributory's Petition: This section states that a contributory may present a petition for winding up of a private company if the number falls below two.

3. PUBLIC COMPANY

By virtue of Section 3(1)(iv), a public company means a company which:

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

A public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The shares and debentures of a public company may be quoted on a Stock Exchange. The number of members is not limited to fifty. It may be noted that in case of a public company, the articles do not contain the restrictions provided in Sections 3(1)(iii) of the Act.

Every public company existing on the commencement of the Companies (Amendment) Act, 2000, with a paid-up capital of less than five lakh rupees, was required to, within a period of two years from such commencement, enhance its paid-up capital to five lakh rupees. Where a public company failed to do so, such company was deemed to be a defunct company within the meaning of Section 560.

The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of *Western Maharashtra Development Corpn. Ltd. V. Bajaj Auto Ltd [2010] 154 Comp Cas 593 (Bom)*. It was held that the Companies Act, 1956, makes a clear distinction in regard to the transferability of

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

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

4. LIMITED COMPANY

Section 2(23) defines 'Limited Company'. It means a company limited by shares or by guarantee.

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

Companies Limited by Shares

Under Section 12(2)(a), a company limited by shares is a registered company where the liability of its members is limited by its Memorandum of Association to the amount, if any, unpaid on the shares respectively held by them. Accordingly, no member of a company limited by shares, can be called upon to pay more than the nominal amount of the shares held by him. If his shares are fully paid-up, he has nothing more to pay. But in the case of partly-paid shares, the unpaid portion is payable at any time during the existence of the company on a call being made, whether the company is a going concern or is being wound up. This is the essence of a company limited by shares and is the most common form in existence.

Companies Limited by Guarantee

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

As regards the funds, a guarantee company without share capital obtains working capital from other sources, e.g. fees or grants. But a guarantee company

having a share capital raises its initial capital from its members, while the normal working funds would be provided from other sources, such as fees, charges, subscriptions, etc.

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

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

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

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

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

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

- True
- False

Correct answer: False

5. UNLIMITED COMPANY

As per Section 12(2) (c) an "unlimited company" is a company not having any limit on the liability of its members. Thus, the maximum liability of the member of such a company, in the event of its being wound up, might stretch up to the full extent of their assets to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the Liquidator can ask the members to contribute to the assets of the company which will be used in the discharge of the debts of the company.

An unlimited company may or may not have share capital. The articles of association of an unlimited company must state the number of members with which

the company is to be registered and if the company has share capital, the amount of share capital with which the company is to be registered [Section 27(1)].

Under Section 32, a company registered as an unlimited company may subsequently convert itself as a limited company, subject to the provision that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

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

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

- **True**
- **False**

Correct answer: True

6. ASSOCIATION NOT FOR PROFIT

As per Section 13(1)(a), it is necessary that the name of every company shall have the last words as ‘limited’, if the company is registered with a limited liability. However, Section 25 permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without being required to use the word ‘limited’ or the words ‘Private Limited’ after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if :

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

The company is registered without paying any stamp duty on its Memorandum and Articles. On registration, the Association enjoys all the privileges of a limited company, and is subject to all its obligations, except, those in respect of which exemption by a special or general order is granted by the Central Government. A licence may be granted by the Central Government under Section 25 of the Act on such conditions and subject to such regulations as it thinks fit and those conditions and regulations shall be binding on the body to which the licence is granted. The Central Government may direct that such conditions and regulations shall be inserted in the Memorandum, or in the Articles, or partly in the one and partly in the other.

A Company, which has been granted licence under Section 25 cannot alter the provisions of its Memorandum with respect to its objects except with the previous approval of the Central Government in writing.

An association registered under the Act, which has been granted a licence

under Sub-section (1) Section 25 is subject to all the obligations under the Act, except in some cases where the Central Government has issued some notifications directing exemption, to such licensed companies from various provisions of the Act, as specified in those notifications.

A member of a company registered under section 25 of the Companies Act, 1956, filed a complaint against the company and others. The member was neither a subscriber to the memorandum of the company who had agreed to become a member thereof nor a person who had agreed in writing to become a member of the company as envisaged under section 41 of the Companies Act, 1956. It was held by the court that the complaint was not maintainable under section 621 of the Companies Act, 1956 Act and had to be quashed. [*Madras Cricket Club V. M. Subbiah* [2010] 154 Comp Cas 353 (Mad)]

The Central Government has issued the following orders directing the exemption of companies licensed under Section 25 from the provisions of the Act specified therein:

S.O. 1578 dated 1st July, 1961 — In exercise of the powers conferred by Sub-Section (6) of Section 25 of the Companies Act, 1956 (1 of 1956), the Central Government hereby directs that a body to which a licence is granted under Section 25, aforesaid shall be exempt from the provisions of the said Act specified in column (1) of the Table below to the extent specified in the corresponding entries in column (2) of the said Table.

TABLE

<i>Provisions of the Act</i>	<i>Extent of exemption</i>
(1)	(2)
Section 2 (45) (Definition of secretary)	Not applicable to the extent to which it prescribes qualifications for a Secretary, (See Notification dated 9.1.1976).
Section 147 (Publication of name by company)	The whole.
Section 160(1)(aa) (Annual return to be made by company not having a share capital)	The whole.
Section 166(2) (Annual general meeting)	The whole, provided that the time, date and place of each annual general meeting are decided upon before-hand by the Board of directors having regard to the directions, if any, given in this regard by the company in general meeting.
Section 171(1) (Length of notice for calling a meeting)	A general meeting may be called by giving a notice in writing of not less than 14 days.

(1)	(2)
Section 209(4-A) (Books of accounts to be kept by company)	Books of account relating to a period of not less than four years immediately proceeding the current year shall be preserved.
Section 219 (Right of members to copies of balance sheet and auditor's report)	Documents referred to in sub-clause (2) may be sent to members not less than fourteen days before the date of general meeting instead of 21 days.
Section 257 (Right of persons other than retiring directors to stand for directorship)	Shall not apply to companies which provide for election of directors by ballot.
Section 264(1) (Consent of candidates for directorship to be filed with the company and consent to act as director to be filed with the Registrar)	The whole.
Section 285 (Board to meet at least once in every three calendar months)	Shall apply only to the extent that the Board of directors, Executive committee or Governing Committee of such companies shall hold at least one meeting within every six calendar months.
Section 287 (Quorum for meetings)	Shall apply only to the extent that the quorum for the Board meeting shall be either eight members or $\frac{1}{4}$ of its total strength whichever is less provided the quorum shall not be less than two members in any case.
Section 299 (Disclosure of interest by directors)	Shall apply only to cases to which Sub-sections (1) and (3) of Section 297 apply.
Section 301 (Register of contracts, companies and firms in which directors are interested)	A register shall be maintained only of contracts of which Sub-sections (1) and (3) of Section 297 apply.

The following further exemptions have been added by **Notification No. S.O. 2767 dated 5th August 1964:**

(1)	(2)
Section 193 (Minutes of proceedings of general meetings and of Board and other meetings)	Minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.
Section 259 (Increase in number of directors to require Govt. sanctions)	The whole.
Section 292 (Certain powers to be exercised by Board only at meetings)	Matters referred to in clauses (c), (d) and (e) of Sub-section (1) may be decided by the Board by circulation instead of at a meeting.
<p>Note that any exemption granted by the Central Government cannot be taken advantage of, where the body concerned has, by its articles, made its own provision in respect of the subject-matter of such exemption.</p>	

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

It is permissible for the Central Government to grant exemption either generally or specifically to a particular company from one or more of the provisions of the Act under Sub-section (6) of Section 25.

7. GOVERNMENT COMPANIES

Section 617 defines a Government company as any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central

Government and partly by one or more State Governments. A subsidiary of a Government company is also treated as a Government company.

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

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

Exemptions to Government Companies from applicability of Notified Sections/ Provisions of the Companies Act, 1956

Section 620 of the Companies Act, 1956 empowers the Central Government to direct by notification in the Official Gazette that any of the provisions of the Act shall not apply to Government companies or apply only with such exceptions, modifications and adaptations, as may be specified in the notification. However, the provisions of Sections 618, 619 and 619A mandatorily apply to such companies.

In exercise of its powers under the above mentioned Section 620, the Central Government has issued notifications modifying the operation of different provisions of the Companies Act to Government companies some of which are as under :

1. Sections 17, 18, 19 and 186 shall apply to a Government company with the substitution of the words "Central Government" for "Court/CLB" wherever it occurs; and Section 166 shall apply with the substitution in the second proviso to Sub-section (1) of the words "Central Government" for the word "Registrar", and in Sub-section (2) of Section 166 with the substitution of the words "such other place as the Central Government may approve in this behalf" for the words "some other place within the city, town or village in which the registered office of the company is situated".
2. Further Government companies are permitted to delete the word "Private" from their name (Sections 21 and 23).
3. The Central Government has made various exemptions in the application of the provisions of the Act to Government companies. Government companies have been exempted from the following sections:
 - (i) Sections 255, 256 and 257 of the Act pertaining to appointment and retirement of directors in companies wholly owned by the Government.
 - (ii) Sections 198, 259, 268, 269, 309, 310, 311, 387 and 388 of the Act pertaining to appointment of managing/whole-time directors and manager and their remuneration.
 - (iii) Proviso to Sub-section (1) of Section 297 of the Act requiring the previous approval of the Central Government in respect of contracts entered into by it with any other Government company.
 - (iv) Section 187C requiring disclosure of beneficial interest in shares of a company.
 - (v) Section 205A requiring transfer of unpaid dividend to a special dividend account shall not apply to a Government company in which the entire paid-up share capital is held by the Central Government or by any state

Government or Governments or by the Central Government or by any State Government or Governments or by the Central Government and one or more State Governments. This is in supersession of an earlier notification No. G.S.R. 231 dated the 31st January, 1978 [G.S.R. 580(E)].

- (vi) Section 295 of the Act shall not apply to a Government company provided that such company shall obtain the approval of the Ministry or Department of the Central Government which is administratively incharge of the company or, as the case may be, the State Government. This is in supersession of an earlier notification No. S.O. 729 dated 24th May, 1978 [G.S.R. 581(E)].
 - (vii) Sections 43A^{*}, 149(2A), 205B, 263 to 266, 307, 308, 316, 317 and 386 of the Act shall not apply to a Government company in which the entire paid-up share capital is held by the Central Government or by any State Government or Governments or by the Central Government and one or more State Governments [G.S.R. 577 (E)].
 - (viii) Sections 165, 187D^{*}, 294 and Sub-sections (2) and (3) of Section 294AA of the Act shall not apply to a Government company [G.S.R. 578(E)].
 - (ix) Section 108 of the Act shall not apply to a Government company [G.S.R. 579(E)].
4. It has further been notified that the following sections of the Companies Act, 1956 shall apply to Government companies with the modification that instead of Court the application will be made to the Central Government.
- (i) Sections 100, 101, 102 and 103 of the Act regarding reduction of capital by a company.
 - (ii) Sections 391, 392 and 394 of the Act pertaining to amalgamation of companies.

Therefore, the legal status of a Government company is not affected because the share capital of the company is contributed by the Central or State Government and all its shares are held by the President of India or Governor of a State or certain nominated offices of the Government. [*Heavy Engineering Mazdoor Union v. State of Bihar* (1969) 39 Com. Cas. 905 (SC)].

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

Case Example

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

^{*} Deleted

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

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

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

Audit in Government Companies

Section 619 of the Act, as amended by the Companies (Amendment) Act, 2000 provides that the auditor of a Government Company shall be appointed or reappointed by the Comptroller and Auditor General of India (C. & A.G.). [Earlier such auditors were appointed or reappointed by the Central Government on the advice of Comptroller and Auditor General of India (C. & A.G.)].

The Comptroller and Auditor General of India has the power to direct the manner in which the accounts are to be audited and to give instructions to the auditor in regard to any matter relating to the performance of his function. The C. & A.G. may also conduct a supplementary test audit by persons authorised by him. The auditor of the company must submit a copy of his audit report to the C. & A.G., who may comment upon, or supplement, the audit report. Such comments or supplementary report must be placed before the annual general meeting of the company at the same time and in the same manner as the auditor's report.

In case of Government Companies, the Central Government must place before both the Houses of Parliament an annual report on the working and affairs of each Government company within three months of its annual general meeting together with a copy of the audit report and any comments upon or supplement to such report made by the Comptroller and Auditor General of India. Where a State Government is a member of a Government company, the annual report is likewise to be placed before the State Legislature (Section 619A).

Section 619B provides that the provisions of Section 619 shall apply to two other classes of companies which are treated as Government companies for the purpose of audit. Accordingly, the appointment of auditors of such companies can be made by C&A.G. in which not less than 51% of the paid-up capital is held jointly by the Government and Government company or companies. Only the provisions relating to audit, applying to Government companies will apply to these companies. In respect of all other matters these companies are in the same position and are governed by the provisions of the Act in the same manner as other companies.

8. FOREIGN COMPANIES

A foreign company is a company which is incorporated in a country outside India under the law of that other country and has a place of business in India. Sections 591 to 602 of the Act deal with such companies.

Foreign companies are of two classes namely :

- (a) Companies incorporated outside India, which have established a place of business in India after April 1, 1956; and
- (b) Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.

Section 592 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies at New Delhi and also with the Registrar of Companies of the State in which such place of business is situated:

- (a) a certified copy of the charter, statutes, or memorandum and articles, of the company, or other instrument constituting or defining the constitution of the company; and if the instrument is not in the English language, a certified translation thereof;
- (b) the full address of the registered or principal office of the company;
- (c) a list of the directors of the company and its secretary with full particulars of their names, nationality, their addresses and business occupations;
- (d) the names and addresses of one or more persons resident in India who are authorised to accept service of process and any notices or other documents required to be served on the company; and
- (e) the full address of the principal place of business in India.

Every foreign company must conspicuously exhibit on the outside of its every office or place of business in India its name ending with the words “-limited” or “-Private Limited”, as the case may be, if it is limited company, and the country of its incorporation in English as well as in the local language. The prospectus issued in India must also disclose the above information.

The same requirements as regards accounts and their filing and as also the registration of the charges created in India are applicable to them, as to Indian companies. No application form for shares or debentures can be issued in India without a copy of the prospectus.

Section 584 of the Companies Act, 1956 provides further that when a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Sections 582 to 590 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

Section 591 provides that where not less than 50% of the paid-up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act, as may be prescribed by the Central Government with regard to the business carried on by it in India, as if it were a company incorporated in India.

As regards the applicability of the provisions of the Companies Act, the following are to be noted :

- (i) The provisions of Section 159 regarding (filing of annual returns) shall, subject to such modifications or adaptations as may be made therein by the rules made under the Act, apply to a foreign company having an established place of business in India, as they apply to a company incorporated in India.
- (ii) The provisions of Section 209 relating to the (maintenance of books of account with respect to moneys received and expended, sales and purchase made and liabilities incurred in the course of or in relation to its business in India), Section 209A (inspection of accounts), Section 233A (Special audit), Section 233B (audit of cost accounts), Section 234-246 (investigations), so far as may be, apply only to the Indian business of a foreign company having an established place of business in India as they apply to a company incorporated in India.

As per Section 602(c), having a share transfer office or share registration office will constitute a place of business. In *Tovarishstvo Manufacture Liudvig Rabenek, Re* [1944] 2 All ER 556 it was held that where representatives of a company incorporated outside the country frequently stayed in a hotel in England for looking after matter of business, it was held that the company had a place of business in England.

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

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

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

- (1) carrying small transactions
- (2) conducting meetings of shareholders or even directors
- (3) operating bank accounts
- (4) transferring of shares or other securities
- (5) operating through independent contractors
- (6) procuring orders

- (7) creating or financing of debts, charges, etc. on property
- (8) securing or collecting debts or enforcing claims to property of any kind.

9. HOLDING AND SUBSIDIARY COMPANIES

'Holding' and 'Subsidiary' companies are relative terms. A company is a holding company of another if the other is its subsidiary.

According to Section 4 of the Companies Act, a company shall be deemed to be subsidiary of another, if and only if:

- (a) that other controls the composition of its Board of directors; or
- (b) that other:
 - (i) where the first-mentioned company is an existing company in respect of which the holders of preference shares issued before commencement of the Companies (Amendment) Act 1960, have the same right in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company;
 - (ii) where the first-mentioned company is any other company, holds more than half in the nominal value of its equity share capital, or
- (c) the first mentioned company is a subsidiary of any company which is the other's subsidiary.

To illustrate, company A is a subsidiary of company B if, and only if:

1. company B (holding company) controls the composition of the Board of directors of company A (subsidiary); or
2. company B (holding company) controls more than 50% voting power of company A (subsidiary); or
3. Company B (holding company) holds more than half in the nominal value of equity shares of company A (subsidiary); or
4. if company A (the subsidiary) is a subsidiary of company C which is subsidiary of company B, then the company A is also a subsidiary of company B.
5. If Company D is the subsidiary of company A then D will be the subsidiary of company C and also of company B.

It may be noted that sufficient control may be obtained over a company by acquiring sufficient equity share capital of that company. But, it is also possible to obtain such control in regard to the composition of the Board of directors without an investment in equity capital of the company. Say by way of an agreement in respect of advancing funds to another company and in return gaining control over the Board of directors. The first of the case envisaged in Section 4 is the case where a control is obtained by a company in the matter of composition of the Board of directors of another company. That would be sufficient to constitute the former as holding company and the other as subsidiary. The second type of case is where more than half of the nominal value of the equity share is held by another company. By virtue of such

holding that other company becomes a holding company and the one whose shares are so held becomes a subsidiary company. The third case envisaged is where a subsidiary company of holding company may be a holding company in relation to another company. That other company is also a subsidiary of the holding company of the first-mentioned subsidiary.

For the purpose of clause (a) above, the composition of Board of directors of a company shall be deemed to be controlled by another company if, and only if, the other company by the exercise of some power exercisable by it at its discretion, without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of directorship with respect to which any of the following conditions is satisfied, viz:

- (a) if a person cannot be appointed to a directorship, without the exercise in his favour by that other company of such a power of appointment;
- (b) if a person's appointment as a director follows necessarily from his appointment as a director or manager of or to any other office or employment in that other company; or
- (c) if the directorship is held by an individual nominated by that other company or by a subsidiary thereof.

In determining whether one company has a controlling interest in another company or whether directors have a controlling interest in a company, it is not necessary to consider whether the interest is a proprietary one and it may be a direct or an indirect interest. The degree of control resulting from a 51 per cent holding is a control within the Act. [*British American Tobacco Company v. IRC*, (1942) 12 Com Cases 129, 134, 135 (CA)].

Where in a certain case, additional directors of a company were appointed as the nominees of another company and these nominees constituted the majority of the Board, the nominating company became the holding company within the meaning of Section 4 of the Act.

Normally a subsidiary company cannot be a member of the holding company. Where it was a member before it became a subsidiary, it shall not have the voting right at a meeting, though it may exercise other rights of members (Section 42).

Section 4 envisages the holding of more than 50% of nominal value of the subsidiary's equity capital. If the holding company holds more than half in nominal value of the subsidiary's equity share capital, the relationship of holding company and subsidiary subsists between them.

Determination of Holding-subsidiary relationship and shareholding

Sub-section (3) of Section 4 provides that in determining whether a company is a subsidiary of another —

- (a) any shares held or power exercisable by that other company in a fiduciary capacity shall be treated as not held or exercisable by it.
- (b) Subject to the provisions of clauses (c) and (d), any shares held or power

exercisable —

- (i) by any person as a nominee for that other company; or
- (ii) by, or by a nominee for, a subsidiary of that other company, not being a subsidiary which is concerned only in a fiduciary capacity; shall be treated as held or exercisable by that other company; or
- (c) any shares held by virtue of the provisions of any debentures of the first-named company or of a trust deed for securing issue of such debentures shall be disregarded; and
- (d) any shares held by way of security only for the purpose of a business transaction entered into in the ordinary course of business, shall not be treated as so held by that other company.

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

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

- True
- False

Correct answer: False

10. INVESTMENT COMPANIES

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

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

According to one set of legal opinion, an "investment company" means company which acquires and holds shares and securities with an intent to earn income only from them by holding them. On the other hand, another school of legal opinion holds that an Investment Company means a company, which acquires shares and securities for earning income by holding them as well as by dealing in such shares and other securities”.

According to Section 2(10A) of the Insurance Act, 1938, an investment company means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

11. PRODUCER COMPANIES

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

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

Objects of Producer Companies

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

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

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

12. FINANCE COMPANIES

According to Rule 2(cc) of the Companies (Acceptance of Deposits) Rules, 1975, a Financial Company means a non-banking company which is a financial

institution within the meaning of clause (c) of Section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934).

A Financial institution has been defined under Section 45-I of the Reserve Bank of India Act, 1934 as follows:

Financial institution means any non-banking institution which carries on as its business or part of its business any of the following activities:

- (i) the financing, whether by way of making loans or advances or otherwise, or any activity other than its own;
- (ii) the acquisition of shares, stocks, bonds, debentures or securities issued by a Government or local authority or other marketable securities of the like nature;
- (iii) the letting or delivery of any goods to a hirer under hire-purchase agreement as defined in clause (c) of Section 2 of the Hire-Purchase Act, 1972;
- (iv) the carrying on of any class of insurance business;
- (v) the managing or conducting or supervising as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any state, or any business, which is similar thereto;
- (vi) collecting for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscription or by sale of units, or other instruments or in any other manner and awarding prizes, gifts, whether in cash or in kind or disbursing monies in any other way to persons from whom monies are collected or to any other person,

but does not include any institution, which carries on as its principal business:

- (a) agricultural operations; or
- (aa) industrial activity; or
- (b) the purchase or sale of any goods (other than securities) or the providing of any services; or
- (c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation: For the purposes of this clause, ~~“industrial activity”~~ means any activity specified in sub-clauses (i) to (xviii) of clause (c) of Section 2 of the Industrial Development Bank of India Act, 1964 (18 of 1964).

- (d) ~~“firm”~~ means a firm as defined in the Indian Partnership Act, 1932 (9 of 1932);
- (e) ~~“non-banking institution”~~ means a company, corporation or co-operative society;
- (f) ~~“non-banking financial company”~~ means—
 - (i) a financial institution which is a company;

- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) such other non-banking institution or class of such institutions, as the bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

The above definition of financial institutions has been set out in broad terms so as to include chit or kuri, housing finance, as well as, loan, investment, miscellaneous non-banking companies.

A non-banking institution has been defined in clause (e) of the said section to mean a company, corporation, co-operative society or firm.

Thus, a financial company is a company or corporation or co-operative society or firm which is a financial institution within the meaning of clause (c) of Section 45-I of the Reserve Bank of India Act, 1934.

13. PUBLIC FINANCIAL INSTITUTIONS

Section 4A (1) of the Companies Act, 1956 provides that the following financial institutions shall be regarded, for the purposes of this Act, as a public financial institution:-

- (i) the Industrial Credit and Investment Corporation of India Limited, a company formed and registered under the Indian Companies Act, 1913;
- (ii) the Industrial Finance Corporation of India, established under section 3 of the Industrial Finance Corporation Act, 1948;
- (iii) the Industrial Development Bank of India, established under section 3 of the Industrial Development Bank of India Act, 1964;
- (iv) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;
- (v) the Unit Trust of India, established under section 3 of the Unit Trust of India Act, 1963;
- (vi) the Infrastructure Development Finance Company Limited, a company formed and registered under this Act.

Sub-section (2) of Section 4(A) of the Companies Act, 1956 empowers the Central Government to specify any other institutions, as it may think fit, to be a public financial institution by issuing a notification in the Official Gazette. However, no institution shall be so specified unless:

- (i) it has been established or constituted by or under any Central Act; or
- (ii) not less than 51% of the paid-up share capital of such institution is held or controlled by the Central Government.

The Central Government has specified the following institutions amongst others to be public financial institutions, namely:—

- (1) The Industrial Reconstruction Bank of India.
- (2) The General Insurance Corporation of India (GIC).

- (3) The National Insurance Company Ltd.
- (4) The New India Assurance Co. Ltd.
- (5) The Oriental Fire and General Insurance Co. Ltd.
- (6) The United Fire and General Insurance Co. Ltd.
- (7) The Shipping Credit & Investment Co. of India Ltd. (SCICI).
- (8) Tourism Finance Corporation of India Ltd. (TFCI).
- (9) IFCI Venture Capital Fund Limited
- (10) Technology Development and Informations Co. of India Ltd.
- (11) Power Finance Corporation Ltd.
- (12) National Housing Bank (NHB).
- (13) Small Industries Development Bank of India (SIDBI).
- (14) Rural Electrification Corporation Ltd.
- (15) Indian Railways Finance Corporation Ltd.
- (16) Industrial Finance Corporation of India Ltd.
- (17) Andhra Pradesh State Financial Corporation.
- (18) Assam Financial Corporation.
- (19) Bihar State Financial Corporation.
- (20) Delhi Financial Corporation.
- (21) Gujarat State Financial Corporation.
- (22) Haryana Financial Corporation.
- (23) Himachal Pradesh Financial Corporation.
- (24) Jammu & Kashmir State Financial Corporation.
- (25) Karnataka State Financial Corporation.
- (26) Kerala Financial Corporation.
- (27) Madhya Pradesh Financial Corporation.
- (28) Maharashtra State Financial Corporation.
- (29) Orissa State Financial Corporation.
- (30) Punjab Financial Corporation.
- (31) Rajasthan Financial Corporation.
- (32) Tamilnadu Industrial Development Corporation Ltd.
- (33) Uttar Pradesh Financial Corporation.
- (34) West Bengal Financial Corporation.
- (35) Indian Renewable Energy Development Agency Limited
- (36) North Eastern Development Finance Corporation Ltd.
- (37) Housing and Urban Development Corporation Limited.
- (38) Export-Import Bank of India.
- (39) National Bank for Agriculture and Rural Development (NABARD)
- (40) National Cooperative Development Corporation (NCDC).
- (41) National Dairy Development Board.

- (42) The Pradeshiya Industrial and Investment Corporation of U.P. Limited.
- (43) Rajasthan State Industrial Development and Investment Corporation Limited.
- (44) SICOM Limited^{*}.
- (45) West Bengal Industrial Development Corporation Limited.
- (46) Tamil Nadu Industrial Development Corporation Limited.
- (47) Punjab State Industrial Development Corporation Limited (PSIDC).
- (48) EDC Limited.
- (49) Tamil Nadu Power Finance and Infrastructure Development Corporation Limited.
- (50) Tamil Nadu Urban Finance and Infrastructure Development Corporation Limited.
- (51) Kerala State Power and Infrastructure Corporation Limited.
- (52) Jammu & Kashmir Development Financial Corporation Limited
- (53) Kerala State Industrial Development Corporation Limited
- (54) India Infrastructure Finance Company Limited
- (55) Gujarat Industrial Investment Corporation Limited
- (56) Andhra Pradesh Industrial Development Corporation Limited
- (57) Karnataka Urban Infrastructure Development and Finance Corporation Limited
- (58) L&T Infrastructure Finance Company Limited
- (59) Srei Infrastructure Finance Limited

Criteria for declaring an institution as Public Financial Institution

Earlier the Central Government was declaring an institution as Public Financial Institution, if it meets any one of clause (i) & (ii) of Sub-Section (2) of Section 4A of the Act. Now, Central Government has framed the following criteria for declaring any financial institution as Public Financial Institution under Section 4A of the companies Act, 1956 (MCA General Circular No. 34/2011 dated 02.06.2011):-

- (a) A company or corporation should be established under a special Act or the Companies Act being Central Act;
- (b) Main business of the company should be industrial/infrastructural financing;
- (c) The Company must be in existence for at least 3 years and their financial statement should show that their income from industrial/infrastructural financing exceeds 50% of their income;
- (d) The net worth of the company should be ₹ One Thousand Crore;
- (e) Company is registered as Infrastructure Finance Company (IFC) with RBI or as an Housing Finance Company (HFC) with National Housing Bank;
- (f) In the case of CPSUs/SPSUs, No restriction shall apply with respect to financing specific sector(s) and net-worth.

^{*} State Industrial Development Corporation of Maharashtra Limited.

14. A BRIEF STUDY OF STATUTORY CORPORATIONS

A Company formed under an Act of Parliament or State Legislature is called a Statutory Company/Corporation. The special enactment contains its constitution, powers and scope of its activities. Change in its structure is possible only by a legislative amendment. Such companies are usually formed to carry on the work of some special public importance and for which the undertaking requires extraordinary powers, sanctions and privileges. A major objective for incorporating statutory corporations is to serve public interest. The need for establishing a statutory corporation is that the State wishes to enter a field of human activity which has traditionally been, or will in normal course be, undertaken by non-official persons and groups. Such companies do not use the word "limited" as part of their names, e.g., Reserve Bank of India, LIC, etc. However, in respect of Insurance, Banking and Electricity Supply companies incorporated and registered under the Companies Act, the provisions of Insurance Act, Banking Regulation Act, and Electricity Supply Act will prevail, respectively, when they are inconsistent with the provisions of the Companies Act, 1956, applicable generally.

A Brief History of Growth of Statutory Corporations in India

As early as 1948, the Government of India had decided to organise the enterprises as statutory corporations. The Industrial Policy Resolution of 1948 had stated: "Management of State enterprises will, as a rule, be through the medium of public corporations under the statutory control of Central Government." In pursuance of this, Damodar Valley Corporation, the Industrial Finance Corporation of India, the Employees' State Insurance Corporation, and now (defunct) the Rehabilitation Finance Administration were created in 1948. In the same year, the Electricity Supply Act was passed, under which electricity boards in various States have been established.

In 1953, the two air corporations, namely, the Indian Airlines and Air India were created under the Air Corporations Act. The State Bank of India was established in 1955, the Life Insurance Corporation in 1956, the Oil and Natural Gas Commission was established in 1956 and it was set up simply by a resolution of the Central Government and technically, it was, what is known as, a subordinate office of the Ministry. However, it was vested with large powers and with handling of many crores of rupees. It was only three years later in 1959 that ONGC became a statutory corporation by the passing of an Act of Parliament. In 1993 Oil and Natural Gas Commission has been converted to that of Oil & Natural Gas Corporation Limited.

Apart from these, the statutory corporation device has been used for enterprises of a banking nature (for example, the Deposit Insurance and Credit Guarantee Corporation, the Unit Trust of India, the Agricultural Refinance and Development Corporation), and to provide enabling laws to create statutory bodies in various states (for example the Road Transport Corporations Act, 1950, and the State Financial Corporations Act, 1951). Two other Acts which established Central Public Corporations, also permitted the State Governments, to establish their own statutory bodies viz. The Warehousing Corporations Act, 1962 and the Food Corporations Act, 1964.

The 14 commercial Banks which were nationalised in 1969, were also made autonomous corporations under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. However, after 1970, even those enterprises which were nationalised, were not given the statutory corporation form, as was being done so far in most cases. Only Government companies were created for dozens of enterprises which were taken over after 1970. The only exception, where a statutory corporation was favoured as against a joint stock company, is the International Airports Authority of India for the development and management of the four international airports of Chennai, Delhi, Kolkata and Mumbai.

Principal Characteristics of Statutory Corporations

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

- (i) ***It is owned by the State.***
- (ii) ***It is created by a special law of Parliament or State Legislature*** defining its objects, powers and privileges and prescribing the form of management and its relationship with Government departments.
- (iii) ***Immunity from Parliamentary Scrutiny:*** A basic and fundamental characteristic of a statutory corporation is its immunity from Parliamentary enquiry into its day-to-day working, as distinct from matters of policy. As stated by Professor Robson, "It has long been recognised that while Parliament has a right to discuss and determine matters of major policy concerning the nationalised industries, the day-to-day conduct of their business by the public corporations should be immune from Parliamentary inquisition".
- (iv) ***Freedom in regard to personnel:*** Another distinguishing characteristic of a public corporation is that excluding the officers taken from the Government department on deputation, its employees are not civil servants and are not governed by Government regulations in respect of conditions of service. They are also not entitled to the protection of Article 311 of the Constitution of India. This applies to the members of the Board of directors and to other employees. Though the statutory corporations are empowered to regulate their personnel policies, many of them have borrowed wholly or partly civil service rules of promotion, seniority, dismissal etc. The corporations are also required to obtain prior approval of the Government for regulations regarding terms and conditions of service of their employees, and also publish these terms and conditions in the Gazette of India. For example, see Section 49(b) of the LIC Act, Section 45(2)(b) of the Air Corporation Act and Section 37(2) of the International Airports Authority Act. In the case of the ONGC, the Act empowers the Government to make rules even for travelling and daily allowances payable to employees [Section 31(2)(a)].
- (v) ***A body corporate:*** Each statutory corporation is a body corporate and can sue and be sued, enter into contracts and acquire property in its own name. For example, the ONGC Act states: "The commission shall be a body corporate, having perpetual succession and a common seal with

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

power to acquire, hold and dispose of property and to contract and shall by the said name sue and be sued" [Section 3(2)]. After laying down the composition of the Commission, the Act states the various functions of the Commission. This is the standard formula for all the statutory corporations. The corporations are given full powers necessary for carrying out their functions, with some exceptions like approval for capital expenditure beyond prescribed limits, and employment of categories of persons.

- (vi) **Distinct relation with the Government:** The most important provision which regulate the relationship of public corporation and Government is the latter's power to issue directions. The ONGC Act, for e.g. provides, "In the discharge of its functions under this Act, the Commission shall be bound by such directions as the Central Government may, for reasons to be stated in writing give it from time to time" [Section 14(3)]. For the LIC the scope of Government directions is restricted because these should relate to "matter of policy involving public interest" [Section 21 of the LIC Act]. More or less the same approach has been adopted by the Acts of other corporations.
- (vii) **Independent Finances:** A major plank of autonomy of a statutory corporation is its independence in respect of its finances. Except for appropriations to provide capital or to cover losses, it is usually independent in its finances. It obtains funds by borrowing either from the Government or, in some cases, from the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenue.
- (viii) **Commercial Audit:** Except in the case of the banks, the financial institutions and the LIC, where chartered accountants are auditors, in all the other corporations, the audit has been entrusted to the Comptroller and Auditor General of India (CAG). In brief, a statutory corporation is ordinarily not subject to the budget, accounting and audit laws and procedure applicable to Government departments.
- (ix) **Operation on business principles:** In case of some corporations, the Acts lay down that "In the discharge of its functions the corporations shall act as far as may be on business principles" [Section 6(3) of the LIC Act]. Similar provisions exist in the International Airports Authority Act (Section 11), and the Air Corporations Act (Section 9). However, the practical implications of these clauses are not clear.

15. WHICH CORPORATIONS ARE "STATE"?

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

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

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

None of these, it is stated, by itself is a conclusive test, nor is this an exhaustive list of operational indices. There may be other indices as well. From all the relevant factors, it is stated the Court should draw an inference whether the corporation is an “agency or instrumentality” of the State.

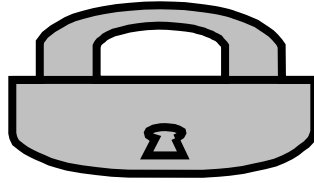
In *International Airport Authority case (ibid)*, the International Airport Authority was held to be “other authority” for the purpose of Article 12 and therefore “State and for that reason was required to observe the principle of equality in its contractual dealings. In *Som Prakash v. Union of India*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

LESSON ROUND-UP



- Three basic types of companies which may be registered under the Act are private companies, public companies and producer companies.
- From the point of view of incorporation, companies can be classified as chartered companies, statutory companies and registered companies.
- Companies can be categorized as unlimited companies, companies limited by guarantee and companies limited by shares.
- Companies can also be classified as associations not for profit having licence under Section 25 of the Act, Government companies, foreign companies, holding and subsidiary companies, investment companies and producer companies.

- A private company has been defined under Section 3(1)(iii) of the Companies Act, 1956 as a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as prescribed, and by its articles restricts the right to transfer its shares, limits the number of its members to fifty, prohibits invitation to public to subscribe or acceptance of deposits from persons other than members, directors or their relatives.
- The Companies Act, 1956 confers certain privileges on private companies. They are also exempted from complying with quite a few provisions of the Act.
- A private company owes certain special obligations as compared to a public company.
- Consequences for infringing the minimum number of members in a private company are several liabilities of members, compulsory winding up and contributory's petition for winding up.
- A public company has been defined under Section 3(1)(iv) of the Act as a company which is not a private company, has a minimum paid-up capital of five lakh rupees or is a private company which is a subsidiary of a company which is not a private company.
- A limited company is a company limited by shares or by guarantee. An unlimited company is a company not having any limit on the liability of its members.
- Associations not for profit with limited liability are permitted to be registered under a licence granted by the Central Government without using the word(s) 'Limited' or 'Private Limited'.
- Section 617 defines a Government company as a company in which not less than fifty one per cent of the paid-up share capital is held by Central or State Government or governments or partly by one and partly by others.
- Auditor of a government company shall be appointed or reappointed by the Comptroller and Auditor General of India (C.&A.G.)
- A foreign company is a company which is incorporated in a country outside India under the law of that other country and has a place of business in India.
- A company is a holding company of another if the other is its subsidiary.
- An investment company is a company, the principal business of which consists in acquiring, holding and dealing in shares and securities.
- A producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. Section 581B(1) of the Act provides the objects for which a producer company may be registered under the Act.
- According to Rule 2(cc) of the Companies (Acceptance of Deposits) Rules, 1975, a 'Financial Company' means a non-banking company which is a financial institution within the meaning of clause (c) of Section 45-1 of the Reserve Bank of India Act, 1934.
- The Central Government has specified certain institutions to be public financial institutions under the powers given to it under sub-section (2) of Section 4(A).
- A company formed under an Act of Parliament or State Legislature is called a Statutory Company/Corporation.
- Principal characteristics of Statutory Corporation are State ownership, creation by special law, immunity from Parliamentary scrutiny, freedom in regard to personnel, body corporate features, distinct relation with the Government, independent finances, commercial audit and operation on business principles.

SELF-TEST QUESTIONS

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

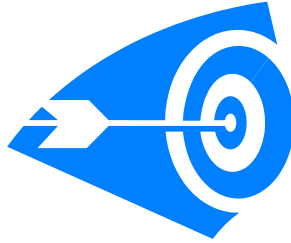
1. State in brief the various kinds of companies which can be registered under the Companies Act, 1956.
2. Define a private company and state the special privileges which it enjoys under the Companies Act, 1956.
3. Discuss in brief disadvantages and obligations of a private company.
4. Define a public company and distinguish it from a private company.
5. What is a Government Company? Summarise the special provisions of the Companies Act relating to Government Companies.
6. Write short notes on:
 - (a) Holding and Subsidiary companies.
 - (b) Investment Companies
 - (c) Finance Companies.
 - (d) Unlimited Companies.
7. Discuss in brief the law relating to statutory corporations.
8. What is a foreign company? Summarise the provisions of the Companies Act relating to foreign companies.

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

STUDY III
INCORPORATION AND ITS CONSEQUENCES-II
PROMOTION AND INCORPORATION OF COMPANIES

A. PROMOTERS

LEARNING OBJECTIVES



This chapter explains the concept of promoters, their legal position, duties, liabilities and their remuneration. It also enumerates the important steps which are to be followed while forming a company. At the end of the lesson, students should be able to understand:

- Definition of a promoter and their legal position.
- Promoters' contract and the ratification thereof.
- Duties of a promoter and the termination of their duties.
- Remedies available to the company against the promoter.
- Liabilities of promoters.
- Remuneration of promoters.
- Important steps in formation of companies.
- Certificate of incorporation as conclusive evidence.

1. DEFINITION OF THE WORD – PROMOTER

The Companies Act, 1956, does not define the expression 'promoters' but the word promoter has been used in Sections 62, 69, 76, 478 and 519 of the Companies Act, 1956. According to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, "promoter" includes:

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

Provided that a director or officer of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter:

Provided further that a financial institution, scheduled bank, foreign institutional investor and mutual fund shall not be deemed to be a promoter merely by virtue of the fact that ten per cent. or more of the equity share capital of the issuer is held by such person;

Provided further that such financial institution, scheduled bank and foreign institutional investor shall be treated as promoter for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;

Before a company can be formed, there must be some persons who have an intention to form a company and who take the necessary steps to carry that intention into operation. Such persons are called 'promoters'. It is they who conceive the idea of forming the company, and it is they who take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire the business or property which it is to manage.

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

Case Example

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

In *Whaley Bridge Calico Printing Co. v. Green* (1880) 5 Q.B.D. 109, Bowen, L.J. held that the term "promoter" is a term not of law but of business usually summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence".

But a person may be a promoter even if he has undertaken a lesser active role in the formation of a company. Any person who becomes a director, places shares or negotiates preliminary agreements, may be covered by this term. Who constitutes a promoter in a particular case is, therefore, a question of fact, there being no clear legislative or judicial definition under the Companies Act, 1956. A company may have several promoters. A promoter may be a natural person or a company.

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

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

There is no mention of the word promoter in the Companies Act, 1956.

- "True"
- "False"

Correct answer: False

2. PROMOTERS' CONTRACT — RATIFICATION THEREOF

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

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

Case Example

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

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

3. LEGAL POSITION OF A PROMOTER

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

Case Example

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

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

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

The promoters undoubtedly stand in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under whose supervision it shall come into

existence and begin to act as a trading corporation [As per Lord Cairns in *Erlanger v. New Sombrero Phosphate Co.*, (1873) 3 App. Case 1218-1236]. In a series of similar cases under the English Law it has been held that the promoters, being in a fiduciary position, may not make, either directly or indirectly, any profit at the expense of the company and that if he does make a profit in disregard of this rule, the company can compel him to account for it. The promoters can be compelled to surrender the secret profits [*Emma Silver Mining Co. v. Grant*, (1879) 11 Ch. D. and *Erlanger v. New Sombrero Phosphate Co.*, (1878) 3 A.C. 1218-1236 (supra)].

4. DUTIES OF A PROMOTER

The Companies Act, 1956, contains no provisions regarding the duties of promoters. Section 62, 63 and 542 only impose liabilities on promoters for untrue statement in the prospectus and fraudulent trading.

There are two fiduciary duties of a promoter, namely:

1. A promoter cannot make either directly or indirectly, any profit at the expense of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it. In relation to disclosure it may be noted that part disclosure is worse than none. A promoter is not forbidden to make profit but he is barred from making any secret profit. He may make a profit out of promotion with the consent of the company in the same way as an agent may retain a profit obtained through his agency with his principal's consent.

Case Example

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

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

Case Example

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

In case, therefore, the promoter wishes to sell his own property to the company,

he should either disclose the fact:

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

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

Promoter's duties under the Indian Contract Act

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

The promoter's duties must be the same as that of a person acting on behalf of another individual without a contract of employment. If he does make any misrepresentation in a prospectus he may be held guilty of fraud under Section 17 of the Indian Contract Act and would be held liable for damages under Section 19 of that Act.

Termination of Promoters' Duties

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

5. REMEDIES AVAILABLE TO THE COMPANY AGAINST THE PROMOTER

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

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

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

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

This may happen in any of the following circumstances:

- (a) Where the promoter bought property with a view to sell it to the company

which he intends to promote, he occupies fiduciary position *vis-a-vis* the company. He must disclose all the facts to the company.

- (b) Where the promoter resells property to the company at an increased price, the property which he purchased after he has commenced to act in the capacity of a promoter, he cannot retain the profit which he has not disclosed to the company.
- (c) Where a person is a promoter for acquiring the property for the company, the rules of agency will apply, so that any profit he makes will belong to the company.

Where, therefore, the promoter bought the property with a view to sell it to the company he promotes, the company may either—

- (a) rescind the contract and if he has made a profit on some ancillary transaction that may also be recovered; or
- (b) retain the property, paying no more for it than what the promoter has paid, depriving him of his profit; or
- (c) where the above remedies would be inappropriate, such as when the property has been altered so as to render rescission impossible and the promoter has already received his inflated price, the company may sue him for misfeasance (breach of duty to disclose). The measure of damages will be the difference between the market value of the property and the contract price.

6. LIABILITIES OF PROMOTERS

A promoter is subject to the following liabilities under the various provisions of the Companies Act, 1956.

1. Section 56 and Schedule II of the Act lays down matters to be stated and reports to be set out in the prospectus. The promoter(s) may be held liable for the non-compliance of the provisions of this Section.
2. Under Section 62, a promoter is liable for any untrue statement in the prospectus to a person who has subscribed for any shares or debentures on the faith of the prospectus. Such a person may sue the promoter for compensation for any loss or damage sustained by him. In the event of a false statement in the prospectus the following consequences will follow:
 - (a) the allotment of shares may be set aside;
 - (b) the promoter may be sued for damages;
 - (c) he may be sued for compensation for misrepresentation under Section 62(1)(c) of the Act;
 - (d) he may be sued for damages by shareholders who have suffered by reason of his non-compliance with the statutory requirements as to the contents of the prospectus;
 - (e) he may become liable to criminal proceedings.

3. By virtue of Section 203, of the Companies Act, 1956 the Court may suspend a promoter from taking part in the management of a company for a period of 5 years if:
 - (a) he is convicted of any offence in connection with the promotion, formation or management of a company; or
 - (b) in liquidation it appears that he:
 - (i) has been guilty of any offence for which he is punishable (whether he has been convicted or not) under Section 542; or
 - (ii) while being an officer of the company, has otherwise been guilty of any fraud or misfeasance in relation to the company or of any breach of his duty to the company.
4. Besides civil liability, the promoters are criminally liable under Section 63 for the issue of prospectus containing untrue statements. Section 63 imposes severe penalty on promoters who make untrue and deceptive statements in prospectus with a view to obtaining capital. The punishment prescribed, is imprisonment for a term which may extend to two years or with fine which may extend to Rs. 50,000/- or with both. A promoter can, however, escape the punishment if he proves:
 - (i) that the statement was immaterial; or
 - (ii) that he had reasonable ground to believe, and did, up to the time of the issue of prospectus, believe that statement was true.
5. A promoter may be liable to public examination like any other director or officer of the company if the court so directs on a liquidator's report alleging fraud in the promotion or formation of the company (Section 478).
6. A company may proceed against a promoter on action for deceit or breach of duty under Section 543, where the promoter has misapplied or retained any property of the company or is guilty of misfeasance or breach of trust in relation to the company.

The following are some of the remedies available to the subscriber who is deceived—

- (1) He may take proceedings to repudiate the contract and require repayment of his money with interest.
- (2) He may, in respect of any untrue statement in the prospectus, bring an action against the directors and promoters for the recovery of compensation.
- (3) He may, bring an action for damages against the directors and other persons responsible for failure to disclose matters in a prospectus.
- (4) He may, in respect of any untrue statement, bring an action against directors or those who are responsible for the prospectus.

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

Misrepresentation of facts: A promoter will be responsible for any misstatement

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

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

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

7. REMUNERATION OF PROMOTERS

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

When a promoter makes proper disclosure, he may expect to be rewarded for his efforts. Therefore, when the company is registered, it may (and usually does) pay or agree to pay some remuneration for services rendered. In practice, a promoter is remunerated in any of the following ways:

- (a) He may sell his own property to the company for cash or against fully paid shares in the company at an over valuation after making full disclosure to a disinterested Board of directors or to the intended shareholders.
- (b) He may be given an option to buy further shares in the company at par.
- (c) He may take commission on the shares sold.
- (d) He may take a grant of some shares in the company.
- (e) He may be paid a lump-sum by the company.
- (f) The articles may provide for a fixed sum to be paid to him. Such a provision has no contractual effect and he cannot sue to enforce it, but if it is acted upon, the company cannot recover its money.

Whatever be the nature of remuneration or benefit, it must be disclosed in the prospectus, if paid, within 2 years preceding the date of the prospectus.

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

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

- True
- False

Correct answer: True

B. INCORPORATION OF COMPANIES

Important Steps

Before the promoter proceeds to incorporate a company, he has to decide the following aspects:

(a) Deciding the types of company

Under the Companies Act, 1956 only three types of companies can be registered, viz., (i) Public companies; (ii) Private companies; and (iii) Producer companies.

In this study, we shall concentrate only on the steps of incorporating Public and Private limited companies. However, a separate lesson is being added to this study material on all the aspects of 'Producer Companies'.

Section 12 of the Act provides that any seven or more persons, or where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their names to the Memorandum of Association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.

These companies may further be classified as follows:

- (i) Companies limited by shares;
- (ii) Companies limited by guarantee with or without share capital; and
- (iii) Unlimited companies with or without share capital.

(b) Application for Availability of Name of company

A company is identified by the name with which it is registered. The Memorandum of Association of a company should, according to Section 13 of the Act, state the name of the company. The name of a company must end with the word "Limited" in the case of a public company and the words "private limited" in the case of a private company. In the case of a Section 25 company, by obtaining a licence from the Regional Director, the requirement as to the addition of the word "limited" or "private limited" to the name can be dispensed with. According to Section 20 of the Act a company cannot be registered with the name which is undesirable or which is identical with or too nearly resembles the name of an existing company. A company will not be allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950.

For deciding the availability of names, the Ministry of Corporate Affairs has issued NAME AVAILABILITY GUIDELINES, 2011 w.e.f. 24.07.2011, which are reproduced as Annexure-I at the end of this chapter.

The aforesaid guidelines are issued in supercession of all the previous circulars and instructions regarding name availability, issued by the Ministry of Corporate Affairs from time to time.

The Companies (Central Government's) General Rules and Forms (Amendment)

Rules, 2011 vide Rule 4A, require the promoters of a company under a proposed name to make an application in e-Form No. 1A, to the Registrar of Companies of the State in which the registered office of the proposed company is to be situated, for ascertaining as to whether the proposed name is undesirable within the meaning of Section 20 of the Act. A fee of Rs. 1000 (w.e.f. 24.07.11) is to be paid along with e-Form 1A [fee can be remitted electronically (by using a credit card or by electronic bank transfer) or by cash/draft, by 'challan' generated electronically on submission of form].

In case the name is undesirable, the registrar may reject the same or ask for resubmission of the application with new names or calls for further information, ordinarily within three days of receipt of the application. The applicant shall be given only upto two opportunities for re-submission of their proposal against the fee paid in the first instance for name availability after the original application is filed.

Where the Registrar informs the promoters of the company that the name is not undesirable, such name shall be available for adoption by the promoters of the company for a period of sixty days from the date the name is allowed. If the name so allowed is not adopted on or before the expiry of the period of sixty days from the date it is allowed, the name allowed shall lapse and no extension will be granted after expiry of sixty days from the date the name is allowed.

Choose the correct answer

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

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

Correct answer: b

(c) Preparation of Memorandum and Articles of Association

The Memorandum of Association is the constitution of a company. It is a document, which amongst other things, defines the area within which the company can act. It is, therefore, required to state the object for which the company has been formed, the business that it would undertake, the liability, the capital which it shall be allowed to raise, the nature of liability of its members, the name of the State where the registered office of the company shall be located etc.

The other important document is the Articles of Association which contains the rules and regulations relating to the internal management of a company.

(d) Vetting of Memorandum and Articles, Printing, Stamping and Signing of the same

The draft of the Memorandum and Articles should be prepared and typed before printing the Memorandum and Articles of Association of a company. It is usual for the

promoters to approach the Registrar of Companies concerned for vetting the draft Memorandum and Articles as the Registrar of Companies may propose some changes.

It has been clarified by the Department vide Circular No. 128(HCC) 64 dated 27.7.1964 that though it may not be possible for the Registrars to accept a definite commitment in this regard, the Registrar should to the extent possible, offer their help and advice to those who may approach them in drawing up the Memorandum and Articles. This would be specially desirable in cases where promoters have no prior experience on company formation. For vetting the Memorandum and Articles no fee is required to be paid by the promoters. The promoters may make a written request on plain paper enclosing a copy of the draft Memorandum and Articles, and after the vetting by the Registrar, the Memorandum and Articles may be printed as required under Section 15 of the Act.

The Memorandum and Articles have to be stamped and the value of stamp differs from State to State as per respective State Stamp laws.

Section 15 also stipulates that every Memorandum should be signed by each subscriber who should 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. In case of companies having share capital, the subscribers to the Memorandum should at least take one share each and they have to state clearly the number and nature of shares taken by them. Where necessary one witness can attest the signatures of all subscribers.

The Articles of Association should also be signed separately by subscribers. The signatures of the subscribers in the Articles of Association are also to be attested by a witness.

(e) Power of Attorney

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

(f) Additional Documents Required

(i) e-Form No. 18: Notice of Registered address

Under Section 146, a company shall as from the day on which it begins to carry on business, or as from the 30th day after the day of its incorporation whichever is earlier, should have a registered office. Where the location of the registered office is finalised prior to Incorporation of a company by the promoters, the promoters can also file along with the Memorandum and Articles, the notice of situation of the Registered office in eForm No. 18 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006. Where the location of the registered office is not finalised, e-Form No. 18 can be filed later but within 30 days from the date of incorporation.

(ii) e-Form No. 32: Particulars of Directors

Where a company by its Articles of Association appoints any person(s) who are

to act as a director, manager or secretary it may also file their particulars, in duplicate, in e-Form No. 32 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006, with the Registrar at the time of registration. However, e-Form No. 32 can also be filed within 30 days of the registration of the company or appointment of first directors.

(iii) Director's Identification Number (DIN)

MCA21 has introduced the concept of Director Identification Number (DIN) which is mandatory, unique and life time identification for all existing and prospective directors. In the scenario of e-filing, DIN is a pre-requisite for filing of certain company related documents. Any individual who is a director or intends to be a director of a company should apply for DIN first.

DIN has to be obtained by the directors of the company before commencing the procedure for incorporation of a company. The reason is that DIN will be required at the time of filing e-form 32.

(g) Statutory Declaration in e-Form No. 1

Section 33(2) requires that a declaration in e-Form No. 1 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006, by an advocate of the Supreme Court or a High Court, or an attorney or pleader entitled to appear before the High Court or a Secretary or a Chartered Accountant practising in India who is engaged in the formation of a company or by a person named in the Articles as a director, manager, or secretary of a company, that all the requirements of the Companies Act, 1956 and the rules thereunder have been complied with in respect of registration and matters precedent and incidental thereto to be filed with the Registrar. The Registrar may accept such a declaration as sufficient evidence of such compliance.

The above declaration should be on a non-judicial stamp paper of appropriate value with reference to the State in which the office of the Registrar of Companies is situated. Alternatively, non-judicial special adhesive stamps may also be affixed to the declaration. e-Form 1 is to be filed electronically and the original duly filled in and signed e-Form 1 on stamp paper are required to be sent to the concerned ROC simultaneously, failing which the filing will not be considered and legal action will be taken.

(h) Payment of Registration Fees

The fee prescribed for registration of company is required to be paid to the Registrar. The quantum of registration fees depends on the nominal capital of the company to be incorporated in case of companies having share capital which has been prescribed in Schedule X to the Act.

(i) Certificate of Incorporation

If all the documents mentioned above are complete and the Registrar of Companies is satisfied that all the requirements, aforesaid, have been complied with by the company and that it is authorised to be registered under the Act, he shall retain and register the Memorandum and Articles, if any. On the registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company that the company is

limited company. From the date of Incorporation mentioned in the Certificate of Incorporation, such of the subscribers to the Memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the Memorandum, capable forthwith of exercising all the functions of an incorporated company and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to assets of the company in the event of its being wound up as mentioned in the Act (Section 34).

A company on registration by the Registrar of Companies becomes a separate legal entity notwithstanding the fact that there was only one governing director who also held a majority of the shares of the company. The separate legal entity enabled a director, representing the company, to enter into a contract of employment with himself in his individual capacity [*Lee v. Lee's Air Farming Ltd.*, (1961) 31 Com Cases 233, 246, 248, 249: (1960) 3 All ER 420 (PC)]. Two companies which are incorporated with the same set of shareholders are nevertheless distinct and separate entities. [*Patinson v. Bindhya Debi*, AIR 1933 Pat 196].

A company may also act, as several banking companies are actually doing, as trustee, executor or administrator, provided its constitution, i.e., its Memorandum of Association permits or authorises the doing of such business.

The advantage of Incorporation is that the company never ceases to exist. It has perpetual succession and remains in existence however often its members change, until it is dissolved by liquidation. The company has an identity and existence independent of the estate and undertakings owned by it, so that even if the estate is taken over by the Government, that does not constitute a taking over of the management of the company. [*Gopalpur Tea Co. Ltd. v. Peshok Tea Co. Ltd.*, (1982) 52 Com Cases 239, 241 (Cal)].

A company incorporated under the Companies Act, is not created by the Companies Act, but comes into existence in accordance with the provisions of the Act. It is not a statutory body because it is not created by statute. It is a body created in accordance with the provisions of the statute. [*Sukhdev Singh v. Bhagat Ram*, (1975) 45 Comp. Cases 285, 297: AIR 1975 SC 1331].

In *State Trading Corporation of India Ltd. v. CTO* (1963) 33 Comp. Cases 1057 it was held that a company is a legal person, but it is not a 'citizen' so as to claim the fundamental rights granted to citizens by the Constitution. This is the effect of Section 2(f) of the Citizenship Act of 1955 which expressly excludes a company or association or body of individuals from citizenship. The effect in reference to the Constitution of India is that while companies can claim the benefit of all the fundamental rights which are guaranteed to "persons", they cannot claim the benefit of fundamental freedom listed in Article 19 which are guaranteed to citizens only.

Conclusive Evidence

According to Section 35 of the Act, a Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of

Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein with rights and liabilities of a natural person, competent to enter into contracts [*Jubilee Cotton Mills Ltd. v. Lewis*, (1924) (A.C. 958)]. The validity of the registration cannot be questioned after the issue of the certificate.

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

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

ANNEXURE I

NAME AVAILABILITY GUIDELINES, 2011

In supersession of all the previous circulars and instructions issued by Ministry of Corporate Affairs from time to time regarding name availability, the applicants and Registrar of Companies are advised to adhere following guidelines while applying or approving a name:

1. As per provisions contained in Section 20 of the Companies Act, 1956, no company is to be registered with undesirable name. A proposed name is considered to be undesirable if it is identical with or too nearly resembling with:
 - (i) Name of a company in existence and names already approved by the Registrar of Companies;
 - (ii) Name of a LLP in existence or names already approved by Registrar of LLP; or
 - (iii) A registered trade-mark or a trade mark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999.
2. While applying for a name in the prescribed e-form-1A, using Digital Signature Certificate (DSC), the applicant shall be required to furnish a declaration to the effect that:
 - (i) he has used the search facilities available on the portal of the Ministry of Corporate Affairs (MCA) i.e., www.mca.gov.in/MCA21 for checking the resemblance of the proposed name(s) with the companies and Limited

Liability Partnerships (LLPs) respectively already registered or the names already approved.

- (ii) the proposed name(s) is/are not infringing the registered trademarks or a trademark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999;
 - (iii) the proposed name(s) is/are not in violation of the provisions of Emblems and Names (Prevention of Improper Use) Act, 1950 as amended from time to time;
 - (iv) the proposed name(s) is not such that its use by the company will constitute an offence under any law for the time being in force.
 - (v) the proposed name is not offensive to any section of people, e.g., proposed name does not contain profanity or words or phrases that are generally considered a slur against an ethnic group, religion, gender or heredity;
 - (vi) he has gone through all the prescribed guidelines, understood the meaning thereof and the proposed name(s) is/are in conformity thereof;
 - (vii) he undertakes to be fully responsible for the consequences, in case the name is subsequently found to be in contravention of the prescribed guidelines.
3. There is an option in the e-form 1A for certification by the practicing Chartered Accountants, Company Secretaries and Cost Accountants, who will certify that he has used the search facilities available on the portal of the Ministry of Corporate Affairs (MCA) i.e., www.mca.gov.in/MCA21 for checking the resemblance of the proposed name(s) with the companies and Limited Liability Partnerships (LLPs) respectively already registered or the names already approved and the search report is attached with the application form. The professional will also certify that the proposed name is not an undesirable name under the provisions of section 20 of the Companies Act, 1956 and also is in conformity with Name Availability Guidelines, 2011.
4. (i) Where e-form 1A has been certified by the professional in the manner stated at '3' above, the name will be made available by the system online to the applicant without backend processing by the Registrar of Companies (ROC). This facility is not available for applications for change of name of existing companies.
- (ii) Where a name has been made available online on the basis of certification of practicing professional in the manner stated above, if it is found later on that the name ought not to have been allowed under provisions of section 20 of the Companies Act read with these Guidelines, the professional shall also be liable for penal action under provisions of the Companies Act, 1956 in addition to the penal action under Regulations of respective professional Institutes.
- (iii) Where e-form 1A has not been certified by the professional, the proposed name will be processed at the back end office of ROC and availability or non availability of name will be communicated to the applicant.
5. The name, if made available, is liable to be withdrawn anytime before registration of the company, if it is found later on that the name ought not to have been allowed. However, ROC will pass a specific order giving reasons for

withdrawal of name, with an opportunity to the applicant of being heard, before withdrawal of such name.

6. The name, if made available to the applicant, shall be reserved for sixty days from the date of approval. If, the proposed company has not been incorporated within such period, the name shall be lapsed and will be available for other applicants.
7. Even after incorporation of the company, the Central Government has the power to direct the company to change the name under section 22 of the Companies Act, 1956, if it comes to his notice or is brought to his notice through an application that the name too nearly resembles that of another existing company or a registered trademark.
8. In determining whether a proposed name is identical with another, the following shall be disregarded:
 - (i) The words Private, Pvt, Pvt., (P), Limited, Ltd, Ltd., LLP, Limited Liability Partnership;
 - (ii) The words appearing at the end of the names – company, and company, co., co, corporation, corp, corpn, corp.;
 - (iii) The plural version of any of the words appearing in the name;
 - (iv) The type and case of letters, spacing between letters and punctuation marks;
 - (v) Joining words together or separating the words, as this does not make a name distinguishable from a name that uses the similar, separated or joined words. Such as Ram Nath Enterprises Pvt. Ltd. will be considered as similar to Ramnath Enterprises Pvt. Ltd.;
 - (vi) The use of a different tense or number of the same word, as this does not distinguish one name from another. Such as, Excellent Industries will be similar to Excellence Industries and similarly Teen Murti Exports Pvt. Ltd. will be to Three Murti Exports Pvt. Ltd.;
 - (vii) Using different phonetic spellings or spelling variations, as this does not distinguish one name from another. For example, J.K. Industries limited is existing then J and K Industries or Jay Kay Industries or J n K Industries or J & K Industries will not be allowed. Similarly if a name contains numeric character like 3, resemblance shall be checked with 'Three' also;
 - (viii) The addition of an internet related designation, such as .COM, .NET, .EDU,.GOV, .ORG, .IN, as this does not make a name distinguishable from another, even where (.) is written as 'dot';
 - (ix) The addition of words like New, Modern, Nav, Shri, Sri, Shree, Sree, Om, Jai, Sai, The, etc., as this does not make a name distinguishable from an existing name such as New Bata Shoe Company, Nav Bharat Electronic etc. Similarly, if it is different from the name of the existing company only to the extent of adding the name of the place, the same shall not be allowed. For example, 'Unique Marbles Delhi Limited' can not be allowed if 'Unique Marbles Limited' is already existing;

Such names may be allowed only if no objection from the existing company by way of Board resolution is produced/ submitted;

- (x) Different combination of the same words, as this does not make a name distinguishable from an existing name, e.g., if there is a company in existence by the name of "Builders and Contractors Limited", the name "Contractors and Builders Limited" should not be allowed;
 - (xi) Exact Hindi translation of the name of an existing company in English especially an existing company with a reputation. For example, Hindustan Steel Industries Ltd. will not be allowed if there exists a company with name 'Hindustan Ispat Udyog Limited';
9. In addition to above, the user shall also adhere to following guidelines: --
- (i) It is not necessary that the proposed name should be indicative of the main object.;
 - (ii) If the Company's main business is finance, housing finance, chit fund, leasing, investments, securities or combination thereof, such name shall not be allowed unless the name is indicative of such related financial activities, viz., Chit Fund/ Investment/Loan, etc.;
 - (iii) If it includes the words indicative of a separate type of business constitution or legal person or any connotation thereof, the same shall not be allowed. e.g., cooperative, sehkari, trust, LLP, partnership, society, proprietor, HUF, firm, Inc., PLC, GmbH, SA, PTE, Sdn, AG etc.;
 - (iv) Abbreviated name such as 'BERD limited' or '23K limited' cannot be given to a new company. However the companies well known in their respective field by abbreviated names are allowed to change their names to abbreviation of their existing name (for Delhi Cloth Mills limited to DCM Limited, Hindustan Machine Tools limited to HMT limited) after following the requirement of Section 21 of the Companies Act, 1956. Further, if the name is only a general one like Cotton Textile Mills Ltd., or Silk Manufacturing Ltd., and not specific like Calcutta Cotton Textiles Mills Limited or Lakshmi Silk Manufacturing Company Limited, the same shall not be allowed;
 - (v) If the proposed name is identical to the name of a company dissolved as a result of liquidation proceeding should not be allowed for a period of 2 years from the date of such dissolution since the dissolution of the company could be declared void within the period aforesaid by an order of the Court under section 559 of the Act. Moreover, if the proposed name is identical with the name of a company which is struck off in pursuance of action under section 560 of the Act, then the same shall not be allowed before the expiry of 20 years from the publication in the Official Gazette being so struck off since the company can be restored anytime within such period by the competent authority;
 - (vi) If the proposed names include words such as 'Insurance' , 'Bank' , 'Stock Exchange' , 'Venture Capital' , 'Asset Management' , 'Nidhi' , 'Mutual fund' etc., the name may be allowed with a declaration by the applicant that the requirements mandated by the respective Act/ regulator, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;
 - (vii) If the proposed name includes the word "State", the same shall be allowed only in case the company is a government company. Also, if the proposed name is containing only the name of a continent, country, state, city such as Asia limited, Germany Limited, Haryana Limited, Mysore Limited, the same

shall not be allowed;

- (viii) If the proposed name contains any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central or any State Government under any law for the time in force, unless the previous approval of Central Government has been obtained for the use of any such word or expression;
 - (ix) If a foreign company is incorporating its subsidiary company, then the original name of the holding company as it is may be allowed with the addition of word India or name of any Indian state or city, if otherwise available;
 - (x) Change of name shall not be allowed to a company which is defaulting in filing its due Annual Returns or Balance Sheets or which has defaulted in repayment of matured deposits and debentures and/or interest thereon;
- 10.** These Name Availability Guidelines, 2011 and revised e-form 1A has been implemented with effect from 24th July, 2011.
- 11.** A fee of Rs. 1,000/- shall be charged w.e.f. 24th July, 2011 for making an application for availability of name in revised e-form 1A as provided under Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2011 dated 14.07.2011.

(Source: MCA General Circular No. 45/2011 and 48/2011 dated 08.07.2011 & 22.07.2011 respectively)

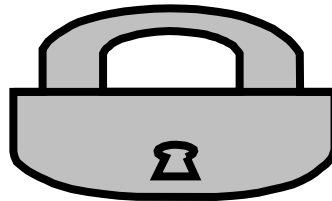
LESSON ROUND-UP



- Though the Companies Act, 1956, does not define the expression 'promoters', SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 has defined it.
- Promoters are the persons who conceive the idea of forming a company, and it is they who take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire the business or property which it is to manage.
- A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company.
- A promoter is not forbidden to make profit but he should not make any secret profit.
- Disclosure by promoters to the company should be through the medium of the Board of Directors.
- A promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed.

- In addition to disclosing secret profits, a promoter has the duty to disclose to the company any interest he has in a transaction entered into by him.
- If a promoter makes a secret profit or does not disclose any profit, the company has remedies against him, varying according to circumstances.
- A promoter may be held liable for non-compliance of provisions of Section 56 and Schedule II of the Act and for any untrue statement in the prospectus.
- He may be suspended by the court from taking part in the management of a company for a period of 5 years in circumstances specified under Section 203.
- A promoter is criminally liable under Section 63. He may be made liable to public examination if the court so orders.
- A company may proceed against a promoter on action for deceit or breach of duty under Section 543.
- A promoter has no legal right to claim promotional expenses for his services unless there is a valid contract.
- Whatever be the nature of remuneration or benefit, it must be disclosed in the prospectus, if paid, within 2 years preceding the date of the prospectus.
- The first step to be taken by a promoter in incorporating a company is to decide on the type of company to be incorporated. Further, the promoter should apply for availability of name of company, prepare the memorandum and articles of association and get them vetted, printed, stamped and signed. The promoter should then execute power of attorney and file any additional documents required. He should then file statutory declaration and pay the registration fees.
- On the registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company that the company is limited company.
- The certificate of incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein.

SELF-TEST QUESTIONS



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

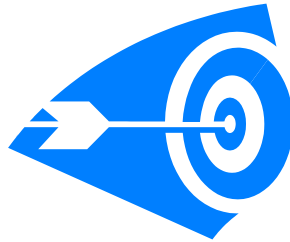
1. Who is a promoter? Write a note on the duties and liabilities of promoters.
2. What are the remedies available to the Company against a promoter?
3. What does 'conclusive evidence' means in relation to certificate of incorporation? Discuss the same citing case laws?

4. "A promoter is not a trustee or agent for the company but he stands in a fiduciary position towards it." Discuss.
 5. State the legal position of a promoter?
 6. What are the remedies available to the company against the promoter?
 7. What steps are required to be taken for the formation of a public limited company?
-

STUDY IV

INCORPORATION AND ITS CONSEQUENCES - III MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

LEARNING OBJECTIVE



This chapter explains in detail the Memorandum of Association and Articles of Association, their purpose, contents and registration. It also discusses the alterations that can be carried out in the Memorandum and Articles of Association and effect of such alterations. Memorandum of Association has been distinguished from Articles of Association herein. It also explains the legal effect of these documents and the doctrine of indoor management.

At the end of the lesson, you should be able to understand:

- Memorandum of Association, its purpose and contents, its printing and signing.
- Name clause, situation clause, objects clause, liability clause, capital clause, association clause and subscription clause.
- Doctrine of *ultra-vires*.
- Alteration of memorandum of association involving alterations of name clause or registered office clause or object clause or liability clause or capital clause.
- Articles of association, its nature and registration, statutory requirements and its contents.
- Alteration of articles of association and its effect.
- Distinction between memorandum and articles.
- Legal effect and interpretation of memorandum and articles of association.
- Doctrine of indoor management and exceptions to it.

1. MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a document which sets out the constitution of the company and is therefore the foundation on which the structure of the company is based. It defines the scope of the company's activities and its relations with the outside world. Its purpose, as observed by Lord Macmillan is "to enable the shareholders, creditors and those who deal with the company to know what is the permitted range of enterprise".

The first step in the formation of a company is to prepare a document called the

memorandum of association. It is a vital document. In fact memorandum is one of the most essential pre-requisites for incorporating a registered company under the Act. This is evidenced in Section 12 of the Act, which provides the mode of forming an incorporated company and states that in the case of a public company, any seven or more persons, and in the case of a private company, any two or more persons, associated for any lawful purpose, may by subscribing their names to a memorandum and complying with the other requirements of this Act in respect of registration, may form an incorporated company, with or without limited liability. To subscribe means to append one's signature or mark a document as an approval or attestation of its contents. According to Section 2(28) of the Companies Act, "memorandum" means memorandum of association of a company as originally framed or altered from time to time in pursuance of any previous companies law or this Act. This definition does not state the nature of this document nor is indicative of its importance. Section 13 of the Act specifies in clear terms the contents of this important document which is a charter of the company.

The memorandum of association of a company contains the fundamental provisions of the company's constitution. It contains the essential conditions upon which the company can be incorporated. In this respect, it is company's charter of its existence and operations and is of supreme importance in determining its powers. It defines as well as confines the powers of the company. It not only shows the objects of formation but also determines the utmost possible scope of its operations beyond which its actions cannot go. "THE MEMORANDUM OF ASSOCIATION", observed Palmer, "is a document of great importance in relation to the proposed company".

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

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

Memorandum determines the utmost possible scope of its operations beyond which its actions cannot go.

- True
- False

Correct Answer: True

2. PURPOSE OF MEMORANDUM

The purpose of the object clause in the memorandum is two fold. First, the intending shareholder before making investment in the company should know the field in, or the purpose for which it is going to be used and what risk he is taking in making the investment. The second purpose is that anyone dealing with the company will know without doubt what is the permitted range of activities of the company [*Cotman v. Brougham* (1918) A.C. 514].

Sections 12 to 23 of the Act prescribe the particulars to be mentioned in a memorandum of association and other requirements. It is the constitution of the company in its relation to the outside world. The company cannot depart from the provisions of the memorandum. If it enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be *ultra vires* the company and hence void.

3. FORM OF MEMORANDUM OF ASSOCIATION

Section 14 of the Companies Act provides that the memorandum of association should be in any one of the Forms specified in Tables B, C, D and E of Schedule I to the Companies Act, 1956, as may be applicable in relation to the type of company proposed to be incorporated or in a Form as near thereto as the circumstances admit. The Form in Table B is applicable in the case of companies limited by shares; the Form in Table C is applicable to companies limited by guarantee and not having a share capital; the Form in Table D is applicable to the companies limited by guarantee and having a share capital; whereas the Form in Table E is applicable to unlimited companies. A company may either adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it, or it may prepare it in any other Form, but the same should be as near thereto as the circumstances may admit.

4. CONTENTS OF MEMORANDUM

As per Section 13, the memorandum of a limited company must state the following:

- (1) (a) the name of company with “Limited” as its last word in the case of a public company; and “Private Limited” as its last word in the case of a private company;
- (b) the state in which the registered office of the company is to be situated;
- (c) in the case of a company in existence immediately before the commencement of the Companies (Amendment) Act, 1965, the objects of the company;
- (d) in the case of a company formed after such commencement:
 - (i) the main objects of the company to be pursued by the company on its incorporation; and objects incidental or ancillary to the attainment of the main objects;
 - (ii) other objects of the company not included in sub-clause (i); and

- (e) in the case of companies (other than trading corporations) with objects not confined to one State, the States to whose territories the objects extend;
- (2) The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.
- (3) The memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves; such amount as may be required not exceeding a specified amount.
- (4) In the case of a company having a share capital—
 - (a) unless the company is an unlimited company, the memorandum shall also state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount;
 - (b) no subscriber of the memorandum shall take less than one share; and
 - (c) each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

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

It is to be noted that the Companies Act, 1956 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act (Section 9).

NAME CLAUSE

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

Section 20 provides that no company shall be registered by a name which, in the opinion of the Central Government, is undesirable. A name which is identical with or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable. [*Lords Insullations India Pvt. Ltd. v. Regional Director, DCA, Chennai & Another* (2004) 122 comp. Cas. 892 (Mad.)] However, merely that few words are common may not render the name too identical and thus undesirable. [*Society of Motor Manufacturers & Traders Limited v. Motor Manufacturers & Traders Mutual Assurance Limited* [1925] 1 Ch. 675].

The Registrar must make preliminary enquiries to ensure that the name allowed

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

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

In case, despite these rules, a company is registered by a name so similar to that of another company that the public are likely to be misled or deceived the Court may grant an injunction restraining it from using that name.

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

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

Section 22 provides that if by inadvertence or otherwise a name has been registered which is identical with or too nearly resembles the name of an existing company, the company may change it by obtaining previous written approval of the Central Government and by passing an ordinary resolution. The Central Government is empowered to direct a company, within 12 months of its registration, to rectify its name if by inadvertence it has been registered with a name similar to that of an existing company. If a company is so directed by the Central Government, it must change the name within 3 months of the direction and with the previous written approval of the Central Government.

In the case of *Atlas Cycles (Haryana) Ltd. v. Atlas Products Pvt. Ltd* [146 (2008) DLT 274 (DB)], use of the brand name as corporate name was settled. Both the plaintiff and the defendant companies belong to same family. The Appellant-plaintiff was the proprietor of the trade mark in the name "Atlas". The Respondent-defendant

company containing the name "Atlas" in its corporate name started dealing in bicycles. The plaintiff objected the use of the name "Atlas" by the defendant company. The Defendants are restrained from using the word 'Atlas' in their corporate/trade name in respect of bicycles and bicycle parts.

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

As a company cannot be registered with a name which is undesirable or which is identical with or too nearly resembles the name of the existing company, the availability of the name is required to be ascertained from the Registrar. However, the Registrar shall not register a company with the words 'stock exchange' as part of its name without obtaining principle approval or no objection of SEBI in order to ensure that the investors are not misled by such names while dealing with members of unrecognised stock exchange. (Circular No. 3/96 dated 12-4-1996).

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

A person cannot be permitted to name a company even after his personal name if that name resembles the name of an existing company. [*K.G. Khosla Compressors Ltd. v. Khosla Extraktions Ltd.*, (1986) 1 Comp LJ 211 : AIR 1986 Del 181]

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

Publication of Name

The name of the company and the address of its registered office must be painted or affixed outside every office or place at which its business is carried on, in a conspicuous position and in letters easily legible in English and in the language in general use in the locality. The name must also be engraved on the company's common seal. Further, the name of the company and the address of the registered office must be mentioned in legible characters in all business letters, in all its bill heads and in all its notices and other official publications, as well as in all negotiable instruments (Section 147).

Department of Company Affairs (now MCA) has clarified that expression of its name in English alone, in addition to the expression in the local language will be a sufficient compliance with the requirements of the section.

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

The words 'outside of every office' do not mean outside the premises in which

the office is situated [*Dr. H.L. Batliwalla Sons & Company Ltd. v. Emperor* (1941) 11 Comp Cas. 154 : AIR 1941 (Bom.) 97]. Where office is situated within a compound, the display outside the office room though inside the building is sufficient.

When the word “Limited” is Dropped

The Central Government may by licence permit the registration of a company with limited liability, without using the word “limited” as part of its name, if it is formed for the promotion of commerce, art, science, religion, charity or any other useful object, and prohibits distribution of its income as dividend to its members (Section 25).

SITUATION CLAUSE

The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein. This can be filed with the Registrar of Companies separately in e-Form No. 18 within 30 days of incorporation of the company.

Registered Office of a Company

Within 30 days of incorporation or on the day when it commences business, whichever is earlier, the company must have a registered office to which all communications and notices may be sent. The company must also give notice of the situation of the registered office to the Registrar.

OBJECTS CLAUSE

The third compulsory clause in the memorandum sets out the objects for which the company has been formed. All companies registered after the coming into force of the Companies (Amendment) Act, 1965, must divide their objects clause into two sub-clauses, namely:

- (i) **Main objects:** This sub-clause contains the main objects of the company to be pursued on its incorporation and objects incidental or ancillary to the attainment of the main objects.
- (ii) **Other objects:** This sub-clause must state other objects which are not included in the “Main objects” and which may be pursued by the company at anytime in the future.

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

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

in the ordinary form, but a railway company cannot issue bills although it may borrow money.

The subscribers to the memorandum of association enjoy almost unrestricted freedom to choose the objects. The only restriction is that objects should not be illegal and against the provisions of the Companies Act, 1956.

Power under Section 17(5) cannot be used by Company Law Board to impose unreasonable conditions on the company.

The power should be used to subserve a general objective namely, investor protection at large and should not be used to serve the purpose of a section of the investors. *A.K.G. Acoustics (India) Ltd., In re.* [1996] 10 SCL 334 (CLB-Delhi).

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

The terms 'incidental' or 'ancillary' in the same clause mean activity arising out of or directly connected to the main activity. For example, the production of by-products is incidental to the manufacture of the main products and also the powers of the company to pursue its objects, the power to borrow etc. Whether an activity is incidental or ancillary to the main activity will have to be determined on a case to case basis.

The memorandum of association of a company is its charter defining the objects of its existence and operations. As pointed out in *Cotman v. Brougham* 1918 AC 514, its purpose is to to enable the shareholders, creditors and those dealing with the company to know what is the permitted range of enterprise. The objects clause or clauses in the memorandum are to be so construed as to confer on the company all powers reasonably required to the attainment of the objects.' -A memorandum of association like any other document must be read fairly and its importance derived from a reasonable interpretation of the language which it employs" [*Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd.* AC 677: (1931) 1 Com. Cases 285 : AIR 1931 PC 182; 62 MLJ 163; *Deuchar v. Gas, Light and Coke Co.*, (1925) AC 691]. The natural and ordinary meaning of the language used in several clauses should be taken into consideration for determining whether a particular transaction does or does not fall within the objects stated in the memorandum [*Bell Houses Ltd. v. City Wall Properties Ltd.* (1966) 36 Com Case 779: (1966) 2 All ER 674 (CA)].

It is *ultra vires* for a company to act beyond the limits of its memorandum. Any attempted departure will be invalid and cannot be validated even if assented to by all the shareholders of the company. *Ultra vires* means an act or transaction of a company, which though it may not be illegal, is beyond the company's powers by reason of not being within the objects of the memorandum of association. The memorandum is, so to speak, the area beyond which a company cannot travel. [*Ashbury Railway Carriage and Iron Company v. Riche*, (1875) LR 7 HL 653]. The Memorandum of Association is the 'Lakshman Rekha' for a company. An act beyond the objects mentioned in the memorandum is *ultra vires* and void and cannot be ratified [*Dr. Lakshmanaswami Mudaliar A. v. LIC* (1963) Comp LJ 248: 1963 33 Com

Cases 420 : AIR 1963 SC 1185]. Where no connection or nexus exists between the exercise of a power and the attainment of an object, exercise of power will be *ultra vires* [*Radha Cinema & Co. v. Chitralipi Films*, 1974 Tax LR 2180 (Cal)].

DOCTRINE OF ULTRA VIRES

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

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

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

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

The memorandum of the company in the said case defined its objects thus: –The objects for which the company is established are to make and sell, or lend or hire, railway plants..... to carry on the business of mechanical engineers and general contractors.....”.

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

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

However, later on, the House of Lords held in other cases that the doctrine of *ultra vires* should be applied reasonably and unless it is expressly prohibited, a

^{*} The word ‘ultra’ means beyond and the word ‘vires’ means the powers, ‘ultra vires’.

company may do an act which is necessary for or incidental to the attainment of its objects. Section 13(1)(d) of the Companies Act, 1956 provides that incidental to or ancillary to the main objects be stated in the memorandum. However, even when such incidental objects are not stated, they would be allowed by the principle of reasonable construction of the memorandum.

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

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

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

Further, in the case of *Bell Houses Ltd. v. City Wall Properties Limited* (1966) 36 Comp. Cas 779, the objects clause included a power to carry on any other trade or business whatsoever which can, in the opinion of the Board of directors, be advantageously carried on by the company. The Court have held the same to be in order.

Corporate charitable spending under Section 293(1)(e) and ultra vires rule

Section 293(1)(e) of the Companies Act, 1956 has statutorily authorised the Board of directors, with the consent of the company in general meeting, to contribute for any charitable or other purpose any amount not exceeding Rs. 50,000/- (fifty thousand) in one financial year or five per cent of the average net profits during the preceding three financial years whichever is greater. Therefore, no question as to vires of such payments is likely to arise. But, directors have no right to give charity out of the company's money unless it would lead to the promotion of the company's objects.

Loans, borrowings, guarantees and ultra vires rule

An *ultra vires* borrowing does not create a relationship of a debtor and creditor. In

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

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

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

Implied Powers

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

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

Powers which are not implied

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

- (1) acquiring any business similar to company's own business. [*Ernest v. Nicholls*, (1857) 6 HLC 40];
- (2) entering into agreement with other persons or companies for carrying on business in partnership or for sharing profit, joint venture or other arrangements. Very clear powers are necessary to justify such transaction [*Re European Society Arbitration Act* (1878) 8 Ch 679];
- (3) taking shares in other companies having similar objects. [*Re Barned's Banking Co., ex parte* and *The Contract Corporation* (1867) 3 Ch. App. 105. *Re William Thomas & Co. Ltd.* (1915) 1 Ch 325];
- (4) taking shares of other companies where such investment authorises the doing indirectly that which will not be *intra vires* if done directly;

- (5) promoting other companies or helping them financially [*Joint Stock Discount Co. v. Brown*, (1869) LR 8 EQ 381];
- (6) a power to sell and dispose of the whole of a company's undertaking;
- (7) a power to use funds for political purposes;
- (8) a power to give gifts and make donations or contribution for charities not relating to the objects stated in the memorandum;
- (9) acting as a surety or as a guarantor.
- (10) Amalgamation cannot be denied to a company merely because its memorandum of association does not provide for it [*Eita India Ltd. In Re* (1997) 24 CLA 37 (Cal.)]

Shareholder's right in respect of *ultra vires* acts

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

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

Effects of *ultra vires* Transactions

- (i) **Void ab initio** – The *ultra vires* acts are null and void *ab initio*. The company is not bound by these acts. Even the company cannot sue or be sued upon [*Ashbury Railway Carriage and Iron Company v. Riche* (Supra)].

Ultra vires contracts are *void ab initio* and hence cannot become *intra vires* by reason of estoppel or ratification.

- (ii) **Injunction:** The members can get an injunction to restrain the company wherein *ultra vires* act has been or is about to be undertaken [*Attorney General v. Gr. Eastern Rly. Co.*, (1880) 5 A.C. 473].
- (iii) **Personal liability of Directors:** It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted to purposes foreign to company's memorandum, the director will be personally liable to replace it. In *Jehangir R. Modi v. Shamji Ladha*, [(1866-67) 4 Bom. HCR (1855)], the Bombay High Court held: –A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit”.

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

However, a distinction must be drawn between transactions which are *ultra vires* the company and the transactions which are *ultra vires* the directors.

Where the directors exceed their authority the same may be ratified by the general body of the shareholders. Provided the company has the capacity to do that transaction as per its memorandum of association.

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

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

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

- True
- False

Correct Answer: True

LIABILITY CLAUSE

The fourth compulsory clause must state that liability of the members is limited, if it is so intended that the company be limited by shares or by guarantee. The effect of this clause is that, in a company limited by shares, no member can be called upon to pay more than what remains unpaid. For example, where a shareholder holding a share of Rs. 100 has paid Rs. 75 on it, he can be called upon to pay the balance of Rs. 25. In case, he has paid the full value of Rs. 100, he cannot be required to pay anything more even if the company owes huge debts to its creditors.

In a company limited by guarantee, the liability clause will state the amount which each member should undertake to contribute to the assets of the company in the event of liquidation of the company. He cannot be called upon to pay anything before the company goes into liquidation.

CAPITAL CLAUSE

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

The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects. The usual way to state the capital in the memorandum is: "The capital of the company is Rs. 10,00,000 divided into 1,00,000 equity shares of Rs. 10 each". This amount lays down the utmost limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 94 of the Companies Act, 1956.

If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorised to issue capital beyond its authorised/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorised capital, the amount received on excess number of shares should be returned.

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

According to Section 148 of the Act, if the amount of the authorised capital, of the company is stated in any notice, advertisement, official publication, business letter, bill head or letter paper, it shall also contain a statement in an equally prominent position and in conspicuous characters of the amount of the capital which has been subscribed and the amount paid-up.

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

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

- True
- False

Correct Answer: True

ASSOCIATION CLAUSE AND SUBSCRIPTION

The memorandum concludes with the subscription clause in which there is a declaration of association. The subscribers to the memorandum declare: ~~We~~, the several persons whose names and addresses subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names”. Then follow the names, address, occupations of the subscribers, and the number of shares each subscriber has taken and his signatures attested by a witness.

The statutory requirements regarding subscription of memorandum are that:

- (a) the memorandum must be signed by each subscriber in the presence of at least one witness who must attest the signatures;
- (b) each subscriber must take at least one share;
- (c) each subscriber must write opposite his name the number of shares which he agrees to take (Section 13).

5. PRINTING AND SIGNING OF MEMORANDUM

As per Section 15 of the Companies Act, 1956, the memorandum must be printed, divided into paragraphs numbered consecutively and signed by seven subscribers (two in the case of the private company) in the presence of at least one witness who shall attest the signatures. Each subscriber must state his address and occupation and the number of shares he takes opposite his name. Only a person *sui juris*, i.e., capable of entering into contract on his own can subscribe to the

memorandum. Both artificial and natural persons can subscribe to memorandum. The memorandum must be stamped according to the Stamp Act of the State in which the registered office of the company is to be situated.

Where a company is a subscriber to the memorandum of association, it must be signed by a duly authorised agent. [*Whitley Partners Ltd. Re* (1886) 32 Ch D 337].

One witness can attest all the signatures provided he is not himself a subscriber to the memorandum [*Seal v. Claridges*, (1881) 7 QBD 516]. If the attestation of a memorandum of association which has been registered turns out to be irregular at a later stage it does not render the same void [*Chotalal v. Dal Sukhram*, (1892) ILR 17 Bom 472].

Subscription induced by misrepresentation

A subscriber to the memorandum cannot, after the issue of the certificate of incorporation, repudiate his subscription on the ground that he was induced to sign by misrepresentation [*Re Metal Constituents Ltd., Lord Lurgan's case - Re*, (1902) 1 Ch 707].

6. ALTERATION OF MEMORANDUM OF ASSOCIATION

The memorandum of association of a company may be altered in the following respects:

- (1) By changing its name (Sections 21 to 24).
- (2) By altering it in regard to the State in which the registered office is to be situated or its objects (Section 17).
- (3) By altering its share capital (Section 94).
- (4) By reorganising its share capital (Sections 391 to 396).
- (5) By reducing its capital (Section 100).
- (6) By making the liability of the directors unlimited (Section 322).

For the purpose of amendment different clauses of the memorandum are broadly classified into two parts, namely,

- (a) part relating to conditions, and
- (b) part relating to other provisions.

The conditions part of the memorandum cannot be amended except by way of procedure expressly laid down in the Companies Act, 1956 [See Section 16(1)]. The provisions relating to the name clause, registered office clause, the objects clause, limited liability clause, subscriber's share clause as provided in Section 13 of the Companies Act, 1956 or any other specific provisions contained in the Act are to be regarded as the conditions contained in the memorandum [Section 16(2)]. For the alteration of those conditions in the memorandum of association, a rigid procedure is to be followed and strict compliance of the procedure is demanded by law. Failure to comply with the express provisions made under the Act for the purpose of alteration of the conditions contained in the memorandum will be deemed as a nullity.

Other provisions which are found included in the memorandum including those relating to appointment of a managing director or manager fall in the category of other provisions in the memorandum [See Section 16(3)]. These may be generally altered in the same manner as the articles of the company unless there are any specific directions as to the procedure to be followed made in the Act. Thus, procedure to be followed as provided in the articles is adhered to for this purpose. The procedure for the alteration of the compulsory clauses or conditions of the memorandum is discussed in detail in the following paragraphs.

7. ALTERATION OF NAME CLAUSE

The name of the company can be altered by a special resolution and with the approval of the Central Government. Approval of the Central Government is not necessary if the change relates to the addition/deletion of the word 'private' to the name. The powers of the Central Government to accord approval to the change of name which were earlier delegated to the Regional Directors have been delegated to the Registrar of Companies w.e.f. 1.7.1985, vide Notification No. GSR 507 dated 24.6.1985. For this purpose an application is required to be made to the Registrar in e-Form No. 1A with a fee of Rs. 1,000/- to ascertain availability of name. The period of validity is sixty days. The change must be communicated to the Registrar by filing e-Form No. 23 prescribed under the Companies (Central Government's) General Rules and Forms, 1956 (as amended) alongwith a printed or typewritten copy of the special resolution and explanatory statement within 30 days of the passing thereof. Also as per the instructions for filling e-form 23, the memorandum and articles of association of a company are also required to be attached. The change in name has to be sanctioned in the light of guidelines prescribed by the Central Government in this behalf. The change of name is not permitted during the pendency of a petition before the Company Law Board under Section 17.

As per existing guidelines, the companies well-known in their respective field by abbreviated names, are allowed to change their names by way of abbreviation (e.g. ABC Ltd.) with the approval of the Ministry of Corporate Affairs after following the requirement of Section 21 of the Companies Act, 1956. It was decided that any such change of name would require only the approval of Regional Director concerned. The companies were however, required to make applications in e-Form No. 1A for availability of the proposed changed names to the concerned Registrar of Companies. This power has been delegated to the Registrar of Companies.

Under Section 22 of the Act, rectification of the name of the company is required to be carried out if, through inadvertence or otherwise, a company is registered by a name which is identical with or too nearly resembles the name of a company already in existence. The rectification of the name must also be carried out if the Central Government so directs within a period of 12 months from the date of registration of the company. The direction of the Central Government is required to be complied with within a period of 3 months from the date thereof. Any default in complying with the direction by the Government render the company and its officers in default liable for punishment with fine which may extend to one thousand rupees for every day during which default continues.

SEBI vide its circular No. SMDRP/POLICY/CIR-8/99 dated April 26, 1999 had

provided that companies who change their name suggesting any new line of business (including software business), shall disclose the turnover and income, etc., from such new activities separately in the quarterly/annual results required to be submitted/published. It was further provided that companies which have changed their names after January 1, 1998 or change the name hereafter shall make such disclosures and shall continue to make these disclosures for a period of 3 years from the date of change in the name.

In addition to these provisions, it has now been decided that all listed companies which decide to change their names shall be required to comply with the following conditions:

1. A time period of atleast 1 year should have elapsed from the last name change.
2. Atleast 50% of its total revenue in the preceding 1 year period should have been accounted for by the new activity suggested by the new name.
3. The new name along with the old name shall be disclosed through the web sites of the respective stock exchange/s where the company is listed and also through the EDIFAR web site for a continuous period of one year, from the date of the last name change. (SEBI/MRD/Policy/AT/Cir-20/2004 dated April 30, 2004).

EFFECT OF CHANGE

The change of name will not affect any rights and obligations of the company, or legal proceedings commenced under the old name. Pursuant to Section 23(3), the change of name shall not affect any rights or obligations of the company, or render defective any legal proceedings by or against it, and any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name.

However, where a company changes its name and the new name has been registered by the Registrar, the commencing of legal proceedings in the former name is not competent [*Malhati Tea Syndicate Ltd. v. Revenue Officer*, (1973) 43 Comp. Cas. 337]. In spite of a change in name the entity of the company continues. The company is not dissolved nor does any new company come into existence. If any legal proceeding is commenced, after change in the name, against the company in its old name, the company should be treated as if it is not in existence. It is not an incurable defect and plaint can be amended to substitute the new name [*Pioneer Protective Glass Fibre (P) Ltd. v. Fibre Glass Pilkington Ltd.*, (1986) 60 Comp. Cas. 707 (Cal.)].

The courts have held that proceedings commenced by the company in its former name can be continued under its new name [*Solvex Oils and Fertilizers v. Bhandari Cross-Fields (P) Ltd.*, (1978) 48 Com Cases 260 (P & H)].

In *Economic Investment Corporation Ltd. v. CIT (WB)* AIR (1970) 40 Comp Case 1 (Cal.), it was held that by change of name, the constitution of the company is not changed, only the name changes. It is not similar to the reconstitution of a partnership which means creation of a new legal entity altogether.

ALTERATION OF REGISTERED OFFICE CLAUSE***(a) Change within the local limits of same town***

Section 146 of the Act provides that a company can change its registered office from one place to another within the local limits of the city, town or village, where it is situated, by a Board resolution. A notice of the change is required to be given to the Registrar in e-Form No. 18 within 30 days of such change. This does not involve alteration of memorandum.

(b) Change from one city to another within the same State

If the registered office is to be shifted from one city, town or village to another city, town or village within the same State, a special resolution has to be passed in the general meeting of the company and a printed or type-written copy of the special resolution alongwith the explanatory statement has to be filed with e-Form No. 23 within 30 days. Also within 30 days of the change of the registered office a notice to the Registrar should be given of the new location of the office in e-Form No. 18. This change of the registered office also does not involve alteration of memorandum.

(c) Change within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies

Section 17A provides that confirmation by the Regional Director will be necessary for changing registered office of a company from one place to another if the change of registered office is from the jurisdiction of one Registrar to the jurisdiction of another within the same State. For this purpose, the company is required to make an application in e-Form No. 1AD.

The Regional Director, after hearing the parties shall pass necessary orders within 4 weeks from the date of the receipt of the application. Thereafter, the company concerned shall file a copy of the said orders to Registrar of Companies (ROC) within 2 months from the date of the confirmation order by Regional Director. The said ROC shall record the ordered changes in its records, while the ROC of the state where the registered office of the company was previously situated, shall transfer all the documents and papers to the present ROC.

(d) Change of Registered office from one State to another

The change of registered office from one State to another State involves alteration of memorandum, and the change can be effected by a special resolution of the company which must be confirmed by the Company Law Board (Section 17).

In order to simplify the procedures and cut timelines, the Ministry has decided that the work relating to confirmation of shifting of registered office from one state to another state and consequent alteration to Memorandum of Association of the company under section 17 of the Companies Act, 1956 shall be shifted from the jurisdiction of Company Law Board to the Central Government. (General Circular No.50/2011 dated 25.07.2011)

It has further been decided to delegate this work to the respective Registrar of

Companies under whose jurisdiction the registered office of the company is situated. The petitions filed with the Company Law Board and pending as on the effective date of notification shall be transferred to respective Registrar of Companies.

According to Section 17(1), a company may, by special resolution alter the provisions of its memorandum so as to change the place of its registered office from one State to another or alter the objects of the company so far as may be required to enable it:

- (a) to carry on its business more economically and more efficiently;
- (b) to attain its main objects by new or improved means;
- (c) to enlarge or change the local area of its operations;
- (d) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company.
- (e) to restrict or abandon any of the objects specified in the memorandum;
- (f) to sell or dispose of the whole, or any part of the undertaking, or of the undertakings, of the company; where a company feels it has grown so big or that management has become difficult and uneconomical, it may alter its objects to sell or dispose of any of its undertakings.
- (g) amalgamate with any other company or body of persons - Section 17(1) and (2).

The alteration of the provisions of memorandum relating to the change of the place of its registered office from one State to another shall not take effect unless it is confirmed by the Central Government. [Section 17(2)].

Central Government shall cause notice of the petition for confirmation of the alteration to be served on the Registrar who shall also be given a reasonable opportunity to appear before the Central Government and state his objections and suggestions, if any, with respect to the confirmation of the alteration [Section 17(4)].

Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper [Section 17(5)].

Central Government shall, in exercising its powers under the section have regard to the rights and interests of the members of the company and of every class of them, as well as to the rights and interests of the creditors of the company and of every class of them [Section 17(6)].

Central Government may, if it thinks fit, adjourn the proceedings in order that an arrangement may be made to its satisfaction for the purchase of the interests of dissentient members; and may give such directions and make such orders as it thinks fit for facilitating or carrying into effect, any such arrangement provided that no part of the capital of the company, may be expended in any such purchase [Section 17(7)].

According to Section 17(3), Central Government must be satisfied, before confirming the alteration in the memorandum that sufficient notice has been given to every person whose interest, in the opinion of the Central Government will be affected by the alteration.

No notice of the petition is required to be served on the State, but in view of the wider language of Section 17, CLB may direct notice to be served on the State if it is of the view that the interest of the State will be affected by the alteration. Where the alteration is affected by changing the registered office from one State to another State, the loss of revenue in one State would be accompanied by increase in revenue in the other and in such a case the interest of a particular State ought not to be considered but it is the interest of the country as a whole which should be considered. The decision to shift the registered office of the company to another state being a domestic matter rests with shareholders and the company is the best judge of how to run its business more economically, efficiently or conveniently, even though it would result in loss of revenue to the state. [*Satyashree Balaji Wires & Cables (P) Ltd.*, In re (2006) 71 CLA 231 (CLB)].

A company was allowed to shift its registered office from Bihar to West Bengal inspite of the fact that Bihar Government had granted lease of land for the company's factory on the condition that it would not shift its registered office. The CLB also held that interest free loans, sales tax, electricity and other subsidies would have no bearing on the shifting [*Usha Beltron Re*, (2000) 27 SCL 124].

Employee's right to object in case of shifting of registered office from one state to another – Some legal cases

In the case of *Bharat Commerce and Industries Ltd., Re*, (1973) 43 Com Cases 162 (Cal.), it was held that employees' union, which was a registered body and which represented quite a number of the employees at the registered office of the company, would have the legal standing to appear before the court and oppose the application on the ground that their interests would be likely to be prejudicially affected if the resolution for shifting the registered office of the company from one state to another is confirmed by the court. However, it was held that the employees' union cannot oppose on the ground that there would be loss of revenue or unemployment in the State or that the meeting at which the special resolution was passed was not itself valid.

Further, in the case of *Metal Box India Ltd. Re*, (2000) 37 CLA 15, it was held that where the shifting of the registered office was in accordance with a scheme approved by the BIFR, it was held that the workers had no right of objection because their continuation in the company's employment was ensured unless, of course, a worker preferred voluntary retirement.

A different dimension to the employees right can be seen in the case of *Kwality Ice Creams (India) P Ltd., Re*, (2009) 91 SCL 231 : (2009) 148 Com Cases 631 : (2010) 98 CLA 218 (CLB). In that case, the company's petition for carrying its registered office from West Bengal to Delhi was opposed by two employees of the head office on the ground that their action against the company would be prejudiced. The CLB said that the facility for litigation is not a valid ground to stall

shifting. There was no restraint order from any court against the proposed shifting. The Company Law Board allowed shifting subject to the condition that the interest of none of the employees at the registered office would be prejudiced by retrenchment or otherwise.

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

Change from one city to another within the same state of the registered office involves alteration of Memorandum.

- True
- False

Correct Answer: False

ALTERATION OF OBJECTS CLAUSE OF THE COMPANY

Earlier for changing the objects of the company, the confirmation of Company Law Board was required. However, the Companies (Amendment) Act 1996 w.e.f. 1.3.1997 has done away with this requirement. Consequently pursuant to Section 17(1) (as discussed earlier) a company can change its object clause by passing a special resolution and confirmation of Company Law Board for the same is not required. Further in case of a listed company, the special resolution for alteration in the object clause of the Memorandum of Association needs to be passed through Postal Ballot on terms of section 192A by a listed company. However the requirement of confining the alteration to the seven points formula of sub-section (1) remains applicable:

(1) To carry on its business more efficiently and economically [Section 17(1)(a)]

When a company is not in fact carrying on any business, it cannot alter its objects under this clause [*Re, Drages Ltd.* (1942) 1 All ER 194]

The true legal position, observed the Delhi High Court, is that the business must remain substantially the same, and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company. [*Delhi Bharat Grain Merchant Assn. Ltd., In re.* (1974) 44 Comp. Cas. 214 (Delhi)].

(2) To attain its main purpose by new or improved means [Section 17(1)(b)]

The expression used is to attain its main purpose'. Under this head an alteration can be made only to enable the company to attain its main purpose, not any purpose [*Kirkadly Café Co.* 1921 SC 681].

(3) To enlarge or change the local area of its operation [Section 17(1)(c)]

When the alteration was intended to enlarge the area of the company's operation, the order of confirmation imposed a condition that the company's name indicating that its business was carried on in a particular area should be changed. [*In Indian Mechanical Gold Extracting Company, In re.* (1891) 3 Ch. 538].

In this case, the company's business was confirmed to India. It wanted to enlarge its operations. It was permitted to do so on the condition that the word Indian was also dropped from its name.

- (4) **To carry on some business, which under existing circumstances, may conveniently or advantageously be combined with the business of the company [Section 17(1)(d)]**

This clause has a wide scope and allows a company to diversify, the only condition being that the alteration should not be prejudicial to or destructive of the existing business.

The general considerations in this regard were stated by Lawrence, J. in *Patent Tyre Company Ltd., In re.* (1923) 2 Ch. 222 at 228:

It is essentially a business proposition, whether an additional business can or cannot be conveniently carried on under existing circumstances, with the business of the company. The additional business, of course must not be destructive of or inconsistent with the existing business, it must leave the existing business substantially what it was before, but the additional business may be one which is different from the original business and yet may well be conveniently and advantageously combined with the business which is being carried on.'

However in *New Asiatic Insurance Co. Ltd. In re.* (1967) 37 Comp. Cas. 331 (Punj.) it was held that confirmation of alteration of objects is not to be refused only because new business is wholly different from existing business.

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

For deleting any portion of the objects clause, the procedure laid down in this clause have to be followed. The word restrict or abandon have been held as not including in the case of a charitable company, substitution of one kind of beneficiary or charity with another. [*Hampstead Garden Suburb Trust Ltd., In re.*, (1908) 2 Ch. 287].

- (6) **To sell or dispose of the whole or any part of the undertaking or any of the undertakings [Section 17(1)(f)].**

If a company wishes to cut-back i.e. where it feels it has diversified in various directions and that management of the company has become difficult or uneconomical, it may alter its objects to sell or dispose of whole or part of its undertaking(s).

- (7) **To amalgamate with any other company or body corporate [Section 17(1)(g)]**

It means that the company was allowed to amalgamate.

A company doing jute business can alter its memorandum so as to do business in rubber if that can conveniently and efficiently be carried on with the existing business [*Juggilal Kamlapat Jute Mills Co. Ltd. v. Registrar of Companies* (1966) 1, Comp. L.J. 292].

In the matter of *Geo Rubber Exports Limited* (Company Petition No. 90/17/SRB/1991 decided on 20.8.1991) the Company Law Board dealt with the question whether the alteration of object clause of Memorandum of Association was in accordance with the provisions of Section 17(1) of the Act in case where the company was not carrying on any business at the time of alteration. The Board observed that there was no prohibition in Section 17 that the company should not be allowed to change its objects clause to enable it to take some new business unless it has actually translated any of its objects as set out in the Memorandum of Association into business. What is contemplated in Section 17(1)(d) is that if there is some existing business, it has to be ensured that the new business to be embarked upon can conveniently or advantageously be combined with the existing business under the existing circumstances and the new business is not inconsistent with or destructive of the existing business. In the instant case it had become difficult for the company which was incorporated for carrying on the business of Rubber Products to start that business because of adverse international market conditions. It therefore had altered its objects clause to carry on the business of a aqua farming, marine products. The CLB observed that if alteration was passed by a special resolution of shareholders and there was no objection from any creditor or shareholder and there was no objection from any other person and the business proposed to be carried on is not illegal, the company can alter its memorandum, even before starting any business.

The validity of a resolution to undertake new business had to be examined in connection with the company's legitimate business and not in connection with an unauthorized business, though the company was actually carrying on that business. Thus, where a company was manufacturing hinges without any authority in the memorandum and it wanted to combine with it, the production of sewing machines also, it was held that Section 17(1)(d) would not cover such a case. [*Link Electro Mechanical Works (P) Ltd. v. Registrar of Companies U.P.* (1963) 2 Comp LJ 111 (All)]. Also, an object negatively expressed, e.g. that 'the company shall not undertake the following objects' could not, in the opinion of CLB, be allowed [*Balaji Mutual Benefit Ltd., Re.* (1994) 4 Comp. LJ.]

REGISTRATION OF ALTERATION

A company shall file with the Registrar, a special resolution passed by it within one month of the date of passing of such resolution in relation to clauses (a) to (g) of Section 17(1) or a certified copy of the Order of the Company Law Board made under Sub-section (5) confirming the alteration within 3 months from the date of order, as the case may be together with the printed copy of the altered memorandum and the Registrar shall register them and certify the registration under his hand within one month from the date of filing of such documents [Section 18(1)]. No such alteration as is referred to in Section 17 (i.e., alteration of objects clause or shifting of the registered office from one State to another) shall have effect until it is registered with the Registrar in accordance with the provisions of Section 18 [Section 19(1)]. Section 19(2) provides that where these documents required to be filed are not so filed with the Registrar within the time allowed under Section 18, the alteration and the order of Central Government made under Section 17(5) and all proceedings connected therewith, shall, at the expiry of such period, become void and inoperative. However the CLB/Central Government, may on sufficient cause shown, revive the order on application made within a further period of one month.

In the case of alteration of the memorandum for shifting the registered office from one State to another, certified copy of the order of the Company Law Board shall be filed by the company with the Registrar of each of the States and each of them shall register it and certify the registration.

The certificate shall be conclusive evidence that all the requirements of this Act with respect to the alteration and confirmation thereof have been complied with. The Registrar of the State from which the registered office is transferred will send to the Registrar of the other State all the documents relating to the company registered in his office.

The Ministry of Corporate Affairs has clarified that the date of order for the purpose of Section 18 shall be the date on which the CLB approves and signs the formal order, and not the date of last hearing.

In the case of *Shivalik Steels & Alloys Pvt. Ltd. v. Registrar of Companies* (Company Petition No. 73/18(4)/91-CLB dated 23.9.1991), the Company filed, certified copy of the order of Company Law Board approving alteration of objects clause in the memorandum of association of the company (as earlier the confirmation of Company Law Board was necessary), with the Registrar of Companies after a lapse of five months as against three months stipulated in Section 18(1) of the Act. The matter however remained with the Registrar for four years without any registration. When the company approached the Registrar for registration of the amended objects clauses as approved by the Company Law Board whose order had been filed, the Registrar advised the company to seek fresh orders of the Company Law Board or have the earlier order revived.

The Company Law Board observed that Section 19(2) leaves no scope for the order to be kept valid and operative excepting when the CLB revives the order on sufficient cause shown. This revival is possible only within a further period of one month after the expiry of a period of three months. In the present case since a total period of five months had already expired, the order as well as the proceedings connected therewith had become void and inoperative by mere expiration of time.

The Board further observed that it is not vested with any power under any section of the Act to revive an order under Section 17 which by operation of law had become void and inoperative. When an order had become void by operation of law, extension of time cannot in any way help because the order no longer exists. The company was therefore advised by the Board to undergo the whole process under Section 17 once again even though it would have preferred to avoid a small company repeating whole process but was helpless.

Again, in the case of *Shivalik Steels & Alloys Pvt. Ltd. v. Registrar of Companies* (Company Petition No. 73/18(4)/91- CLB dated 23.9.91- CLB decided on 23.9.91), the alteration of situation clause was approved by the Company Law Board and a certified copy of the order was filed with the Registrar within time but without the requisite documents i.e. a printed copy of the memorandum of association as altered, Form No. 21 of the Companies (Central Government's) General Rules and Forms, 1956 and the requisite fee. The Registrar did not register the alteration and advised the company to seek condonation of delay under Section 18(4) in filing other documents. The Board granted extension of time for registration of the alteration on the grounds that Form 21

is merely in the nature of a covering letter and does not provide for any additional information. Supplying a copy of the altered memorandum is again in the nature of a formality for record purposes. Thus in effect the object contemplated under Section 18(1) is served with filing of the certified copy of the Order of CLB. However, technically the filing is not complete and hence the Registrar cannot register the alteration without the compliance with the formalities though mere failure to file the accompanying documents does not nullify the filing of the basic documents.

The main spirit behind Section 18(3) of the Companies Act, 1956 in regard to the filing of the Court's (presently CLB) order confirming the transfer of the company's registered office from one State to another State with the Registrar of the Companies of each State is that the Registrar of Companies from whose State the registered office is transferred should keep the Court (presently CLB) order duly registered in his office as an evidence to such shifting and should transfer all other records of the company to the Registrar of Companies to whose State the Registered Office has been so shifted. The other Registrar of Companies will register the other copy of the Court (presently CLB) order and keep that order with the records transferred to him by his counterpart.

A question has been raised about the applicability of Sections 18 and 637B of the Companies Act, 1956 to a case where there has been delay on the part of a company in filing copy of the CLB order under Section 17 in respect of shifting of the registered office of the company from one State to another. The above matter has since been examined very carefully. The Department (now Ministry) is of the view that an order by the CLB under Section 17(1) relating to the shifting of the registered office from one State to another comes under Section 18(3) and will, therefore, be governed by the procedure prescribed thereunder. In other words, Sub-section (3) of Section 18 is an independent Sub-section and will cover only cases which relate to the transfer of the registered office from one State to another State. Such cases will, therefore, not be covered by the provisions of Sections 18(1) and 18(4). Since no time limit has been prescribed under Section 18(3), the provisions of Section 637B(b) will also not apply to such cases. In terms of the above view, a company continues to remain on the register of the ROC of the State from which it is proposed to shift and also in respect of which it has got an order of CLB under Section 17(1) till it files the aforesaid order with him and the ROC certifies under his hands about such transfer.

Section 17(4) empowers the Company Law Board to extend the time for registration beyond three months by such period as it thinks proper. An application under this Sub-section should mention that - (1) the delay in filing the certified copy of the order may please be condoned and the documents already filed may please be ordered to be taken on record; (2) the alteration of the memorandum as sanctioned may please be ordered to be registered by the Registrar; and (3) the CLB may pass any other order that it considers necessary [*Shiv Prakash Janakraj & Co. Pvt. Ltd. v. Registrar of Companies* (1963) 2 Comp. L.J. 228 (Punj)].

Under Section 637B(b), the Central Government has been empowered to condone delay in filing any document with the Registrar. In view of the express provisions made in Sections 18(4) and 19, the delay in filing the order of Company Law Board beyond the permissible time limit cannot be condoned by Central Government.

ALTERATION OF LIABILITY CLAUSE

Ordinarily, the limited liability clause of a company cannot be altered so as to make the liability unlimited, unless the articles permit such alteration by a special resolution to make the liability of the directors or of any one director or manager unlimited. In such case, however, the liability of the person holding office as director or manager before such alteration shall not be made unlimited until the expiry of this present term. His liability for the unexpired period of the present term can be made unlimited only if he gives his consent to his liability becoming unlimited (Section 323). Section 32 permits an unlimited company to register as a limited company. On alteration, the Registrar shall close the former registration of the company and the new registration shall take effect as if it were the first registration. The registration of an unlimited company as a limited company shall not, however, affect any debts, liabilities, obligations or contracts incurred or entered into, before the conversion. The whole procedure for forming a new company will have to be followed in respect of the above sections.

ALTERATION OF CAPITAL CLAUSE

(a) A company can make the following types of alterations by an ordinary resolution, if authorised by its articles to do so (Section 94):

(i) increase its share capital by issue of new shares;

A company may at any time increase its authorised share capital by the alteration of its memorandum. Although, section 94(1) (a) of the Companies Act, 1956 refers to the issue of new shares, it really deals with a case of increase in the authorised share capital, and not increase of the issued share capital. The case of increase of the issued or subscribed capital is dealt with separately by section 81 of the Act.

(ii) consolidate existing shares into shares of larger denomination;

(iii) sub-divide its shares or any of them into shares of smaller amount than is fixed by memorandum such that the proportion between the amount paid and unpaid shall remain the same.

(iv) convert fully-paid shares into stock or *vice versa*; and

(v) cancel unissued shares and to that extent diminish the amount of its share capital. Such cancellation shall not, however, be deemed as reduction of share capital.

All such alterations do not require the confirmation by the Company Law Board. These alterations are, however, required to be notified giving details of the share consolidated, divided, converted, sub-divided, redeemed or cancelled or the stock reconverted, as the case may be, and a copy of the resolution should be filed with the Registrar within 30 days of the passing of the resolution.

The Registrar shall record the notice and make any alteration which may be necessary in the company' memorandum or articles or both. It must be noted that cancellation of shares does not amount to reduction of share capital.

ARTICLES OF ASSOCIATION

NATURE OF ARTICLES

According to Section 2(2) of the Companies Act, 1956, 'articles' means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

The articles of association of a company are its by-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company *inter se*. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1875) L.R. 7 H.L. 653 as follows:

"The articles play a part subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made..... The memorandum, is as it were..... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for their own governance as they think fit".

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members *inter se*. This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal v. The Calcutta Stock Exchange Association Ltd.*, AIR 1971 SC 422, (1971) 41 Com Cases 51]. But the Articles of Association of a company are not 'law' and do not have the force of law. In *Kinetic Engineering Ltd. v. Sadhana Gadia*, (1992) 74 Com Cases 82 : (1992) 1 Comp LJ 62 (CLB), the CLB held that if any provision of the articles or the memorandum is contrary to any provisions of any law, it will be invalid in toto.

Articles Subordinate to Memorandum

The following companies must have their own articles viz. *unlimited companies, companies limited by guarantee and private companies limited by shares under the Companies Act*. The articles of a company are subordinate to and controlled by the memorandum of association and any clause in the Articles going beyond the memorandum will be *ultra vires*. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to

what they think fit. Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum [*Ashbury v. Watson, (1885) 30 Ch. D 376 (CA)*]. Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is *void* and incapable of ratification.

But neither the articles nor the memorandum can authorise the company to do anything so as to contravene any of the provisions of the Act. [See *Re Peveril Gold Mines, (1989) 1 Ch 122 (CA)*].

Articles in relation to Memorandum

The functions of the Articles in relation to the Memorandum have already been summed up in the *Ashbury Railway Carriage case* and even though the articles are subordinate to the memorandum yet if there be any ambiguity in the memorandum, the articles may be used to explain it but not so as to extend the objects. [Re. *South Durham Brewery Company (1885) 3 Ch. D 261*]. The memorandum of a company was not clear as to the classes of shares to be issued by a company, the articles made clear the doubt by giving the power to the company to issue shares of different classes.

The relationship between the two documents was further emphasised in *Guinness v. Land Corporation of Ireland, (1882) 22 Ch D 349*, where it was observed: "The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors, and the outside public, as well as of the shareholders. The articles of association are the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation, and the internal regulations of the company are to be construed together..... In any case it is, as it seems to me, certain that for anything which the Act of Parliament says shall be in the memorandum you must look the memorandum alone. If the legislature has said one instrument is to be dominant you cannot turn to another instrument and read it in order to modify the provisions of the dominant instrument". Where the memorandum clearly establishes the rights of shareholders, a reference in the memorandum to the articles and an ambiguity said to arise from the construction of the articles should not be used to depart from the clear meaning of the memorandum so as to diminish those rights [*Scottish National Trust Co. Ltd. 1928 SC 499 (Scot)*; *Kinetic Engineering Ltd. v. Sadhana Gadia, (1992) 1 Comp LJ 62 (CLB)*].

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

Regulations provided for in the Articles must not exceed the powers of the company as laid down by its Memorandum.

- True
- False

Correct Answer: *True*

REGISTRATION OF ARTICLES

Section 26 of the Companies Act, 1956 provides that a public company limited by

shares may at its option register its articles of association signed by the same subscribers as to the memorandum, or alternatively it may adopt all or any of the regulations contained in Table A of First Schedule of the Act. If articles are not registered, automatically Table A applies, and if registered, Table A applies except in so far as it is excluded by the articles. To avoid any confusion, normally every public company delivers its articles alongwith the memorandum for registration. Further it will be specifically stated therein that Table A will not apply. The articles of a private company must contain the four restrictions as contained in Section 3(1)(iii). The articles of association of an unlimited company should 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 it is to be registered [Section 27(1)].

In the case of a company limited by guarantee the articles shall state the number of members with which it is to be registered [Section 27(2)].

A company limited by guarantee or a private company limited by shares or an unlimited company must register their articles. The companies limited by guarantee or unlimited company might adopt any of the appropriate regulations of Table C, D and E respectively in Schedule I (Section 29).

STATUTORY REQUIREMENTS

Section 30 requires that the articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act, 1956.

CONTENTS OF ARTICLES

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

1. Exclusion wholly or in part of Table A.
2. Adoption of preliminary contracts.
3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
9. Nomination.
10. Forfeiture of shares.
11. Alteration of capital.
12. Buy back.
13. Share certificates.
14. Dematerialisation.
15. Conversion of shares into stock.
16. Voting rights and proxies.

17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
19. Nominee directors.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
26. General meetings.
27. Directors meetings.
28. Borrowing powers.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Provision regarding common seal.
33. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

PROVISION IN ARTICLES AS REGARDS EXPULSION OF A MEMBER

The proviso to Section 29 provides that nothing in Section 29 shall be deemed to prevent a company from including any additional matters in its Articles, in so far as they are not inconsistent with the provisions contained in the Form in any of the Tables C, D and E, which might have been adopted by the company.

In the light of this proviso, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 29 of the Act.

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles, because the Companies Act is a general law whereas the Securities Contracts Regulation (SCR) Act is a special law. The regulation of stock exchanges is done by SCR Act and SEBI Act and not by Companies Act. Hence, the Articles of Stock Exchange may provide for additional matters as per SCR Act, which may not be possible for inclusion in the Articles of a company as per the provisions of the Companies Act. [*Madras Stock Exchange Ltd. v. S.S.R. Rajkumar* (2003) 116 Comp. Cas. 214 (Mad.)].

ALTERATION OF ARTICLES OF ASSOCIATION

A company has a statutory right to alter its articles of association. But the power

to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Section 31 provides that subject to the provisions of the Act and the conditions contained in its memorandum, a company may, by special resolution, alter its articles, and adds that any alteration so made shall be as valid as if originally contained in the articles. However, no alteration made in the articles which has the effect of converting a public company into private company shall have effect unless such alteration has been approved by the Central Government. [Proviso to Section 31(1)].

The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles [*Walker v. London Tramway Co.* (1879) 12 Ch. D. 705].

However, in spite of the power to alter its articles, a company can exercise this power subject only to certain limitations. These are:

1. The alteration must not exceed the powers given by the memorandum. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

Similarly, where a resolution was passed expelling a member and authorising the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act [*Madhava Ramachandra Kamath v. Canara Banking Corporation* [1941] 11 Comp. Cas. 78 (Mad)].

On the other hand, articles may impose on the company conditions stricter than those provided under the law; for example, they may provide that a matter should be passed by a special resolution when the Act requires it to be passed by an ordinary resolution.

3. The Articles must not include anything which is illegal or opposed to public policy.
4. The alteration must be *bona fide* for the benefit of the company as a whole.
5. The alteration must not constitute a fraud on the minority by a majority. If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter. [*All India Railway Mens Benefit Fund v. Jamadar Baheshwarnath Bali* (1945) 15 Comp. Cas. 142 (Nag.)]

In *Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd.* [1992] 73 Comp. Cas. 80 (Ker.), the Kerala High Court held that no majority of shareholders can, by altering the article retrospectively, affect, the prejudice of the consenting owners of shares, the right already existing under a contract nor take away the right accrued, e.g., after a transfer of share is lodged, the company cannot have a right of lien so as to defeat the transfer.

6. An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Central Government [Section 31].
7. Articles cannot be altered so as to compel an existing member to take or subscribe for more shares or in any way increase his liability to contribute to the share capital, unless he gives his consent in writing (Section 38).
8. By effecting alteration in its articles, a company cannot defeat escape from its contractual obligation with any person. The company will always be liable in such a case.
9. The Articles of Association cannot be altered so as to have retrospective effects. The articles only operate from the date of the amendment [*Pyare Lal Sharma v. Managing Director, J.K. Industries Ltd.* (1989) 3 Comp. L.J. (SL) 70].
10. The alteration must not be inconsistent with an order of the Court under Sections 397 or 398 and 404.
11. In the case of listed companies, earlier articles cannot be altered except with the approval of Stock Exchange(s) concerned.
12. Amendment of Articles relating to Managing, Whole-time director and non-rotational directors requires Central Government's approval. (Section 268)

Subject to the foregoing conditions, the Articles in a company can be altered and no clause can be included in the Articles that it is not alterable. Persons who become members of a company have no right to assume that the Articles will always remain in a particular form.

Of course a section or a class of shareholders cannot be unfairly or oppressively treated. Thus, though the requisite majority of members could pass a special resolution to alter the Articles and if the alteration has the effect of making a fraud on the minority, the minority shareholders not being less than the number specified in Section 397 and 398 could move the Court for redressing their grievances. The Courts have entertained such applications from shareholders even where they are smaller in number [See *Menier N. Hooper Telegraph Works* (1874) 9 Ch. App. 350].

As already mentioned, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company. [*Southern Foundries v. Shirlaw*, quoted above].

The discussion on the above matter will not be complete without referring to the rule in *Foss v. Harbottle* (1843) 2 Hare 461 where the court held that no individual shareholder nor a minority of shareholders in a company can take it upon himself or themselves to remedy an alleged wrong involved in the actions of directors if the said wrongful act is something which the majority can regularise and approve of.

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

The Articles of Association are subsidiary both to the Companies Act and the Memorandum of Association.

- True
- False

Correct Answer: True

Effect of Altered Articles

Alteration binds members in the same way as original articles. The provision of Section 36 providing that the articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles.

After considering the scheme of the Companies Act, the Department (now Ministry) is of the view that amendment of articles of association of a company providing for expulsion of a member by the management is opposed to the fundamental principles of the company jurisprudence and is *ultra vires* of the company. Such a provision is repugnant to the various provisions in the Companies Act pertaining to the rights of a member in a public limited company and cuts across the scheme of the Act as it has the effect of negating the powers of the Central Government under Section 111 and the powers of the courts under Sections 107 and 395 and is, therefore, void by the operation of the provisions of Section 9. The articles of association is a contract between the company and its members setting out the rights of members *inter se* under the contract and expulsion of a member is not only a violation of this contract but it is also opposed to the principles of natural justice. Moreover, under Section 23 of the Indian Contract Act, any agreement which is contrary to any law or opposed to public policy would be deemed to be unlawful and void.

DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between the memorandum and articles are given below:

1. Memorandum of association is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation. Articles of association are the rules and regulations framed to govern this internal management of the company.
2. Clauses of the memorandum cannot be easily altered. They can only be altered in accordance with the mode prescribed by the Act. In some of the cases, alteration requires the permission of the Company Law Board or the Court. In the case of articles of association, members have a right to alter the articles by a special resolution. Generally there is no need to obtain the permission of the Court or the Company Law Board for alteration of the articles.
3. Memorandum of association cannot include any clause contrary to the provisions of the Companies Act. The articles of association are subsidiary both to the Companies Act and the memorandum of association.
4. The memorandum generally defines the relation between the company and the outsiders, while the articles regulate the relationship between the company and its members and between the members *inter se*.
5. Acts done by a company beyond the scope of the memorandum are absolutely void and *ultra vires* and cannot be ratified even by unanimous vote of all the shareholders. But the acts of the directors beyond the articles can be ratified by the shareholders.

LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES

The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles. Also, all moneys payable by any member to the company under the memorandum or articles shall be a debt due from him to the company (Section 36).

We shall examine the extent to which the memorandum and articles bind:

- (a) the members to the company;
- (b) the company to the members;
- (c) the members *inter se*; and
- (d) the company to outsiders.

Members Bound to the Company

The memorandum and articles constitute a contract binding the members of the company. The members, as members, are bound to the company. Each member must, therefore, observe the provisions of the memorandum and articles.

Each member is bound by the covenants of the Memorandum as originally made and as altered from time to time *Malleson v. National Insurance Co*. In another case, the shareholders could not enter into an agreement which was contrary to or inconsistent with the articles of association of the company [*V.B. Rangaraj v. V.B. Gopalkrishnan* (1992) 73 Comp. Cas 201 (SC)].

In *Boreland's Trustee v. Steel Brother and Co. Ltd.* (1901) 1 Ch. 279, the articles of a company contained a clause that on the bankruptcy of a member his shares would be sold to other persons and at a price fixed by the directors. *B*, a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at their true value. It was held that the trustee was bound by the articles, as the shares were purchased by *B* in terms of the articles.

Company Bound to the Members

Since the articles constitute a contract binding the company to its members in their capacity as members, a member can bring an action against the company for infringement by it of the memorandum or articles. For example, an individual member can sue the company for an injunction restraining it from improper payment of dividend [*Hoole v. Great Western Railway* (1867) 3 Ch. D. 262]. Further, the company is bound to individual members in respect of their ordinary rights as members, e.g. the right to receive share certificate in respect of shares allotted to them, or to receive notice of general meeting, etc. Normally, action for breach of articles against the company can be brought only by a majority of the members. Individual or minority members cannot bring such a suit except when it is intended for enforcement of personal rights of members or to prevent the company from doing any *ultra vires* or illegal act, fraud, or oppression and mismanagement.

Member Bound to Member

As between the members *inter se* each member is bound by the articles to the

other members but that does not mean the memorandum and articles create an express contract among the members of the company. Thus, a member of a company has no right to bring a suit to enforce the articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members *inter se* are regulated. A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or *ultra vires* acts.

Articles do not affect or regulate the rights arising out of a commercial contract, with which the members have no concern, i.e., rights completely outside the company's relationship.

Company not Bound to Outsiders

The term "outsider" signifies a person who is not a member of the company even if he is a director or solicitor to the company. Even in regard to members, the articles bind the company to them in their capacity as members.

As between outsiders and the company, neither the memorandum nor the articles would give any contractual rights to outsiders against the company or its members even though the names of outsiders are mentioned in those documents in connection with the arrangements that the company might have contemplated for carrying on its business. The articles do not confer any contractual rights even upon a member in a capacity other than that of a member. To succeed, the party suing must prove a contract outside and independent of the articles [*Eley v. Positive Life Insurance Co.*, (1876) 1 E.X.D. 88].

In this case the articles provided that the solicitor to the company would not be removed from office except for misconduct. *Eley* acted as solicitor to the company and also became a member of the company. The company discontinued his services and then he sued the company for damages for breach of contract. It was held that he had no cause of action because the articles did not constitute any contract between the company and himself. His action was dismissed.

This rule, however, proved to be rather harsh and so the Courts later on modified it. The modified rule is as follows:

While the articles cannot create a contract between the company and any person other than a member in his capacity as a member, they may indicate the basis upon which contracts may be made by the company. If such a contract is entered into whether with a member of the company or any other person, the conditions stated in the articles will be tacitly adopted by that contract, unless expressly negated or varied by the contract itself.

The question sometimes arises as to whether directors are bound by whatever is contained in the articles. In case the directors contravene the provisions in the articles, the directors render themselves liable to an action by members. On the other hand, members can also ratify acts of directors. If any loss is incurred by the company, directors are liable to reimburse to the company any loss so incurred.

CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

The memorandum and articles, when registered, become public documents and

can be inspected by anyone on payment of nominal fee. Therefore, every person who contemplates entering into a contract with a company has the means of ascertaining and is consequently presumed to know, not only the exact powers of the company but also the extent to which these powers have been delegated to the directors, and of any limitations placed upon the exercise of these powers. In other words, every person dealing with the company is deemed to have a "constructive notice" of the contents of its memorandum and articles. In fact, he is regarded not only as having read those documents but also as having understood them according to their proper meaning [*Griffith v. Paget*, (1877) Ch. D. 517]. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum, or outside the limits set on the authority of the directors, he cannot, as a general rule, acquire any rights under the contract against the company [*Mohony v. East Holyfrod Mining Co.*, (1875) L.R. 7 H.L. 869]. For example, if the articles provide that a bill of exchange to be effective must be signed by two directors, a person dealing with the company must see that it is so signed; otherwise he cannot claim under it.

In another case, the articles required that all documents should be signed by the managing director, secretary and the working director on behalf of the company. A deed of mortgage was executed by the secretary and the working director only and the Court held that no claim would lie under such a deed. The court said that the mortgagee should have consulted the articles before the deed was executed. Therefore, even though the mortgagee may have acted in good faith and the money borrowed applied for the purpose of the company, the mortgage was nevertheless invalid, *Kotla Venkataswamy v. Rammurthy*, AIR 1934 Mad 579; The doctrine of indoor management protects third parties who are entitled to an assurance that all the procedural aspects of a transaction are carried out.

Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.

The impact of this doctrine on practical relations is thus stated in HALSBURY: "A company is subject to the rule that, where the conduct of a party charged with a notice shows that he had suspicions of a state of facts the knowledge of which would affect his legal rights, but that he deliberately refrained from making inquiries, he will be treated as having had notice, though he is not entitled to claim for his own advantage," [*Jones v. Smith*, (1841) 1 Hare 43].

MONEY PAYABLE BY MEMBERS IS A DEBT [SUB-SECTION (2) OF SECTION 36]

Though all money payable under the memorandum or articles by members is a debt due, the liability on the debt is not enforceable, unless proper notice is given in accordance with articles. [*Pabna Dhana-Bhandar Co. Ltd. v. Foyezud din Mia* (1933) 3 Com Cases 41 : AIR 1932 Cal 716].

INTERPRETATION OF MEMORANDUM AND ARTICLES

Articles should be construed as a business document so as to give business

efficacy preference to a construction which will prove unworkable [*Holmes v. Keyes (Lord)* (1958) 2 All ER 129 (CA)];. Where the conduct of the parties reveals that there has been some practice in vogue for several years which was accepted by everyone concerned without any challenge or question, then that practice in the course of long years in itself becomes an indication that the rules or articles which are framed by way of internal management were understood in that sense [*Krishnaswamy (S) v. South India film Chamber of Commerce*, AIR 1969 Mad 42 : (1968) 1 Comp LJ 75; cited in *Sunil Dev v. Delhi and District Cricket Assn.*, (1990) 2 Comp LJ 245, 255 : (1994) 80 Comp. Cases 174 (Del)].

The memorandum must like any other document be construed according to accepted principles applicable to the interpretation of all legal documents. No rigid canon of construction is to be applied to such a document. Like any other document, it must be read fairly and its import derived from a reasonable interpretation of the language which it employs. [*A Lakshmanaswami Mudaliar v. LIC of India* (1963) 33 Comp. Cases 420, 430 (SC); *Egyptian Salt & Soda Co. v. Port Said Salt Assn.*, (1931) AC 677 : AIR 1931 PC 182)].

The memorandum and articles must be read together in the event of any ambiguity. In *Angostura Bitters & Co. Ltd. v. Kerr*, (1933) AC 550 : (1934) 4 Comp Cases 1; the Privy Council held : —“Except in respect of such matters as must be statutory provided for by the conjunction with the articles. The two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum or to supplement it upon any matter as to which it is silent” — quoted with approval by the Supreme Court in *A. Lakshmanaswami Mudaliar v. LIC of India Ltd.* (1963) SC 1185.

DOCTRINE OF INDOOR MANAGEMENT

While the doctrine of “constructive notice” seeks to protect the company against the outsiders, the principal of indoor management operates to protect the outsiders against the company.

According to this doctrine, as laid down in *Royal British Bank v. Turquand*, (1856) 119 E.R. 886, persons dealing with a company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the memorandum and articles, are not bound to inquire the regularity of any internal proceedings. In other words, while persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. It is no part of the duty of an outsider to see that the company carries out its own internal regulations.

In *Royal British Bank v. Turquand*, the directors of a banking company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by resolution of the company in general meeting, be authorised to borrow. The directors gave a bond to Turquand without the authority of any such resolution. It was held that Turquand could sue the company on the strength of the bond, as he was entitled to assume that the necessary resolution had been passed. Lord Hatherly observed : —“Outsiders are bound to know the external position of the company, but are not bound to know its indoor management”.

Section 290 Provides for the Validity of Acts of Directors - Acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason or any defect or disqualification or had terminated by virtue of any provisions contained in this Act or in the articles:

Provided that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been shown in the company to be invalid or to have terminated.

The object of the section is to protect persons dealing with the company - outsiders as well as members by providing that the acts of a person acting as director will be treated as valid although it may afterwards be discovered that his appointment was invalid or that it had terminated under any provision of this Act or the Articles of the company [*Ram Raghubir Lal v. United Refineries (Burma) Ltd.*, (1932) 2 Com Cases 359; AIR 1931 Rang 139].

Relation of company with members and outsiders

The validation of the acts of unqualified directors may apply to circumstances from two different angles : (1) as between outsiders, strangers and the company as in *Royal British Bank v. Turquand*, (1956) 5 E&B 327, *British Asbestos Co. Ltd. v. Boyd*. (1903) 2 Ch 439 : (1900-3) All ER Rep 323; and *Ram Buran Singh v. Mufassil Bank Ltd.* AIR 1925 All 206; and (2) in relation to the internal affairs of the company as in *Dawson v. African Consolidated Land & Trading Co.*, (1898) 1 Ch 6 (CA), where calls made by unqualified directors were held valid. Even if the public documents of the company, and the facts which are apparent, would make it clear that a director was not duly qualified to act, this will not oust the effect of the Section 290 (*British Asbestos case*) (supra). Similarly in *Boschoek Proprietary Co. Ltd.*, v. *Fuke*, (1906) 1 Ch 148, a resolution of a general meeting convened by *de facto* directors was upheld.

Forgery and incompetent acts

This section does not apply where the act itself is not in the competence of the Board of directors, e.g. compromising unpaid calls under the guise of forfeiture, the transaction being *ultra vires* and invalid [*Bhagirath Spinning & Wvg. Co. v. Balaji Bhavani Pawar*, AIR 1930 Bom. 267].

Directors not aware of their disqualification

The allotment and forfeiture of shares made by the directors who continued to act even after they were disqualified but were not aware of it, were saved by the Section 292. [*Shiromani Sugar Mills Ltd. v. Debi Prasad*, (1950) 20 Comp Cas 296: AIR 1950 All 508]. Where this section does not save the situation, the company may in general meeting ratify allotment of shares even if made by *de facto* directors with mala fide intentions [*Bamford v. Bamford*, (1969) 39 Com Cases 838 : (1969) 2 WLR (1107) (CA) and an appeal (1969) : 1All ER 969].

Where the directors in question were not aware of the fact that by virtue of certain provisions in the articles, they had vacated their office, their acts in passing resolutions for starting certain business transactions were held to be valid [*Seth Mohan Lal v. Grain Chambers Ltd.*, (1968) 38 Comp Cases 543 : AIR 1968 SC 772; *Shiromani Sugar Mills Ltd. v. Debi Prasad*, (Supra).]

It is important to remember that the doctrine of “constructive notice”, can be invoked by the company and it does not operate against the company. It operates against the person who has failed to inquire but does not operate in his favour. But the doctrine of “indoor management” can be invoked by the person dealing with the company and cannot be invoked by the company.

An outsider is entitled to act on a certified copy of the resolution of the Board of directors delegating the powers of borrowing money to the managing director subject to the limitation mentioned therein [*C.K. Siva Sankara Panicker v. Kerala State Financial Corporation*, (1980) 50 Comp. Cas. 817 (Ker.)].

EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The above noted ‘doctrine of indoor management’ is, however, subject to certain exceptions. In other words, relief on the ground of ‘indoor management’ cannot be claimed by an outsider dealing with the company in the following circumstances.

1. **Where the outsider had knowledge of irregularity** — The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company. Thus, a person knowing fully well that the directors do not have the authority to make the transaction but still enters into it, cannot seek protection under the rule of indoor management. In *Howard v. Patent Ivory Co.* (38 Ch. D 156), the articles of a company empowered the directors to borrow upto one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting. Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount. Held that, the debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity.
2. **No knowledge of memorandum and articles** — Again, the rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them. In *Rama Corporation v. Proved Tin & General Investment Co.* (1952) 1All. ER 554, T was a director in the company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. The Plaintiff relied on the rule of indoor management. Held, they could not because they even did not know that power could be delegated.
3. **Forgery** — The rule of indoor management does not extend to transactions involving forgery or to transactions which are otherwise void or illegal *ab initio*. In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction, and the question of his consent being free or otherwise does not arise. Consequently, it is not that the title of the person

is defective but there is no title at all. Therefore, howsoever clever the forgery might have been the personates acquire no rights at all. Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management [*Rouben v. Great Fingal Consolidated* (1906) AC 439].

Forgery, in the case of a company, can take different forms. It may, besides forgery of the signatures of the authorised officials, include the execution of a document towards the personal discharge of an official's liability instead of the liability of the company. Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted [*Kreditbank Cassel v. Schenkers Ltd.* (1927) 1 KB 826]. The bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

4. **Negligence** — The doctrine of indoor management, in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he is estopped from relying on the Rule. In *Al Underwood v. Benkof Liverpool* (1924) 1 KB 775, a person who was a sole director and principal shareholder of a company paid into his own account cheques drawn in favour of the company. Held, that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

Similarly, in *B. Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd.* AIR 1942 Oudh 417, an accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

5. Again, the doctrine of indoor management does not apply where the question is in regard to the very existence of an agency. In *Varkey Souriar v. Keraleeya Banking Co. Ltd.* (1957) 27 Comp. Cas. 591 (Ker.), the Kerala High Court held that the doctrine of indoor management cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is in regard to the very existence of the agency.
6. This Doctrine is also not applicable where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely *ultra vires* the directors/officers but *ultra vires* the company itself — *Pacific Coast Coal Mines v. Arbuthnot* (1917) AC 607.

In the end, it is worthwhile to mention that section 9 of the Companies Act, 1956 gives overriding force and effect to the provisions of the Act, notwithstanding anything to the contrary contained in the memorandum or articles of a company or in any agreement executed by it or for that matter in any resolution of the company in general meeting or of its board of directors. A provision contained in the memorandum, articles, agreement or resolution to the extent to which it is repugnant to the provisions of the Act, will be regarded as void.

LESSON ROUND-UP

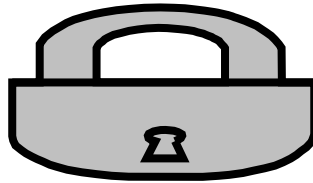


- The Memorandum of Association is a document which sets out the constitution of the company and is the foundation on which the structure of the company stands. It defines as well as confines the powers of the company. If the company enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be *ultra vires* the company and hence void. However, the Companies Act, 1956 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act.
- The first clause in the memorandum of association of the company states the name by which the company is known. The company may adopt any suitable name provided it is not undesirable. The second clause is situation clause. Accordingly, within 30 days of incorporation or on the day when it commences business, whichever is earlier, the company must have a registered office to which all communications and notices may be sent.
- The objects clause is of great importance because it determines the purpose and the capacity of the company. An act beyond the objects mentioned in the memorandum is *ultra vires* and void and cannot be ratified.
- The fourth clause must state that liability of the members is limited, if it is so intended that the company be limited by shares or by guarantee. Fifth clause must state the amount of the capital with which the company is registered, unless the company is an unlimited company. The memorandum concludes with the subscription clause in which there is a declaration of association.
- The memorandum of association of a company may be altered by changing its name, altering it in regard to the State in which the registered office is to be situated or its objects, altering or reorganizing its share capital, reducing its capital or making the liability of the directors unlimited.
- The change of name will not affect any rights and obligations of the company, or legal proceedings commenced under the old name.
- Alteration of Registered Office Clause can be change of registered office within the local limits of same town or from one city to another within the same state or within the same state from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies or from one state to another.

- Objects clause of the company may be altered to enable it to carry on its business more economically and more efficiently; to attain its main objects by new or improved means; to enlarge or change the local area of its operations; to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company; to restrict or abandon any of the objects specified in the memorandum; to alter its objects to sell or dispose of any of its undertakings where a company feels it has grown so big or that management has become difficult and uneconomical; or to amalgamate with any other company or body of persons.
- No alteration of objects clause or shifting of the registered office from one state to another shall have effect unless it is registered with registrar in accordance with provisions of Section 18 of the Act.
- The limited liability clause of a company cannot be altered so as to make the liability unlimited, unless the articles permit such alteration by a special resolution to make the liability of the directors or of any one director or manager unlimited.
- Being a domestic affair, the Companies Act permits the companies to decide the extent, mode etc. of reduction of its share capital, subject to the approval of the court.
- Articles means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.
- The memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members.
- The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. They must not contain anything illegal or *ultra vires* the memorandum and should not be contrary to the provisions of the Companies Act, 1956.
- A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Any alteration so made shall be as valid as if originally contained in the articles.
- The memorandum of association and articles of association can be clearly distinguished from each other.
- The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.
- As per doctrine of constructive notice, every person dealing with the company is deemed to have a “constructive notice” of the contents of its memorandum and articles. Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.

- While the doctrine of constructive notice seeks to protect the company against the outsiders, the doctrine of indoor management operates to protect the outsiders against the company. While persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. However, there are certain exceptions to doctrine of indoor management.

SELF-TEST QUESTIONS



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

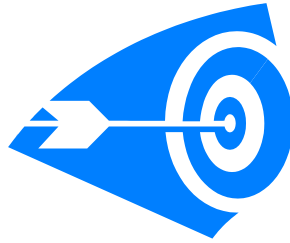
1. What do you understand by the memorandum of association? What is its purpose?
2. ~~M~~Memorandum of association is a charter of the company". Comment upon the statement and explain the clauses which are included in a memorandum of association of a company.
3. What is ~~r~~registered office" of a company? Within how much time a company must have a registered office?
4. What do you understand by the doctrine of "*ultra-vires*"? Discuss the decided case "*Ashbury Railway & Iron Co. v. Riche*".
5. What is the importance of the objects clause of the memorandum of association? If a company undertakes to do anything which is not either expressly or impliedly provided for by the objects clause, what would be the consequences?
6. ~~T~~The power of altering the articles is wide, yet it is subject to a large number of limitations". Explain.
7. Discuss the extent to which articles of association binds:
 - (a) the members to the company,
 - (b) the company to the members,
 - (c) the members among themselves, and
 - (d) the company to the outsiders.
8. Distinguish Articles from Memorandum.
9. What is the meaning and significance of the doctrine of ~~I~~ndoor Management". Discuss with reference to decided case "*Royal British Bank v. Turquand*".

STUDY V

INCORPORATION AND ITS CONSEQUENCES - IV

CONTRACTS AND CONVERSIONS

LEARNING OBJECTIVES



This chapter explains the various types of contracts entered into by a public and private company viz. preliminary or pre-incorporation contracts, provisional contracts, contracts made after obtaining certificate to commence business. It also explains the concept of common seal. It gives the procedure for conversion of a private company into a public company and *vice versa*. It further gives provisions for commencement of business by a company, both when it has issued a prospectus and when it has not issued prospectus. At the end of the lesson, you should be able to understand:

- Preliminary or pre-incorporation contracts and provisional contracts.
- Contracts made after obtaining certificate of commencing business in case of public company and after incorporation in case of private company.
- Common seal.
- Conversion of private company into public company.
- Conversion of public company into private company.
- Commencement of business – where company has issued prospectus, where company has not issued prospectus.
- Commencement of new business by an existing company.

1. PRELIMINARY CONTRACTS

A company being an artificial person can contract only through its agents. A contract will be binding on a company only, if it is made on its behalf by any person acting under its authority, express or implied. The powers of the company are defined by its Memorandum of Association and any contract made beyond the limits laid down in the Memorandum of Association, will be *ultra vires* to the company and void even if all the shareholders assent to it.

When the company is being formed, the promoters, purporting to act on behalf of the company, enter into contracts for the purchase of property, or for securing the services of managers or other experts. Such contracts are obviously made before the incorporation of the company.

There are three situations as discussed below in the case of a public company in which contracts are made:

- (a) Contracts made on behalf of the company before its incorporation—preliminary or pre-incorporation contracts.
- (b) Contracts made after incorporation but before obtaining the certificate to commence business—provisional contracts.
- (c) Contracts made after obtaining the certificate to commence business.

However, in the case of a private company, there are only two situations in which contracts are made, i.e. contracts made on behalf of companies before incorporation and contracts made after incorporation. The reason is that a private company can commence its business immediately after obtaining a certificate of incorporation. Hence, there is no need for provisional contracts in the case of a Private company.

(a) Pre-incorporation Contracts

In Pennington's Company Law, the position is stated as under:

–Although a contract made before the company's incorporation cannot bind the company, it is not wholly denied of legal effect. It takes effect as a personal contract with the persons who purport to contract on the company's behalf and they are liable to pay damages for failure to perform the promises made in the company's name, even though the contract expressly provides that only the company's paid-up capital shall be answerable for performance”.

Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation. Before incorporation, a company is non-existent and has no capacity to contract. Consequently, nobody can contract as agent on its behalf because an act which cannot be done by the principal himself cannot be done by him through an agent. Hence, a contract by a promoter purporting to act on behalf of a company prior to its incorporation never binds the company because at the time the contract was concluded the company was not in existence. Therefore it has no legal existence. Even if the parties act on the contract it will not bind the company. [*Northumberland Avenue Hotel Co.*, (1886) 33 Ch.D. 16 (CA)]. Further even after incorporation such a purported contract cannot be ratified by the company (*Kelner v. Baxter* (1866) L.R. 2 C.P. 174]. The persons purporting to act as agents on behalf of the company would be personally liable. In *Kelner v. Baxter (ibid)* three persons A, B and C purported to enter into a contract as agents on behalf of a company before its incorporation for the purchase of certain goods from Kelner and signed it : –A, B and C, Directors”. The company later obtained the certificate of incorporation but collapsed before the money was paid for the goods which were supplied to it by Kelner. It was held that A, B and C were personally liable on the agreement and no subsequent ratification by the company would relieve them from that liability without the assent of Kelner.

Even if the company takes some benefit from a contract purported to have been made before its formation, the contract is not binding on the company. The promoters alone, therefore, remain personally liable for any contract they purport to make on behalf of the company, unless the company enters into the contract in terms

of such agreement after incorporation. A company cannot ratify a pre-incorporation contract, but it is open to it to enter into a new contract after its incorporation to give effect to a contract made before its formation [*Howard v. Patent Ivory Co.* (1888) 38 Ch.D.] Since the pre-incorporation contract is a nullity, even the company cannot sue the vendor of property if he fails to carry out such a contract.

In India, however, Sections 15 and 19 of the Specific Relief Act, 1963, have considerably alleviated the difficulty. Section 15(h) provides that where the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of incorporation, the company may, if it has accepted the contract, and has communicated such acceptance to the other party to the contract, obtain specific performance of the contract. Under Section 19(e) under similar circumstances, specific performance may be enforced against the company by the other party to the contract.

A company cannot acquire shares prior to its incorporation. Where a company was named as the transferee in the share transfer forms prior to its incorporation, it was held that such transfers could not be registered. [*Inlec Investment (P) Ltd. v. Dynamatic Hydraulics Ltd.*, (1989) 3 Comp LJ 221, 225 (CLB)].

Any pre-incorporation agreement to subscribe to shares of a company to be formed, cannot be enforced and is usually revocable unless accepted by the company after its formation.

(b) Provisional Contracts

In the case of a private company the question of provisional contracts does not arise as it can commence business immediately on its incorporation.

In the case of a public company, contracts made after incorporation but before the grant of certificate of commencement of business are provisional and are not binding on the company until the company is entitled to commence business on the grant of the certificate. But on the issue of the certificate to commence business such contracts automatically become binding i.e. without any ratification — Sub-section (4) of Section 149.

If, therefore, a public company is wound up before it is entitled to commence business the persons who have rendered services or supplied goods or materials to the company can have no claim against it [*In Re. Electrical Manufacturing Co.* (1906) 2 Ch. 390].

(c) Contracts made after issue of Certificate of Commencement of Business in the case of Public Company, and after Incorporation in the case of Private Company

A company can do all such acts, as by its Memorandum, it is expressly or impliedly authorised, to do. Any purported act, which is not so authorized, is *ultra vires* the company, and the company cannot enforce it, nor can the other party enforce it against the company. Such a contract cannot be ratified even if every member of the company assents to it, as it is *void ab initio*. This rule is commonly known as the Doctrine of *Ultra Vires*. '*Ultra vires*' means "beyond the powers". The

powers of the company are derived from its Memorandum of Association and the statute constituting it. Consequently, only those contracts which are *intra vires* or within the powers of the company will be valid and binding.

Where a contract is *intra vires* the company but *ultra vires* the directors, the company may be liable and may even ratify it. According to the rule in *Royal British Bank v. Turquand* (1856) 6 E and B 327, so long as the act done by the directors is not inconsistent with the memorandum and articles, an outsider is entitled to assume that the directors have acted properly.

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

If a public company is wound up before it is entitled to commence business, the persons who have rendered services or supplied goods or materials to the company can have no claim against it.

- True
- False

Correct answer: True

2. COMMON SEAL

Since a body corporate is not a living person who can sign, therefore every company should necessarily have an instrument known as common seal which is used for making a physical impression to act as its signature on certain important documents. Pursuant to Section 147(1)(b), every company shall have its name engraven in legible characters on its seal. Since, Section 147(1)(b) provides that the name of the company should be engraven, it appears that the seal should be made of metal.

Common seal and contracting under common seal: The following deeds and contracts are not valid unless made under the seal of the company:

- (i) Power of attorney which would be required to be made in favour of a person to execute the deeds on behalf of the company;
- (ii) Share certificates;
- (iii) Share warrants;
- (iv) Any deed as required by the Articles.

3. CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

The conversion of a private company into a public company can be grouped under the following heads:

- (i) By choice or volition;
- (ii) By default.

(i) Conversion by choice or volition (Section 44)

In accordance with Section 44 of the Companies Act, 1956 the conversion of a Private Company into a Public Company by choice will require the following:

- (a) Alteration of its Articles of Association by special resolution in such a manner that they no longer include the restrictive provisions of Section 3(1)(iii).

- (b) Alteration of name of the company by special resolution by deleting the word “private”.
- (c) Filing of copy of special resolution along with explanatory statement in e-Form No. 23 along with fee prescribed under Schedule X to the Companies Act.
- (d) Filing of prospectus or statement in lieu of prospectus with the Registrar.
- (e) Increase the number of members to atleast seven and the number of directors to atleast three.
- (f) Enhancement of paid-up capital to atleast rupees five lakhs or such higher paid-up capital as may be prescribed.

(ii) Conversion by default

Under Section 43 of the Companies Act, 1956, if a private limited company fails to comply with any of the four restrictive provisions required by Section 3(1)(iii) to be incorporated in its articles, the company ceases to be a private company and ceases to have the privileges and exemptions conferred on it by the Act as a private company. It becomes a public company and all the provisions of the Act applicable to such companies become applicable to it. However the Company Law Board has been vested with power to grant relief in suitable cases where it is satisfied that the infringement of the conditions was accidental and it is just and equitable to grant relief.

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

A Private Limited Company cease to be a Private Company and becomes a Public Company when it fails to comply with any of the four restrictive provisions required by Section 3(1)(iii) to be incorporated in its articles.

- True
- False

Correct answer: True

4. PRIVATE COMPANY (WHICH IS A SUBSIDIARY OF PUBLIC COMPANY) DEEMED TO BE A PUBLIC COMPANY

On and from the commencement of the Companies (Amendment) Act, 2000, a private company which is a subsidiary of a public company, is treated as a public company by virtue of change in the definition of the public company under Section 3(1)(iv) of the Companies Act, 1956. It places such a ‘private company’ at the same level as that of a public company and thereby demarcates between a private company and a private company which is not a subsidiary of a public company. Such private companies are deprived of certain privileges and exemptions to which a private company is entitled.

5. CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

A public company can be converted into a private company only after the approval of the Central Government. It cannot be treated as a private company till the Central Government accords its approval.

Conversion of a public company into a private company will require:

- (i) Passing of a special resolution authorising the conversion and altering the Articles so as to include the matters specified in Section 3(1)(iii).
- (ii) Changing the name of the company by special resolution as required by Section 21.
- (iii) Obtaining the approval of the Central Government as required by Section 31. Proviso to Section 31(1) provides that no alteration made in the Articles which has the effect of converting a public company shall have effect unless such alteration has been approved by the Central Government.
- (iv) Filing of printed copy of the articles as altered within one month of the receipt of the approval of the Central Government with the Registrar of Companies.

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

A Public Company can be converted into a Private Company only after the approval of the Central Government.

- True
- False

Correct answer: True

6. COMMENCEMENT OF BUSINESS

A private company or a company having no share capital may commence business and exercise its various powers immediately after it is incorporated. Once it has received its Certificate of Incorporation, nothing further is required.

A public company, on the other hand, must obtain a certificate of commencement of business from the Registrar before it can commence business or exercise its borrowing powers. In order to obtain this certificate, the company must comply with Section 149 of the Companies Act. If the company has issued a prospectus then Section 149(1) applies and if it has not issued a prospectus, Section 149(2) applies.

A public company having share capital, must obtain certificate to commence business from the Registrar of Companies before it commences its business or exercise its borrowing powers. In order to obtain this certificate, the company must comply with the provisions of the Section 149 of the Companies Act, 1956.

“Commence any business” does not mean merely the business for which the company was started, but it includes the power to borrow and any transaction including sale, and purchase of property, etc. [*Kishangarh Electric Supply Co., Ltd. v. United State of Rajasthan*, AIR 1960 Raj. 49]. But “Commencement of business” does not include taking of preliminary steps, entering into provisional contracts and allotment of shares.

The certificate is conclusive evidence that a company is entitled to commence business.

Once a certificate to commence business has been issued to a company a writ cannot be issued to cancel the certificate of a company under the Companies Act, 1956 [*Muluk Mohamed v. Capital Stock Exchange Kerala Ltd.* (1991) 72 Com Cases 333 (Ker)].

In case of a private company, there is no requirement to obtain a certificate to commence business. It can start business immediately on its incorporation.

The effect of this section is to make the Public company, not bound by any contract or transaction until and unless the company is entitled to commence business. [See *Re Otto Electrical Manufacturing Co., (1905) Ltd., Jenkin's Claim* (1906) 2 Ch. 390].

Where the company has issued a prospectus

Section 149(1) provides that if a company having a share capital has issued a prospectus inviting public to subscribe for its shares, it shall not commence any business or exercise any borrowing powers unless:

- (a) shares held subject to the payment of the whole amount thereof in cash have been allotted to an amount not less in the whole than the minimum subscription.
- (b) every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares offered for public subscription.
- (c) no money is, or may become, liable to be repaid to applicants for any shares or debentures which have been offered for public subscription by reason of any failure to apply for, or to obtain, permission for the shares or debentures to be dealt in on any recognised stock exchange; and
- (d) there has been filed with the Registrar a duly verified declaration by one of the directors or the secretary, or where the company has not appointed a secretary, a secretary in whole-time practice, in the prescribed form (e-Form No. 19) that clauses (a), (b) and (c) mentioned above have been complied with.

Where the company has not issued a prospectus

If a public company having share capital has not issued a prospectus, Section 149(2) requires that it shall not commence any business or exercise any borrowing powers unless:

- (a) it has filed with the Registrar a statement in lieu of prospectus;
- (b) every director of the company has paid to the company on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares payable in cash;
- (c) there has been filed with the Registrar duly verified declaration by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in wholetime practice in the prescribed form (e-Form No. 20), that clause (b), as stated above, has been complied with.

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

Section 149 of the Companies Act further provides for penalty. If any company commences business or exercises borrowing powers in contravention of this Section, then every person who is in default shall be liable to a fine which may extend to Rs. 5,000/- for every day of default.

The certificate to commence business entitles the company to commence business given in the main objects clause of the Memorandum of Association. No business given in the "other objects clause" can be commenced without obtaining prior approval of the shareholders by way of special resolution. However, the Central Government, may on an application made by the Board of directors, allow a company to commence business in the "other objects clause", even after an ordinary resolution is passed by the company in general meeting.

7. COMMENCEMENT OF NEW BUSINESS BY AN EXISTING COMPANY

Section 13 requires that every company formed on or after October 15, 1965 must state in its memorandum (i) 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 not included in (i) above, separately. Section 149 prohibits a company from commencing any business stated under other objects without obtaining the prior approval of the shareholders in general meeting by a special resolution. It also requires the filing with the Registrar a declaration in e-Form No. 20A verified by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole-time practice, that the approval by special resolution has been given by the company in general meeting. The Central Government, may, however, on application by the Board of directors allow the company to commence new business, even if the special resolution is not passed by the company in general meeting, but passed by a simple majority [Section 149(2B)].

In this connection, the Department of Company Affairs (now Ministry of Corporate Affairs), has clarified that new business means a business which is not germane to the existing business carried on by the company. The guiding criterion, therefore, is whether the new activity is germane to the original business or not. In case the reply is 'yes', no special resolution is necessary and *vice versa*.

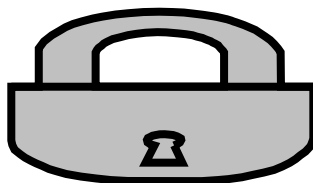
LESSON ROUND-UP



- Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation.
- A company cannot ratify a pre-incorporation contract, but it is open for the company to enter into a new contract after its incorporation to give effect to a contract made before its formation.

- In case of a public company, contracts made after incorporation but before the grant of certificate of commencement of business are provisional and are not binding on the company until the company is entitled to commence business on the grant of the certificate. There is no need for provisional contracts in the case of a private company.
- Only those contracts which are *intra vires* or within the powers of the company will be valid and binding. Where a contract is *intra vires* the company but *ultra vires* the directors, the company may be liable and may even ratify it.
- Pursuant to Section 147(1)(b), every company shall have its name engraved in legible characters on its seal.
- Conversion of a private company into a public company can be grouped as conversion by choice or volition and by default.
- On and from the commencement of the Companies (Amendment) Act, 2000, a private company which is a subsidiary of a public company, is treated as a public company.
- A public company can be converted into a private company only after the approval of the Central Government.
- A private company or a company having no share capital may commence business and exercise its various powers immediately after it is incorporated. A public company, on the other hand, must obtain a certificate to commence business from the Registrar before it can commence business or exercise its borrowing powers.
- The certificate is conclusive evidence that a company is entitled to commence business.
- The certificate to commence business entitles the company to commence business given in the main objects clause of the Memorandum of Association.
- Where a company having a share capital has issued a prospectus inviting public to subscribe for its shares or has not issued a prospectus, Sections 149(1) and (2), respectively require that it shall not commence any business or exercise any borrowing powers unless complying with the provisions provided therein.
- For commencement of new business by an existing company, the guiding criterion is whether the new activity is germane to the original business or not. In case the reply is yes, no special resolution is necessary and *vice versa*.

SELF-TEST QUESTIONS



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

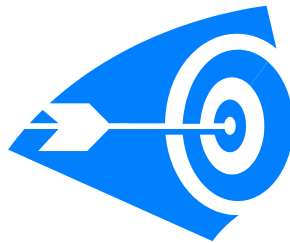
1. (a) Discuss the legal effects of pre-incorporation contracts and provisional contracts.

- (b) –A company cannot ratify a pre-incorporation contract though it is open to it to enter into fresh contract” — Discuss.
2. A, a furniture dealer, entered into a contract with the company for the furnishing of the offices of the company. The company went into liquidation before it could obtain certificate of commencement of business. Can A claim in the winding-up for the price of the furniture supplied to the company?
 3. What are the requirements for conversion of a public company into a private company?
 4. Can contracts before incorporation be enforced against the company?
 5. State the provisions for conversion of a private company into a public company.
 6. Write short notes on:
 - (a) Pre-incorporation contracts;
 - (b) Commencement of business;
 - (c) Common Seal;
 - (d) Conversion by default under Section 43 of the Companies Act, 1956.
-

STUDY VI

FINANCIAL STRUCTURE AND MEMBERSHIP-I
CONCEPT OF CAPITAL AND FINANCING OF COMPANIES

LEARNING OBJECTIVES



This lesson explains the concept of capital and various sources of capital. It gives the meaning of shares and different kinds of shares. The lesson also gives provisions regarding issue of shares at premium and discount. Provisions for issue of sweat equity shares, bonus shares, rights issue, and employee stock option scheme under the Companies Act as well as SEBI guidelines are explained herein.

At the end of the lesson, you should be able to understand:

- Meaning of the term 'capital' and its classification.
- Meaning and nature of shares, kinds of shares viz., equity share capital and preference share capital, comparison between equity and preference shares.
- Issue of sweat equity shares.
- Various sources of capital.
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 [ICDR].
- Issue of shares/securities at premium/discount.
- Further issue of shares, right issue, bonus shares.
- Employee stock option scheme.
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.
- SEBI (Issue of Sweat Equity) Regulations, 2002.

1. MEANING OF THE TERM "CAPITAL"

The term "Capital" has variety of meanings. It may mean one thing to an economist, one to an accountant, while another to a businessman or a lawyer. A layman views capital as the money, which a company has raised by issue of its shares. It uses this money to meet its requirements by way of acquiring business premises and stock-in-trade, which are called the fixed capital and the circulating capital respectively.

The phrase "loan or borrowed capital" is sometimes used to mean money borrowed by the company and secured by issuing debentures. This, however, is not the proper use of the word "capital".

In relation to a company limited by shares, the word “capital” means the share capital i.e., the capital in terms of rupees divided into specified number of shares of a fixed amount each. For e.g. share capital of a company is Rs. 1, 00,000 which can be divided into 10,000 shares of Rs. 10 each or 1,000 shares of Rs. 100 each, whichever is feasible to the company.

Share capital is not an essential clause for the formation of a company under the Companies Act but where the memorandum provides for “Share Capital”, it is synonymous with the term “Capital” and the memorandum must state the amount of capital and its division into various types, number and value of shares. Companies limited by guarantee or unlimited companies or companies u/s 25 of the Companies Act, 1956 need not have share capital.

2. USE OF THE WORD “CAPITAL” IN DIFFERENT SENSES

In Company Law, the “Capital” is the share capital of a company, which is classified as:

- (a) **Nominal, Authorised or Registered Capital:** This is the sum stated in the memorandum of association of a company limited by shares as the capital of the company with which it is registered. It is the maximum amount which the company is authorized to raise by issuing shares. This is the capital, on which the company had paid the prescribed fee at the time of registration; hence it is also called Registered Capital. As and when this is increased, fees for such increase will have to be paid to the Registrar in accordance with table in Schedule X appended to the Companies Act. This is divided into shares of uniform denominations. The amount of nominal capital is fixed on the basis of the projections of fund requirements of the company for its business activities.
- (b) **Issued Capital:** It is that part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.
- (c) **Subscribed Capital:** It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. It is clear that the entire issued capital may or may not be subscribed.
- (d) **Called up Capital:** It is that portion of the subscribed capital which has been called up or demanded on the shares by the company e.g., where Rs. 5 has been called up on each of 40,000 shares of a nominal value of Rs. 10, the called up capital is Rs. 2,00,000.
- (e) **Uncalled Capital:** It is the total amount not yet called up or demanded by the company on the shares subscribed, which the shareholders are liable to pay as and when called, e.g., in the above case, uncalled capital is Rs. 2,00,000.
- (f) **Paid-up-Capital:** It is the part of the total called up amount which is actually paid by the shareholder e.g., in (d) above, if only Rs. 1,90,000 is actually paid by the shareholders the paid-up capital is taken as Rs. 1,90,000 only.
- (g) **Unpaid Capital:** It is the total of the called-up capital remaining unpaid i.e., Rs. 10,000 from (f) above or the difference between called up and paid-up capital.

- (h) **Reserve Capital:** It is that part of the uncalled capital of a company which the limited company has decided by special resolution in terms of Section 99 of the Companies Act, 1956, not to call except in the event and for the purpose of the company being wound up. For instance, in the above example, out of the Rs. 5 per share uncalled capital, Rs. 2 per share may be resolved to be kept as reserve capital. (Reserve capital should not be confused with capital reserve, which is created out of profits).
- (i) **Capital Reserve:** Capital Reserve is created out of profits or earnings. As oppose to revenue reserve, Capital reserve is not ordinarily available for distribution among the share holders of the company as dividend . Capital reserve may be statutory capital reserve or non statutory capital reserve. Statutory Capital Reserves includes “securities premium account” “the capital redemption reserve account etc. Non-Statutory Capital Reserve may include revaluation reserve, reserve created on sale of capital assets, assets replacement reserve etc.
- (j) **Preference and Equity Share Capital:** The share capital of a public company may consist of only two kinds of shares i.e. preference shares and equity shares. Equity share capital may be with similar rights or with different rights as to dividend, voting or otherwise in accordance with the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. A preference share has a preference in regard to payment of fixed amount of dividend or fixed rate of dividend and preferential right of the repayment of capital in the event of winding up of company. With regard to payment of dividend, preference shares may be cumulative or non-cumulative. Equity shareholders are entitled to the residue of the divisible profits, if any, after the preference shareholders have received their fixed rate of dividend (Section 85).
- (k) **Fixed and Circulating Capital:** Fixed capital comprises of that part of capital which is invested in fixed assets acquired for retention and use, e.g., land, buildings, plant and machinery, whereas circulating or floating capital is that part of capital which is invested in acquiring current assets like stock of goods, bills of exchange, cash, etc. It is required for use in the day-to-day business operations and keeps on circulating.

TEST YOUR KNOWLEDGE**Choose the correct answer**

For which type of capital a company pays the prescribed fees at the time of registration?

- (a) Subscribed capital
- (b) Authorised capital
- (c) Paid-up capital
- (d) Issued capital

Correct answer: (b)

TEST YOUR KNOWLEDGE**Choose the correct answer**

Which of the following can be distributed among the shareholders?

- (a) Reserve capital
- (b) Capital reserve
- (c) Revenue reserve
- (d) Debenture capital

Correct answer: (c)

3. MEANING AND NATURE OF A SHARE

Section 2(46) of the Act defines a share as “a share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied.

Nature of a Share

- (a) *A share is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities while the company is a going concern and in its winding up.* (Halsbury's Laws of England)
- (b) A share is the measure of a shareholder in the company measured by a sum of money, for the purposes of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se. in accordance with the Companies Act (*Borland's Trustee v. Steel Bros.*, (1901)
- (c) A share is a right to participate in the profits made by a company, while it is a going concern and declares a dividend and in the assets of company when it is wound up. [*Bacha Guzdar v. CIT* 57 Bom. L.R. 617 (SC)].
- (d) A share is not a sum of money but a bundle of rights and liabilities; it is an interest measured by a sum of money. These rights and liabilities are regulated by the articles of a company.
- (e) Section 82 of the Companies Act provides that a share or other interest of any member in a company is a movable property transferable in the manner provided by the articles of the company
- (f) In India, a share is regarded as goods.. According to the Sale of Goods Act, 1930, “Goods” means any kind of movable property other than actionable claim and money, and includes stock and shares
- (g) According to Section 83 of the Companies Act, 1956 each share in a company having a share capital shall be distinguished by its appropriate number but this provision shall not apply to shares held with depository

TEST YOUR KNOWLEDGE

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

A share is a right to participate in the profits made by a company.

- True
- False

Correct answer: True

4. KINDS OF SHARES

Section 86 of the Companies Act, 1956 as amended by the Companies (Amendment) Act, 2000 permits a company limited by shares to issue two classes of shares, namely:

(a) Equity share capital—

- (i) with voting rights; or
- (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

(b) Preference Share Capital

The amendment enables companies to issue a variety of equity shares with differential rights etc. to meet the varied requirements of investors. Consequent upon the substitution of Section 86 with new section empowering companies to issue shares with differential rights, Section 88 prohibiting issue of shares with disproportionate rights has been deleted.

The Companies (Amendment) Act, 2000 has, by substituting Section 86 of the Act, empowered companies to issue equity share capital with differential rights as to dividend, voting or otherwise in accordance with the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001.

The text of the Rules is given hereunder:

COMPANIES (ISSUE OF SHARE CAPITAL WITH DIFFERENTIAL VOTING RIGHTS) RULES, 2001

[Issued by the Ministry of Law, Justice and Company Affairs, (Department of Company Affairs) Vide F.No. 1/13/2000.-CL.V; Published in the Gazette of India Extraordinary Part II, Section 3, Sub-section (i) dated 9-3-2001]

NOTIFICATION

G.S.R. 167 (E) — In exercise of the powers conferred by sub-clause (ii) of clause (a) of Section 86 read with clause (a) and (b) of Sub-section (1) of Section 642 of the Companies Act, 1956, the Central Government hereby makes the following rules, namely:

1. Short title and commencement

- (1) These rules may be called the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001.
- (2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions

- (1) In these rules, unless the contexts otherwise requires—
 - (a) “Act” means the Companies Act, 1956 (1 of 1956),
 - (b) “differential voting rights includes rights as to dividend or voting.”
 - (c) “financial year” means financial year as defined under clause (17) of Section 2 of the Act.

- (2) Words and expressions used and not defined in these rules but defined in the Companies Act, 1956 shall have the same meaning respectively assigned to them in that Act.

3. Conditions: Every company limited by shares may issue with differential rights as to dividend, voting or otherwise, if —

- (1) The company has distributable profits in terms of Section 205 of the Companies Act, 1956 for preceding three financial years preceding the year in which it was decided to issue such shares.
- (2) The company has not defaulted in filing annual accounts and annual returns for three financial years immediately preceding the financial year of the year in which it was decided to issue such share.
- (3) The company has not failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend.
- (4) The Articles of Association of the company authorises the issue of shares with differential voting rights.
- (5) The company has not been convicted of any offence arising under, Securities Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, Foreign Exchange Management Act, 1999.
- (6) The company has not defaulted in meeting investors' grievances.
- (7) The company has obtained the approval of shareholders in General Meeting by passing resolution as required under the provision of sub-clause (a) Sub-section (1) of Section 94 read with Sub-section (2) of the said section.
- (8) The listed public company obtained approval of shareholders through Postal Ballot.
- (9) The notice of the meeting at which resolution is proposed to be passed is accompanied by an explanatory statement stating—
 - (a) the rate of voting right which the equity share capital with differential voting right shall carry;
 - (b) the scale or in proportion to which the voting rights of such class or type of shares will vary;
 - (c) the company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity share capital with voting rights;
 - (d) the shares with differential voting rights shall not exceed 25% of the total share capital issued;
 - (e) that a member of the company holding any equity share with differential voting rights shall be entitled to bonus shares, right shares of the same class;
 - (f) the holders of the equity with different voting rights shall enjoy all other rights to which the holder is entitled to excepting right to vote as indicated in (a) above.

4. Register: Every company referred to in Rule 3 shall maintain a registrar as required under Section 150 of the Act containing the particulars of differential rights to which the holder is entitled to.

5. PREFERENCE SHARES OR PREFERENCE SHARE CAPITAL

Section 85(1) of the Companies Act, 1956 provides that a preference share or preference share capital is that part of share capital which fulfills both the following requirements:

- (a) With respect to dividend, it carries a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to income-tax.
- (b) With respect to capital, it carries on winding up or re-payment of capital a preferential right to be repaid the amount of the capital paid-up or deemed to have been paid-up whether or not there is preferential right to the payment of either or both of the following amounts, namely:
 - (i) any money remaining unpaid, in respect of the amount specified in clause (a) up to the date of winding up or re-payment of capital; and
 - (ii) any fixed premium or premium on any fixed scale specified in the memorandum or articles of the company.

6. TYPES OF PREFERENCE SHARES

Preference shares may be of various types, namely:

- (a) **Participating or non-participating:** Participating preference shares are those shares which are entitled to a fixed preferential dividend and, in addition, they carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders. For example, after 20% dividend has been paid to equity shareholders, the preference shareholders may share the surplus profit equally with equity shareholders. Again in the event of winding up, if after paying back both the preference and equity shareholders there is still any surplus left then the participating preference shareholders get additional share in the surplus assets of the company. Unless expressly provided, preference shareholders get only the fixed preferential dividend and nothing more. The right to participate may be given either in the memorandum or articles or by virtue of their terms of issue.
- (b) **Cumulative and non-cumulative shares:** With regard to the payment of dividends, preference shares may be cumulative or non-cumulative. A cumulative preference share confers a right on its holder to claim fixed dividend of the past and the current year(s) and out of future profits. The dividend keeps on accumulating until it is fully paid. The non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividend out of the profits of each year. If no profits are available in any year, the shareholders get nothing, nor they can claim, unpaid dividend in any subsequent year.

Preference shares are cumulative unless expressly stated to be non-cumulative. Dividends on preference shares, like equity shares, can be paid only out of profits.

- (c) **Redeemable and irredeemable Preference Shares:** Subject to an authority in the articles of association, a public limited company may issue redeemable

preference shares to be redeemed either at a fixed date or after a certain period of time during the life time of the company provided the company complied with the following conditions laid down in Section 80 of the Act.

- (i) the articles must provide for the issue of such shares;
- (ii) they may be redeemed only out of profits available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption;
- (iii) if premium is payable on redemption, it must have been provided for out of profits or out of company's securities premium account, before the shares are redeemed;
- (iv) no such shares can be redeemed unless they are fully paid;
- (v) where the shares are redeemed otherwise than out of the proceeds of the fresh issue, a sum equal to the nominal amount of the shares redeemed shall be transferred out of profits which would otherwise have been available for dividend, to the "Capital Redemption Reserve Account." This fund may also be applied by the company in paying up unissued shares of the company to be issued to the members of the company as fully paid shares.

It may be noted that redemption of preference shares in pursuance of this section is not to be taken as reducing the amount of the authorised capital of the company. Provisions of the Act with regard to reduction of capital are not required to be complied with. Also, where a company has redeemed preference shares, it has the power to issue new shares upto the nominal amount of the shares redeemed with the result the share capital of the company shall not be deemed to have been increased with the issue of new shares. It may be further noted that notice of redemption of preference shares must be sent to the Registrar under Section 95 of the Act.

The Companies (Amendment) Act, 1996 has however prohibited the issue of any preference share which is irredeemable or is redeemable after the expiry of the period of twenty years from the date of its issue.

7. EQUITY SHARES

In accordance with the provisions of Section 85(2) of the Companies Act, "Equity Share Capital" means with reference to any such company, any share capital which is not preference share capital. Thus, a share or share capital which does not satisfy the definition of preference share capital, is equity (ordinary) share capital. Equity shareholders receive dividends out of profits as recommended by the Board of directors and as declared by the shareholders in an annual general meeting, only after due allowance for depreciation has been made and after preference shares, if any, have been paid their fixed dividend. Under Section 86, equity shares may be issued with differential rights as to dividend, voting or otherwise in accordance with the Companies (Issue of Share Capital with Differential Voting Rights) Rules 2001.

8. PREFERENCE SHARES COMPARED WITH EQUITY SHARES

<i>S.No</i>	<i>Preference capital</i>	<i>Equity share capital</i>
1	Preference shares are entitled to a fixed rate of dividend	The rate of dividend on equity shares depends upon the amount of profit available and the funds requirements of the company for future expansion etc
2	Dividend on the preference shares is paid in preference to the equity shares	The dividend on equity shares is paid only after the preference dividend has been paid
3	In case of winding up, preference share holder get preference over equity share holders with regard to the payment of capital	In case of winding up, equity share holder get payment of capital after the payment of capital to preference shareholders
4	Dividend on preference share may be cumulative	The dividend on equity shares is paid only after the preference dividend has been paid and it is not cumulative
5	The voting rights of preference shareholders are restricted. A preference shareholder can vote only when his special rights as a preference shareholder are being varied or their dividend is in arrears paid for a period of two years immediately preceding the meeting or for any three years in the preceding six years.	An equity shareholder can vote on all matters affecting the company
6	No bonus shares/right shares are issued to preference share holders	A company may issue rights shares or bonus shares to the company's existing equity shareholders
7	Redeemable preference shares may be redeemed by the company	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy back of its own shares.

Whether equity shares already issued can be converted into redeemable preference shares?

In *Chowgule & Co. (P) Ltd.* 1972 Tax LR 2163 the Judicial Commissioner of Goa, relying on the judgment in the case of *St. James Court Estates Ltd.* [1994] Ch. 6, held that where the equity shares are sought to be converted into redeemable preference shares it was necessary to adopt the process of reduction of capital under Sections 100-104 of the Companies Act, 1956.

9. ISSUE OF SWEAT EQUITY SHARES

Sweat equity shares mean equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. Section 79A [inserted by the Companies (Amendment) Act, 1999] permits issue of such equity shares to employees or directors in recognition of their contribution for providing know-how etc. as aforesaid. As the contribution made by employees/directors results in increased profits to the company for a number of years, sweat equity shares, provide a new form of adequate return. For the purpose of issue of sweat equity shares, 'company' means a company which is incorporated, formed and registered under this Act and includes its subsidiary company incorporated outside India.

Intellectual property rights are the exclusive property rights, which can be prevented from use by others without the authorization of the owners and include patents for invention, industrial designs, copyrights in literacy/scientific etc. matters, registered or pending trade marks etc.

Value additions refer to the increase in value of company's products etc. in economic terms, which is attributable to the efforts of an employee or a director, in any manner.

Notwithstanding anything contained in Section 79, a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- (i) the issue has been authorised by a special resolution passed by the company in the general meeting.
- (ii) the following are clearly specified in the resolution:
 - (a) number of shares
 - (b) current market price
 - (c) consideration, if any
 - (d) class or classes of directors or employees to whom such equity shares are to be issued.
- (iii) as on the date of issue, atleast one year should have elapsed from the date on which the company was entitled to commence business.
- (iv) a company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the regulations made in this behalf by SEBI.
- (v) a company whose shares are not so listed should issue sweat equity shares in compliance with the rules made in this behalf.

The text of SEBI (Issue of Sweat Equity) Regulations, 2002 and Unlisted Companies (Issue of Sweat Shares) Rules, 2003 are given as Annexure.

TEST YOUR KNOWLEDGE**Multiple choice question**

Which of the following are reasons for the issue of sweat equity shares to employees/directors?

- (a) Making available some intellectual property rights to the company
- (b) Providing some know how to the company
- (c) Doing some value additions in the company that results in increased profits
- (d) Taking shares in bulk

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

10. SOURCES OF CAPITAL**Raising of Capital from Promoters**

When a company has been registered and has received the Certificate of Incorporation from the Registrar of Companies, it is ready to raise capital sufficient to commence business and to carry on its business satisfactorily.

A company raises its share capital in the first instance by issuing shares. Initially it is mostly raised from the promoters/directors of the company and their friends/relatives. It may repeat this process of raising capital as many times as required during its existence and for expansion of its business. A private company obtains the necessary capital from promoters, friends and relatives by private placements/arrangement as public at large can not be invited to subscribe to its share capital but where, large amount of capital is needed to run an enterprise, a public company is formed and the promoters normally intend to approach the general public for a greater part of the capital required by the company. It is no doubt possible for a public company also to raise the necessary capital by Private Placement (not made to more than forty-nine persons at a time) without inviting the general public to subscribe to its share capital. But public companies raise major portion of their capital from the public at large on account of its various advantages.

Raising of Capital from Public

Broadly speaking, there are three methods by which a company can raise capital from the public:

- (a) **By issuing a prospectus:** This is the most obvious method by which a company seeks to raise capital from the public. It invites offers from members of the public to subscribe for its shares or debentures, through the prospectus. An investor studies the prospectus and, if convinced, about the prospects of the company, applies for shares.
- (b) **By an offer for sale or by deemed prospectus:** Here the company offers or agrees to allocate shares or debentures at a price to a financial institution or an Issue House for sale to the public. The Issuing House publishes a document called an 'Offer For Sale' with an application form attached offering to the public shares or debentures for sale at a price higher than what its holder(s) had paid for them or at par. This document is deemed to be

prospectus in law [Section 64(1)]. On receipt of applications from the public, the Issue House renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct holder of the shares.

- (c) **By private placement of Shares:** A private limited company is prohibited by the Act and the Articles from inviting the public for subscription of shares or debentures. It also need not file a statement in lieu of prospectus. Its shares are issued privately to a small number of persons known/related to the promoters. A public company can also raise capital by private placement whereby a broker or an underwriter finds persons, normally his clients, who wish to buy the shares. He acts merely as an agent and his function is simply to procure buyers for the shares, i.e. to “place” them. Since no public offer is made, there is no need to issue any prospectus in this case.

Unlisted public companies are required to comply with the Companies (Preferential allotment) Rules, 2011 which are given as an annexure at the end of this lesson.

Raising Capital from Existing Shareholders

The capital is also raised by issue of rights shares (Section 81) to the existing shareholders. In this case the shares are allotted to the existing equity shareholders in proportion to their original shareholding, e.g., two share against every lot of five shares held by a member. For this purpose, the companies are required to issue letter of offer as per provisions of the Act and SEBI Guidelines.

Public Issue of Shares

Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, SEBI (ICDR) Regulations 2009 including the Rules made thereunder and the guidelines and instructions issued by the concerned Government authorities, the Stock Exchanges and the SEBI etc. Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrar to the issue; solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, SEBI etc. The whole process of issue of shares can be divided into two (i) pre-issue activities and (ii) post issue activities. All activities beginning with the planning of capital issue till the opening of the subscription list are pre-issue activities while all activities subsequent to the opening of the subscription list may be called post issue activities.

The public issue of securities may be and is usually made:

1. by prospectus, and issuance of securities in physical form, which shall not be listed on any stock exchange, or
2. by prospectus and issuance of securities in dematerialized format.

Since only the demat shares are being admitted for dealings on the stock exchanges, hence the securities can be issued only with the purpose of allotting the shares in Demat Form.

Further, the public issue of securities can be through normal and existing method and fully or partly by following Book Building method.

11. SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009 [ICDR REGULATIONS]

SEBI ICDR Regulations for Issue of Equity Shares

The ICDR Regulations have been made primarily by repealing the SEBI (Disclosure and Investor Protection) Guidelines, 2000. While incorporating the provisions of the rescinded Guidelines into the ICDR Regulations, certain changes have been made by removing the redundant provisions, modifying certain provisions on account of changes necessitated due to market design and bringing more clarity to the provisions of the rescinded Guidelines.

The important aspects of SEBI Guidelines, with reference to issue of equity shares are discussed in the following paragraphs:

A company cannot issue securities if it has been prohibited from accessing the capital market by order/direction of SEBI. Also, a company cannot make a public issue of securities unless it has made an application for listing of those securities in the stock exchange. A company should enter into an agreement with a depository for dematerializations of securities already issued or proposed to be issued to the public/existing shareholders and give an option to subscribers/shareholders/investors to receive the security certificates or hold securities in dematerialized form with a depository.

A draft prospectus should be filed by a company with SEBI through an eligible Merchant Banker, atleast 30 days prior to the filing of prospectus with the Registrar and if any changes are specified by SEBI, the same should be carried out before filing the prospectus with ROC.

Following further filings/approvals/submissions shall be obtained under SEBI (ICDR) Regulations 2009

- The draft offer document is made available to the public for at least 21 days from the date of such filing with SEBI.
- A statement on the comments received from public on draft offer document is filed with SEBI.
- The observations/suggestions of SEBI on draft offer documents have been carried out while registering of prospectus with ROC.
- A copy of letter of offer is filed with SEBI and with stock exchanges where the securities are proposed to be listed, simultaneously while registering the prospectus with ROC /before opening of the issue.

It may be noted that contents of offer documents hosted on Websites are the same as printed versions filed with ROC. Further the information contained in the offer document and particulars as per audited financial statements in the offer document are not more than six months old from the opening of the issue.

An unlisted company which is coming out with a public issue should satisfy the

conditions spelt out in the Regulations. Further, a company should, as on the date of filing of draft offer document and final offer document should have obtained a credit rating from at least one credit rating agency registered with SEBI and disclosed in the offer document. Also, it should not be in the list of willful defaulters of RBI, and should not have defaulted in payment of interest or repayment of principal in respect of debentures issued to the public, for a period of more than 6 months.

The public/rights issue by listed companies and public issue by unlisted companies may be freely priced. Differential pricing may be resorted to for applicants in firm allotment category, provided the price at which security is offered to them, is higher than the price at which securities are offered to public.

The issuer company can mention a price band of 20% in the offer documents filed with the Board and actual price can be determined at a later date before filing of the offer document with ROCs. In case the Board of Directors has been authorized to determine the offer price within a specified price band, such price shall be determined by a resolution to be passed by the Board of Directors.

An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with Sub-section (4) of Section 13 of the Companies Act, 1956 and in compliance with the following and other norms as may be specified by SEBI from time to time.

- (i) Subject to the provisions of the Companies Act, 1956 the SEBI Act and these regulations, an issuer making an initial public offer may determine the face value of the equity shares in the following manner:
 - (a) if the issue price is Rs. 500/- or more, the issuer company shall have a discretion to fix the face value below Rs. 10/- per share subject to the condition that the face value shall in no case be less than Re. 1 per share.
 - (b) if issue price is less than Rs. 500/ per share, the face value shall be Rs. 10/- per share.
- (ii) The disclosure about the face value of shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisement, offer documents and in application forms in identical font size as that of issue price or price band.

The promoters of the issuer shall contribute in the public issue as follows:

- (a) in case of an initial public offer, not less than twenty per cent of the post issue capital;
- (b) in case of a further public offer, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital;
- (c) in case of a composite issue, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital excluding the rights issue component.

The entire promoters contribution including premium must be received at least

one day prior to the issue opening date and kept in an escrow account with a scheduled commercial bank and should be released to the company only along with public issue proceeds. However, if the promoters' contribution is brought before the public issue and is deployed by the company, it shall disclose the use of such funds in the cash flow statement.

If the promoters' minimum contribution exceeds Rs. 100 crores, the promoters can bring in Rs. 100 crores before the opening of the issue and balance contribution in advance on *pro rata* basis before the calls are made on public.

A copy of the resolution of the Board of Directors of the company, allotting the shares or convertible instruments to promoters against the moneys received alongwith a Chartered Accountant's certificate certifying that the promoters contribution has been brought in, alongwith the names and addresses of friends, relatives and associates who have contributed to the promoters' quota alongwith subscription made by each of them, should be filed with SEBI, before the opening of the issue.

The minimum promoters contribution is subject to lock-in-period of 3 years from the date of commencement of commercial production or date of allotment in the public issue whichever is later.

Any contribution made by promoters over and above the minimum contribution shall be subject to a lock-in-period of 1 year in case of all the companies.

Shares held by promoter(s) which are locked-in, can be transferred to and amongst promoter/promoter group or to a new promoter or persons in control of the company, subject to continuation of lock-in in the hands of transferees for the remaining period subject to Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as applicable. In other words, the lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

Shares held by the person other than the promoters, prior to Initial Public Offering (IPO), which are locked-in as per these Regulations, may also be transferred to any other person holding shares which are locked in subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as applicable.

The securities which are subject to lock-in shall carry inscription 'non-transferable' along with duration of specified non-transferable period mentioned in the face of the security certificate.

The lead merchant banker shall ensure that for public issue, offer documents and other issue materials are dispatched to various stock exchanges, brokers, underwriters, bankers etc. in advance and that in case of rights issue, abridged letters of offer are dispatched to all shareholders atleast one week before the issue opening date. Every company making a public issue is required to appoint a compliance officer and intimate the name of the compliance officer to SEBI. Compliance Officer shall directly liaise with SEBI with regard to compliance with various laws, rules

regulations, and other directives issued by SEBI and investor complaints related matters.

The net offer to public:

- (a) in case of an initial public offer, shall be at least ten per cent or twenty five per cent of the post-issue capital, as the case may be; and
- (b) in case of a further public offer, shall be at least ten per cent. or twenty five per cent. of the issue size, as the case may be.

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited.

The issue must open within 12 months from the date of issuance of the observation by SEBI, if any or within 3 months from the expiry of date mentioned in resolution 6(2) of the regulations, if no observation letter is issued. However, in case of Shelf prospectus the first issue may be opened within three months of issuance of observations by the Board.

A public issue shall be kept open for at least three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band. In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus shall be extended for a minimum period of three working days. Provided that the total bidding period shall not exceed ten working days. A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

The allotment of specified securities to applicants other than anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer.

In case of the violation of these guidelines, SEBI has been empowered to direct the persons concerned to refund any money collected under an issue to the investors with or without requisite interest as the case may be and not to access the capital market for a particular period. In respect of violations by stock exchanges, SEBI can direct the exchange concerned not to list or permit trading in the securities and to forfeit the security deposit by the issuer company. In case of violations by intermediaries, SEBI may suspend or cancel the certificate of registration of any intermediary who fails to exercise due diligence or fails to comply with the obligations entrusted under the guidelines or who is alleged to have updated any of these guidelines. SEBI is under an obligation to follow the specified procedures provided under the regulations dealing with such intermediaries.

For details of public issue of shares by listed companies, students are advised to refer to the text of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

12. PREFERENTIAL ISSUE BY EXISTING LISTED COMPANIES

All issues of capital by listed companies whose equity share capital is listed on any stock exchange by way of equity shares/FCDs/PCDs or any other financial instruments on a preferential basis which would be converted into or exchanged with equity shares at a later date to any select group of persons shall comply with the requirements of ICDR Regulations.

The provisions relating to preferential issue by existing listed companies shall not apply where the preferential issue of equity shares is made:

- (a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956;
- (b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956;
- (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

A listed issuer may make a preferential issue of specified securities, if:

- (a) a special resolution has been passed by its shareholders;
- (b) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;
- (c) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;
- (d) the issuer has obtained the Permanent Account Number of the proposed allottees.

Accordingly, the offer prices of shares issued on preferential basis should not be less than the higher of the average of the weekly high and low of the closing price of related shares quoted on the stock exchange during the six months or two weeks preceding the relevant date. The relevant date for this purpose refers to a date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue.

In case of issue of warrants on preferential basis with an option to apply and get shares allotted, the price of resultant shares will also be determined in the above manner. However the issuer may adopt relevant date as mentioned above or a date thirty days prior to the date on which the warrant holders become entitled to apply for the shares. At least twenty five percent of price of shares to be issued against warrants should be paid on the date of their allotment to exercise options for purchasing shares in lieu of warrants and this is to be adjusted against the price payable subsequently for acquisition of shares and if the option to acquire shares is not exercised, the whole of the amount so paid shall stand forfeited. The balance seventy five per cent of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

FCDs/PCDs/Shares acquired by way of conversion of warrants or other financial

instruments issued on preferential basis to promoter/promoter group are subject to lock-in-period of three years from the date of their allotment. Also, the instruments allotted on preferential basis to any person including promoters/promoters group shall be locked-in for a period of one year from the date of allotment. The company shall place a certificate, duly signed from statutory auditors of company in the general body meeting of the shareholders, to the effect that the preferential issue is in accordance with the requirements contained in SEBI regulations. Copies of the auditors certificate should also be laid before the meeting of the shareholders convened to consider the proposed issue.

No listed company can make a preferential issue of instruments to any person unless the entire shareholding of such person(s) in the company, if any, is held by him in dematerialized form. The entire pre-preferential shareholding of such allottees should be locked-in from the relevant date upto six months from the date of preferential allotment. The locked in shares/instruments may be transferred to and amongst promoter/promoters group or to a new promoter(s) or person(s) in control of the company, subject to continuation of lock-in in the hands of transferee and compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. Allotment pursuant to any resolution passed at a meeting of shareholders granting consent for preferential issues should be completed within a period of fifteen days from the date of passing of the resolution or if any Central Government order is pending, within 15 days of such approval. The equity shares and securities convertible into equity shares at a later date, so allotted should be made fully paid-up at the time of meeting.

In case of preferential allotment of shares to promoters, their relatives, associates and related entities for consideration other than cash, valuation of the assets forming the consideration should be done by an independent qualified valuer and the valuation report should be submitted to the exchanges where shares of the issuer company are listed.

Preferential allotment of shares made to FIIs should also conform with the Guidelines issued by the Government of India/Board/Reserve Bank of India in addition to SEBI Regulations.

13. ISSUE OF SHARES/SECURITIES AT A PREMIUM

A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value, e.g. Rs. 100 shares at a price of Rs. 110, thereby earning a premium of Rs. 10 per share irrespective of the fact whether the securities are listed on Stock Exchange or not (Section 78).

The Companies Act, 1956, does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. However, the Companies Act does impose conditions regulating the utilisation of the amount of premium collected on securities. Firstly, the premium cannot be treated as profit and as such the amount of premium is not available for distribution as dividend. Secondly, the amount of premium whether received in cash or in kind must be kept in a separate account, known as the "Securities Premium Account". Thirdly, the amount of premium is to be maintained with the same sanctity as the share capital.

Where a company issues shares at a premium, even though the consideration

may be other than cash, a sum equal to the amount or value of the premium must be transferred to the securities premium account. [*Head (Henry) & Co. Ltd. v. Ropner Holding Ltd.* (1951) 2 All ER 994: (152) Ch 124 (Ch D)].

Securities premium account is to be maintained and the securities premium cannot be used otherwise than for the specific purposes mentioned in Section 78(2). [*CIT v. Allahabad Bank Ltd.*, (1969) 39 Com Cases 760, 763: AIR 169 SC 1058]. These purposes are specified in Sub-section (2) and they do not include distribution by way of dividend. [*Brown v. Gaumont British Picture Corpn. Ltd.*, (1937) 2 all ER 699: (1937) Ch 402].

The annual balance-sheet must disclose the amount of share premium (securities premium) as a separate item and if it is, partly or wholly disposed of, must indicate how it is disposed of or exhausted. [See Schedule VI Part I].

Any premium paid does not give the shareholder any preferential rights in case of a winding up. Monies in the securities premium account cannot be treated as free reserves, as they are in the nature of capital reserve [See Departmental Circular No. 3/77 dated 15.4.1977].

In accordance with the provisions of Section 78(2) of the Act, the securities premium can be utilised only for:

- (a) issuing fully paid bonus shares to members;
- (b) writing off the balance of the preliminary expenses of the company;
- (c) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company; and
- (d) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company.

When shares are issued at a premium the provisions of Section 78 of the Act are to be complied with. Other steps involved in issue of shares are the same as those for the procedure for issue of shares. A private company and an unlisted company not making a public issue is at liberty to issue capital at a premium as may be decided by the Board of directors.

14. ISSUE OF SHARES AT A DISCOUNT

A company may issue shares at a price less than the nominal value of shares i.e. at a discount. However, the Companies Act discourages issue of shares at a discount. Allotment of shares at a discount without complying with the stringent requirements of the Act is *ultra vires* and the allottees who have been put on the register of members become liable to pay the full value of their shares.

Section 79 provides that a company may issue shares at a discount provided it satisfies the following conditions:

- (a) the shares must be of the class already issued;
- (b) at least one year must have elapsed since the company became entitled to commence business;
- (c) the issue must be authorised by resolution of the general meeting of the

company specifying maximum rate of discount at which shares are to be issued;

- (d) the resolution must be confirmed by the Company Law Board.
- (e) the rate of discount cannot exceed 10 per cent or such higher percentage as is permitted by the Company Law Board in special cases;
- (f) the shares must be issued within two months of the sanction by the Company Law Board or within such extended time as the Company Law Board may allow; and
- (g) every prospectus relating to the issue of shares must contain the particulars of the discount allowed on the issue of the shares, or of so much of that discount as has not been written off at the time of issue of the prospectus.

If a default is made then the company, and every officer who is in default shall be liable to a fine up to Rs. 500.

Note: Provisions regarding issue of shares at a discount do not apply to debentures since debentures, not being in the nature of the share capital, may be issued at a discount if the ultimate objective is not to convert them into shares.

Issue of sweat equity shares to employees and directors at a discount under section 79A is outside the scope of this section. Sanction of the Company Law Board is not required even if the issue is at a discount.

It may be noted that provision is made for allowing a higher discount than ten per cent in proper cases, where the permission of the Company Law Board is obtained therefor.

It is no longer necessary to disclose the issue of such shares or particulars of the discount allowed thereon, in any balance-sheet of the company, issued subsequent to the issue of the shares.

Where shares are issued at a price lower than the market price but above nominal value, such an issue is not an issue at a discount. "At a discount" means a price less than the nominal value.

The fact that the market quotation for the shares is already below par would not justify issuing shares at a price less than the nominal value.

Therefore, for issue of convertible debentures, the requirements of section 79 have to be complied with. Further, sanction of the Company Law Board is required to be obtained.

However, section 79 does not apply to non-convertible debentures which can be issued at a discount, as such debentures do not form part of a company's capital.

The provision fixing the minimum period of one year after the commencement of business is probably to ensure that a reasonable time has elapsed in which the value of existing shares may be established.

Where shares are issued at a discount contrary to the provisions of the section 79, not only the directors authorising the unauthorised issue but also the allottees, if their names have been entered in the register of members and they have accepted the allotment, will be liable to the company for the full amount of the shares. Full value of the shares can be recovered by the liquidator in the winding up of the

company. [*Welton v. Saffrey*, (1897) AC 299]. Where share certificates have been issued showing full payment and the shares have been transferred to a bona fide transferee, the company would have to treat him as a fully paid shareholder and in such a case the company can receive from the directors an amount equal to the discount allowed on those shares. [*Hirsche v. Sims* (1894) AC 654 (PC) See also. *London Trust Co. v. Mackenzie* (1893) 62 LJ Ch. 870].

TEST YOUR KNOWLEDGE

Choose the correct answer

What is the maximum discount on shares that a company can offer in a general case?

- (a) 5 %
- (b) 10 %
- (c) 15 %
- (d) 20 %

Correct answer: b)

15. FURTHER ISSUE OF SHARES

Section 81 of the Companies Act provides for the issue of “Rights Shares” and states that whenever at any time after expiry of two years from the incorporation of a company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital by allotment of further shares, such shares shall be offered to the existing holders of equity shares in proportion to the capital paid-up on their shares at the time of further issue. For listed companies, the information as regards the quantum of such issue and the proportion in which rights shall be offered shall be supplied to the concerned Stock Exchanges in advance.

The company must give notice to each of the equity shareholders, giving him option to take the shares offered to him by the company. The shareholder must be informed of the number of shares he has opted to buy giving him at least 15 days to decide. If the shareholder does not convey to the company his acceptance of the company’s offer of further shares he shall be deemed to have declined the offer. Unless the articles of the company otherwise provide, the directors must state in the notice of offer of rights shares the fact that the shareholder has also the right to renounce the offer in whole or in part, in favour of some other persons.

If a shareholder has neither renounced in favour of another person nor accepted the shares, the Board of directors may dispose of the shares so declined in such manner as it thinks would be most beneficial to the company.

Section 81(1A) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders in any manner whatsoever provided —

- (1) the company in General Meeting passes a special resolution to this effect.
- (2) where only an ordinary resolution has been passed, the approval of the

Central Government is obtained by the Board of directors stating that the proposal is most beneficial to the company.

The restrictions contained in Section 81 of the Act regarding issue of further shares do not apply to:

- (i) a private company;
- (ii) increase of the subscribed capital of public company caused by the exercise of an option attached on debentures issued or loans raised by the company to convert such debentures or loans into shares of the company or to subscribe for shares in the company [Section 81(3)].

Provided the terms containing such an option:

- (a) have been approved by the Central Government before the issue of debentures or raising of loans is in conformity with the rules made by the Government; and
- (b) have been approved by a special resolution passed in the general meeting before the issue of debentures or raising of loans in cases where the debentures have not issued to or loans raised from the Government or any institutions specified by the Government.
- (c) conversion of part or whole of the debentures issued to or loans raised from the Government in shares of the company in pursuance of a direction issued by the Central Government in public interest on such terms and conditions as appear to be fair and reasonable to the Central Government even if such debentures/loans do not contain a term providing for option for conversion of debentures/loans into shares of the company.

Under the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to Convert Debentures or Loans into Shares) Rules, 1977 as modified by Amendment Rules, 1978, where the terms of issue of debentures or the raising of loans by a public company provides for an option to convert such debentures or loans or any part thereof into shares in the company or to subscribe for shares in the company, shall not require the approval of the Central Government under proviso to Section 81(3)(a) of the Act, if such terms conform to the following requirements, namely:

- (a) the debentures or loans may be issued or raised either through private subscriptions or through the issue of a prospectus to the public;
- (b) a public financial institution defined in the Act either underwrites or subscribes or sanctions the whole or part of the issue of debentures or the raising of loans, as the case may be;
- (c) having regard to the financial position of the company, the terms of issue of the debentures or the terms of the loans, as the case may be, the rate of interest payable on the debentures or loans, the capital of the company, its loans, liabilities, its reserves, its profits during the immediately preceding five years and the current market price of shares of the company, as may be applicable, the financial institutions provide for the terms including the term providing for an option to convert such debentures or loans or any part thereof into shares in the company or to subscribe for shares therein, either

at par or at a premium not exceeding twenty-five percent of the face value of the shares.

Judicial Pronouncement relating to further issue of shares by a company

- (a) ***Nanlal Zaver v. Bombay Life Assurance Co. Ltd., AIR 1950 SC 172: (1950) 20 Com Cases 179:*** Section 81 is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the directors decide to increase the capital within the authorised limit, by issue of further shares. [

The above judgement was followed by the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 51 Com Cases 743 at 816: AIR 1981 SC 1298: (1982) 1 Comp LJ1. The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they do not exercise powers for the benefit of the company but simply and solely for personal aggrandisement and to the detriment of the company, the court will interfere and prevent the directors from doing so.

- (b) ***See Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*** The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers or to enable it to comply with statutory requirements.

The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time.

- (c) ***Balkrishan Gupta v. Swadeshi Polytex Ltd. (1985) 58 Com Cases 563: AIR 1985 SC 520***. Although the term 'holders of the equity shares' is used in Sub-section (1)(a) and 'members' in Sub-section (1-A)(b) of Section 81, the two terms are synonymous and mean persons whose names are entered in the register of members
- (d) ***In Worldwide Agencies (P) Ltd. v. Margaret T. Desor, (1990) 67 Com Cases 607: AIR 1990 SC 737***, it was held that persons who have become entitled to the shares of a deceased member can exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not.
- (e) ***Mathalone (R) v. Bombay Life Assurance Co. Ltd. AIR 1953 SC 385: (1954) 24 Com Cases 1***. The Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

16. RIGHTS ISSUE

Rights issue is an issue of capital under Section 81(1) of the Companies Act, 1956 to be offered to the existing shareholders of the company through a letter of

offer. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders unless they do not intend to subscribe to their entitlements. A listed company has to comply SEBI (ICDR) Regulations and cannot make any issue of security through a rights issue where the aggregate value of securities including premium, if any, exceeds Rs.50 lacs, unless it has filed a draft letter of offer with the Board, through an eligible Merchant Banker, atleast 30 days prior to the filing of letter of offer with Designated Stock Exchange (DSE). If within 30 days from the date of filing of draft letter of offer, the Board specifies changes, if any, in the draft letter of offer, the issuer or lead Merchant Banker should carry out such changes before filing the draft letter of offer with DSE. In case the aggregate value of the securities offered is less than Rs.50 lacs, it should be ensured that a letter of offer is prepared in accordance with disclosure requirements of SEBI guidelines and the same is filed with SEBI for information and for being put on SEBI website. As in this case, the price or price band is not necessarily to be disclosed in the draft letter of offer filed with the Board, the issue price may be determined anytime before fixation of the record date in consultation with Designated Stock Exchange. The funds collected against rights issue can be utilized by the issuer company against rights issue only after satisfying designated stock exchange that minimum 90% subscription has been received.

The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof. The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on which the equity shares offered in the rights issue were issued.

It should be certified that the requirements with respect to issue of securities in dematerialized form, partly paid up shares to be made fully paid up, firm arrangements of finance through verifiable means, pricing by listed companies, composite issue of capital at differential prices, freedom to determine denomination of shares, Memorandum of Understanding Inter re allocation of responsibilities of Merchant Bankers, Competence and Appointment of Intermediaries, further issue of capital etc. are complied *mutatis mutandis*, as in the case of public issue.

In a rights issue, the abridged letter of offer should be dispatched to all shareholders atleast one week before the date of opening of issue except where a specific request for letter of offer is received from any shareholder.

Withdrawal of rights issue after announcement of record date in relation to such issue is not permitted. If such withdrawal has been made, no application for listing of any securities of the company should be made for a minimum period of 12 months

from the record date. However, for the shares resulting from the conversion of PCDs/FCDs/Warrants issued prior to the announcing of record date in relation to rights issue listing may be granted by the concerned stock exchanges. It should be ensured that the quantum of issue through a rights issue (as in case of public issue) does not exceed the amount specified in the prospectus/letter of offer.

TEST YOUR KNOWLEDGE**Choose the correct answer**

Which of the following types of shares are issued by a company to raise capital from the existing shareholders?

- (a) Equity shares
- (b) Rights shares
- (c) Preference shares
- (d) Bonus shares

Correct answer: (b)

17. BONUS SHARES

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras v. A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

Advantages of Issuing Bonus Shares

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

Pursuant to the provisions of Section 78 of the Companies Act, 1956, securities premium account can be used in utilising unissued shares of the company to be issued to its members as fully-paid bonus shares. Other free reserves created out of the profits during earlier years like general reserve, capital redemption reserve account [Section 80(5)], devolvement rebate reserve etc. can be utilised by company for issue of fully paid bonus shares to its members.

There are no guidelines on issuing bonus shares by private or unlisted companies. However, the SEBI has issued regulations for Bonus Issue which are contained in Chapter IX of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to bonus issues by listed companies.

When a company has accumulated free reserves and is desirous of bridging the gap between the capital and fixed assets, it issues bonus shares to its equity shareholders. Such an issue would not place any fresh funds in the hands of the company. On the contrary, after a bonus issue it would become necessary for the company to earn more to effectively service the increased capital. The shareholder will, however, be benefitted by way of higher return on investment and more number of shares in their hands.

The following conditions must be satisfied before issuing bonus shares:

- (a) Bonus Issue must be authorised by the articles of the company. Such a provision is generally there in articles of almost all the companies as they adopt Table A of Schedule 1 of the Act (Regulation 96).
- (b) Bonus Issue must be sanctioned by shareholders in general meeting on recommendation of the Board of directors of the company.
- (c) ICDR Regulations issued by SEBI must be complied with.
- (d) Authorised Capital must be increased where necessary.

18. SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS), REGULATIONS, 2009 PERTAINING TO BONUS ISSUE – CHAPTER IX

Conditions for bonus issue

Subject to the provisions of the Companies Act, 1956 or any other applicable law for the time being in force, a listed issuer may issue bonus shares to its members if:

(a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.:

Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;

(b) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(c) it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

(d) the partly paid shares, if any outstanding on the date of allotment, are made fully paid up.

Restriction on bonus issue.

(1) No issuer shall make a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, unless it has made reservation of equity shares of the same class in favour of the holders of

such outstanding convertible debt instruments in proportion to the convertible part thereof.

(2) The equity shares reserved for the holders of fully or partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on which the bonus shares were issued.

Bonus shares only against reserves, etc. if capitalised in cash.

(1) The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.

(2) Without prejudice to the provisions of sub-regulation (1), the bonus share shall not be issued in lieu of dividend.

Completion of bonus issue.

(1) An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors:

Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

(2) Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

TEST YOUR KNOWLEDGE

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

Bonus shares help companies to reduce the gap between capital and fixed assets.

- True
- False

Correct answer: True

19. EMPLOYEE STOCK OPTION SCHEME

The term 'Employee Stock Option' (ESOP) has been defined under Sub-section (15A) of Section 2 of the Companies Act, 1956, according to which 'employee stock option' means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.

SEBI has issued SEBI (Employee Stock Option Scheme and Employee Stock

Purchase Scheme) Guidelines, 1999 according to which Employee Stock Option Scheme means a scheme under which the company grants option to its employees and option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.

The issue of ESOPs would be subject to approval by shareholders through a special resolution. In cases of employee being offered more than 1% shares, a specific disclosure and approval would be necessary in the annual general meeting.

A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company.

The operation of the ESOP Scheme would have to be under the superintendence and direction of a Compensation Committee of the Board of directors in which there would be a majority of independent directors. With the specific approval of the shareholders, the scheme would be allowed to cover the employees of a subsidiary or a holding company.

TEST YOUR KNOWLEDGE

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

Employee stock option scheme means a right but not an obligation granted to an employee to buy the shares of the company at a pre-determined price.

- True
- False

Correct answer: True

20. SEBI (EMPLOYEE STOCK OPTION SCHEME AND EMPLOYEE STOCK PURCHASE SCHEME) GUIDELINES, 1999

In November 1997, SEBI constituted a Group to review the existing regulations relating to Employee Stock Options Plans (ESOP) and recommend changes thereto.

The Group submitted its report in June 1999 and has recommended Guidelines to be called SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. The Guiding Principles for the Group in recommending the guidelines was the important role that Employee Stock Options play in rewarding and motivating employees, in attracting and retaining the best talent, and in ensuring employee commitment and performance. In several knowledge based industries. India's competitive strength is derived from the skills and talent of its people and Employee Stock Options are critical to the success of Indian companies in the global market place.

The Group also took note of the fact that the typical employee in India is not a hard-nosed investor. To bring a significant number of employees on board a stock option scheme, has to be sufficiently attractive to convince the average skeptical employee. While a liberal stock option scheme would lead to earning dilution for existing shareholders, it could be beneficial.

The Guidelines as made effective by SEBI since 19th June, 1999 as amended, are reproduced hereunder:

21. SEBI (EMPLOYEE STOCK OPTION SCHEME AND EMPLOYEE STOCK PURCHASE SCHEME) GUIDELINES, 1999 AS AMENDED

The amended guidelines are provided hereunder:

1. Short title and commencement

1.1 These Guidelines have been issued by Securities and Exchange Board of India under Section 11 of the Securities and Exchange Board of India Act, 1992.

1.2 These Guidelines may be called the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme), Guidelines, 1999.

2. Definitions

2.1 In these Guidelines, unless otherwise defined:

(1) **“employee”** means:

- (a) a permanent employee of the company working in India or out of India; or
- (b) a director of the company, whether a whole time director or not; or
- (c) an employee as defined in sub-clause (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.

(2) **“employee compensation”** means the total cost incurred by the company towards employee compensation including basic salary, dearness allowance, other allowances, bonus and commissions including the value of all perquisites provided, but does not include:

- (a) the fair value of the option granted under an Employee Stock Option Scheme; and
- (b) the discount at which shares are issued under an Employee Stock Purchase Scheme.

(2A) **“employee stock option”** means the option given to the whole-time directors, officers or employees of a company which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price.

(3) **“employee stock option scheme (ESOS)”** means a scheme under which a company grants employee stock option.

(4) **“employee stock purchase scheme (ESPS)”** means a scheme under which the company offers shares to employees as part of a public issue or otherwise.

(4a) **“ESOS shares”** means shares arising out of exercise of options granted under ESOS.

(4b) **“ESPS shares”** means arising out of grant of shares under ESPS.

(5) **“exercise”** means making of an application by the employee to the company for issue of shares against option vested in him in pursuance of the ESOS.

(6) **“exercise period”** means the time period after vesting within which the

employee should exercise his right to apply for shares against the option vested in him in pursuance of the ESOS.

(7) “**exercise price**” means the price payable by the employee for exercising the option granted to him in pursuance of ESOS.

(7a) “**fair value**” of an option means the fair value calculated in accordance with Schedule III.

(8) “**grant**” means issue of option to employees under ESOS.

(9) “**independent director**” means a director of the company, not being a whole time director and who is neither a promoter nor belongs to the promoter group.

(9a) “**intrinsic value**” means the excess of the market price of the share under ESOS over the exercise price of the option (including up-front payment, if any).

(10) “**market price**” means the latest available closing price, prior to the date of the meeting of the Board of Directors in which options are granted/shares are issued, on the stock exchange on which the shares of the company are listed. If the shares are listed on more than one stock exchange then the stock exchange where there is highest trading volume on the said date shall be considered.

(11) “**option grantee**” means an employee having right but not an obligation to exercise in pursuance of the ESOS.

(12) “**promoter**” means:

- (a) the person or persons who are in over-all control of the company;
- (b) the person or persons who are instrumental in the formation of the company or programme pursuant to which the shares were offered to the public;
- (c) the person or persons named in the offer document as promoter(s). Provided that a director or officer of the company if they are acting as such only in their professional capacity will not be deemed to be a promoter.

[*Explanation: Where a promoter of a company is a body corporate, the promoters of that body corporate shall also be deemed to be promoters of the company.*]

(13) “**promoter group**” means:

- (a) an immediate relative of the promoter (i.e. spouse of that person, or any parents, brother, sister or child of the person or of the spouse);
- (b) persons whose shareholding is aggregated for the purpose of disclosing in the offer document “shareholding of the promoter group”.

(14) “**share**” means equity shares and securities convertible into equity shares and shall include American Depository Receipts (ADRs), Global Depository Receipts (GDRs) or other depository receipts, representing underlying equity shares or securities convertible into equity shares.

(15) “**vesting**” means the process by which the employee is given the right to apply for shares of the company against the option granted to him in pursuance of ESOS.

(16) “vesting period” means the period during which the vesting of the option granted to the employee in pursuance of ESOS takes place.

All other expressions unless defined herein shall have the same meaning as have been assigned to them under the Securities and Exchange Board of India Act, 1992 or the Securities Contracts (Regulation) Act, 1956 or the Companies Act, 1956, SEBI (Disclosure and Investor Protection) Guidelines, or any statutory modification or re-enactment thereof, as the case may be.

3. Applicability

3.1 These Guidelines shall apply to any company whose shares are listed on any recognised stock exchange in India.

PART A – ESOS

4. Eligibility to participate in ESOS

4.1 An employee shall be eligible to participate in ESOS of the company.

4.2 An employee who is a promoter or belongs to the promoter group shall not be eligible to participate in the ESOS.

4.3 A director who either by himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESOS.

5. Compensation Committee

5.1 No ESOS shall be offered unless the disclosures, as specified in Schedule IV are made by the company to the prospective option grantees and the company constitutes a Compensation Committee for administration and superintendence of the ESOS.

5.2 The Compensation Committee shall be a Committee of the Board of directors consisting of a majority of independent directors.

5.3 The Compensation Committee shall, *inter alia*, formulate the detailed terms and conditions of the ESOS including:

- (a) the quantum of option to be granted under an ESOS per employee and in aggregate.
- (b) the conditions under which option vested in employees may lapse in case of termination of employment for misconduct;
- (c) the exercise period within which the employee should exercise the option and that option would lapse on failure to exercise the option within the exercise period;
- (d) the specified time period within which the employee shall exercise the vested options in the event of termination or resignation of an employee.
- (e) the right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period;
- (f) the procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of corporate actions such as rights

issues, bonus issues, merger, sale of division and others. In this regard following shall be taken into consideration by the compensation committee:

- (i) the number and the price of ESOS shall be adjusted in a manner such that total value of the ESOS remains the same after the corporate action.
- (ii) for this purpose global best practices in this area including the procedures followed by the derivative markets in India and abroad shall be considered.
- (iii) the vesting period and the life of the options shall be left unaltered as far as possible to protect the rights of the option holders.
- (g) the grant, vest and exercise of option in case of employees who are on long leave, and
- (h) the procedure for cashless exercise of options.

5.4 The Compensation Committee shall frame suitable policies and systems to ensure that there is no violation of:

- (a) Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and
- (b) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995, by any employee.

6. Shareholder approval

6.1 No ESOS can be offered to employees of a company unless the shareholders of the company approve ESOS by passing a special resolution in the general meeting.

6.2 The explanatory statement to the notice and the resolution proposed to be passed in general meeting for ESOS shall, *inter alia*, contain the following information:

- (a) the total number of options to be granted;
- (b) identification of classes of employees entitled to participate in the ESOS;
- (c) requirements of vesting and period of vesting;
- (d) maximum period (subject to clause 9.1) within which the options shall be vested;
- (e) exercise price or pricing formula;
- (f) exercise period and process of exercise;
- (g) the appraisal process for determining the eligibility of employees to the ESOS;
- (h) maximum number of options to be issued per employee and in aggregate;
- (i) a statement to the effect that the company shall conform to the accounting policies specified in clause 13.1;
- (j) the method which the company shall use to value its options whether fair value or intrinsic value;
- (k) the following statement:
'In case the company calculates the employee compensation cost using the

intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed in the Directors' report and also the impact of this difference on profits and on EPS of the company shall also be disclosed in the Directors' report.

6.3 Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of:

- (a) grant of option to employees of subsidiary or holding company and,
- (b) grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

7. Variation of terms of ESOS

7.1 The company shall not vary the terms of the ESOS in any manner, which may be detrimental to the interests of the employees.

7.2 The company may by special resolution in a general meeting vary the terms of ESOS offered pursuant to an earlier resolution of a general body but not yet exercised by the employee provided such variation is not prejudicial to the interests of the option holders.

7.3 The provisions of clause 6.3 shall apply to such variation of terms as they do to the original grant of option.

7.4 The notice for passing special resolution for variation of terms of ESOS shall disclose full details of the variation, the rationale therefor, and the details of the employees who are beneficiary of such variation.

7.5 A company may re-price the options which are not exercised whether or not they have been listed if ESOSs were rendered unattractive due to fall in the price of the shares in the market.

Provided that the company ensures that such re-pricing shall not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such re-pricing.

8. Pricing

8.1 The companies granting option to its employees pursuant to ESOS will have the freedom to determine the exercise price subject to conforming to the accounting policies specified in clause 13.1

Provided that in case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed in the Directors report and also the impact of this difference on profits and on Earning Per Share of the company shall also be disclosed in the Directors' report.

9. Lock-in period and rights of the option-holder

9.1 There shall be a minimum period of one year between the grant of options and vesting of options.

Provided that in a case where options are granted by an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum visiting period required under this clause.

9.2 The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

9.3 The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

10. Consequence of failure to exercise option

10.1 The amount payable by the employee, if any, at the time of grant of option:

- (a) may be forfeited by the company if the option is not exercised by the employee within the exercise period; or
- (b) the amount may be refunded to the employee if the option are not vested due to non-fulfillment of condition relating to vesting of option as per the ESOS.

11. Non transferability of option

11.1 Option granted to an employee shall not be transferable to any person.

11.2 (a) No person other than the employee to whom the option is granted shall be entitled to exercise the option.

(b) Under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provision of the Companies Act.

11.3 The option granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

11.4 In the event of the death of employee while in employment, all the option granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

11.5 In case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.

11.6 In the event of resignation or termination of the employee, all options not vested as on that day shall expire. However, the employee shall, subject to the provision of clause 5.3(b) shall be entitled to retain all the vested options.

12. Disclosure in the Directors' Report

12.1 The Board of Directors, shall, *inter alia*, disclose either in the Directors' Report or in the annexure to the Directors' Report, the following details of the ESOS:

- (a) options granted;

- (b) the pricing formula;
- (c) options vested;
- (d) options exercised;
- (e) the total number of shares arising as a result of exercise of option;
- (f) options lapsed;
- (g) variation of terms of options;
- (h) money realised by exercise of options;
- (i) total number of options in force;
- (j) employee wise details of options granted to:
 - (i) senior managerial personnel;
 - (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year.
 - (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions of the company at the time of grant.
- (k) Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) 20 'Earnings Per Share'.
- (l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.
- (m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.
- (n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted-average information:
 - (i) risk-free interest rate,
 - (ii) expected life,
 - (iii) expected volatility,
 - (iv) expected dividends, and
 - (v) the price of the underlying share in market at the time of option grant.

12.2 Until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures shall be made either in the Directors' Report or in an Annexure thereto of the information specified in clause 12.1 in respect of such options also.

12.3 Until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosure shall be made either in the Directors' Report or in an

Annexure thereto of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified in clause 13 in respect of such options.

13. Accounting Policies

13.1 Every company that has passed a resolution for an ESOS under clause 6.1 of these guidelines shall comply with the accounting policies specified in Schedule I.

13.2 Where a scheme provides for graded vesting, the vesting period shall be determined separately for each portion of the option and shall be accounted for accordingly.

14. Certificate from Auditors

14.1 In the case of every company that has passed a resolution for an ESOS under clause 6.1 of these guidelines, the Board of Directors shall at each annual general meeting place before the shareholders a certificate from the auditors of the company that the scheme has been implemented in accordance with these guidelines and in accordance with the resolution of the company in the general meeting.

PART B – ESPS

16. Eligibility to participate in ESPS

16.1 An employee shall be eligible to participate in the ESPS.

16.2 An employee who is a promoter or belongs to the promoter group shall not be eligible to participate in the ESPS.

16.3 A director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESPS.

17. Shareholder Approval

17.1 No ESPS shall be offered to employees of the company unless the shareholders of the company approve ESPS by passing special resolution in the meeting of the general body of the shareholders.

17.2 The explanatory statement to the notice shall specify:

- (a) the price of the shares and also the number of shares to be offered to each employee.
- (b) the appraisal process for determining the eligibility of employee for ESPS.
- (c) Total number of shares to be issued.

17.3 The number of shares offered may be different for different categories of employees.

17.4 The special resolution shall state that the company shall conform to the accounting policies specified in clause 19.2.

17.5 Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of:

- (a) allotment of shares to employees of subsidiary or holding company and,
- (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

18. Pricing and Lock-in

18.1 The company shall have the freedom to determine price of shares to be issued under an ESPS, provided they conform to the provisions of clause 19.2.

18.2 Shares issued under an ESPS shall be locked in for a minimum period of one year from the date of allotment.

Provided that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock in period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.

18.3 If the ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employee pursuant to ESPS shall not be subject to any lock-in.

19. Disclosure and Accounting Policies

19.1 The Directors' Report or Annexure thereto shall contain, *inter alia*, the following disclosures:

- (a) the details of the number of shares issued in ESPS;
- (b) the price at which such shares are issued;
- (c) employee-wise details of the shares issued to:
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;
 - (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
- (d) diluted Earning Per Share (EPS) pursuant to issuance of shares under ESPS; and
- (e) consideration received against the issuance of shares.

19.2 Every company that has passed a resolution for an ESPS under clause 17.1 of these guidelines shall comply with the accounting policies specified in Schedule II.

20. Preferential Allotment

20.1 Nothing in these guidelines shall apply to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

22. Listing

Automatic Listing

SEBI, vide its Press Release bearing ref. No. PR 16/2001 dated 17/11/2001 informed that to further facilitate the issue of ESOS and ESPS, it has agreed at a meeting of Stock Exchanges that the exchanges would grant automatic listing of all securities under the said scheme. This will alleviate the need of the company required to approach stock exchanges time and again for listing of small quantities of securities under the said scheme.

22.1 The shares arising pursuant to an ESOS and shares issued under at ESPS shall be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:

- (a) The ESOS/ESPS is in accordance with these Guidelines.
- (b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.
- (c) As and when ESOS/ESPS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.

22.2 The shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO shall be listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with SEBI (ICDR) Regulations, 2009 and, where applicable, clause 22.2A.

22.2A (a) No listed company shall make any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares (hereinafter in this clause referred to as 'pre-IPO scheme') unless:

- (i) such pre-IPO scheme is in conformity with these guidelines; and
- (ii) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO.

Provided that the ratification under item (ii) may be done any time prior to grant of new options under such pre -IPO scheme.

(b) No change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change.

Provided that nothing in this sub-clause shall apply to any adjustments for corporate actions made in accordance with these guidelines.

22.3 For listing of shares issued pursuant to ESOS or ESPS the company shall obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.

22.4 The provisions relating to lock-in of pre -IPO shares specified in SEBI (Disclosure and Investor Protection) Guidelines, 2000 shall not be applicable to the shares allotted to employees other than promoters before the IPO under a pre-IPO ESOS/ESPS, subject to compliance with clauses 15.3 and 22.2.

22.6 The listed companies shall file the ESOS or ESPS Schemes through EDIFAR filing.

22.7 When holding company issues ESOS/ESPS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares shall be disclosed in the 'notes to accounts' of the financial statements of the subsidiary company.

22.7A In a case falling under clause 22.7, if the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the 'notes to accounts' to their financial statements.

22.8 The Company shall appoint a registered Merchant Banker for the implementation of ESOS and ESPS as per these guidelines till the stage of framing the ESOS/ESPS and obtaining in -principal approval from the stock exchanges in accordance with clause 22.1 (b).

22A. ESOS/ESPS through Trust Route

22A.1 In case of ESOS/ESPS administered through a Trust, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS.

23. Commencement of the Guidelines

23.1 These guidelines shall come into force with effect from 19th June, 1999 and will be applicable to the options/shares granted/allotted on or after 19th June, 1999 unless otherwise specified in the Guidelines.

SCHEDULE I (Clause 13.1)

Accounting Policies for ESOS

(a) In respect of options granted during any accounting period, the accounting value of the options shall be treated as another form of employee compensation in the financial statements of the company.

(b) The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the intrinsic value of the option or, if the company so chooses, the fair value of the option.

(c) Where the accounting value is accounted for as employee compensation in accordance with 'b', the amount shall be amortised on a straight-line basis over the vesting period.

(d) When an unvested option lapses by virtue of the employee not conforming to the vesting conditions after the accounting value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expenses, equal to the amortized portion of the accounting value of the lapsed options and a credit to deferred employee compensation expense equal to the unamortized portion.

(e) When a vested option lapses on expiry of the exercise period, after the fair

value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expenses.

The accounting treatment specified above can be illustrated by the following numerical example:

Suppose a company grants 500 options on 1/4/1999 at Rs. 40 when the market price is Rs. 160, the vesting period is two and a half years, the maximum exercise period is one year. Also suppose that 150 unvested options lapse on 1/5/2001, 300 options are exercised on 30/6/2002 and 50 vested options lapse at the end of the exercise period. The accounting value of the option being:

$$500 \times (160-40) = 500 \times 120 = 60,000$$

The accounting entries would be as follows:

1/4/1999

Deferred Employee Compensation	60,000
Expense Employee Stock Options Outstanding (Grant of 500 options at a discount of Rs. 120 each)	60,000

31/3/2000

Employee Compensation Expense	24,000
Deferred Employee Compensation Expense (Amortisation of the deferred compensation over two and a half years on straight-line basis)	24,000

31/3/2001

Employee Compensation Expense	24,000
Deferred Employee Compensation Expenses (Amortisation of the deferred compensation over two and a half years on straight-line basis)	24,000

1/5/2001

Employee Stock Options Outstanding	18,000
Employee Compensation Expense	14,400
Deferred Employee Compensation Expense (Reversal of compensation accounting on lapse of 150 unvested options)	3,600

31/3/2002

Employee Compensation Expense	8,400
Deferred Employee Compensation Expense (Amortisation of the deferred compensation over two and a half years on straight-line basis)	8,400

30/6/2002

Cash	12,000
Employee Stock Options Outstanding	36,000
Paid Up Equity Capital	3,000
Share Premium Account	45,000

(Exercise of 300 options at an exercise price of Rs. 40 each and an accounting value of Rs 120 each)

1/10/2002

Employee Stock Options Outstanding	6,000
Employee Compensation Expense	6,000

(Reversal of compensation accounting on lapse of 50 vested options at the end of exercise period)

The T-Accounts for Employee Stock Options Outstanding and Deferred Employee Compensation Expense would be as follows:

Employees Stock Options Outstanding Account

<i>Date</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
1.5.2001	Employee Compensation/Deferred Compensation	18,000	1.4.1999	Deferred Compensation	60,000
30.6.2002	Paid-up Capital/Share Premium	36,000			
1.10.2002	Employee Compensation	<u>6,000</u>			<u> </u>
		60,000			60,000

Deferred Employees Compensation Expense Account

<i>Date</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
1.4.1999	ESOS Outstanding	60,000	31.3.2000	Employee Compensation	24,000
			31.3.2001	Employee Compensation	24,000
			1.5.2001	ESOS Outstanding	3,600
			31.3.2002	Employee Compensation	<u>8,400</u>
		<u>60,000</u>			60,000

Employee Stock Options Outstanding will appear in the Balance Sheet as part of Net Worth or Shareholders' Equity. Deferred Employee Compensation will appear in the Balance Sheet as a negative item as part of Net Worth or Shareholders' Equity.

SCHEDULE II
(Clause 19.2)

Accounting Policies for ESPS

(a) In respect of shares issued under an ESPS during any accounting period, the accounting value of the shares so issued shall be treated as another form of employee compensation in the financial statements of the company.

(b) The accounting value of shares issued under ESPS shall be equal to the aggregate of price discount over all shares issued under ESPS during any accounting period:

Explanation: For this purpose:

Price discount means the excess of the market price of the shares over the price at which they are issued under the ESPS.

The accounting treatment prescribed above can be illustrated by the following numerical example:

Suppose a company issues 500 shares on 1/4/1999 under an ESPS at Rs. 40 when the market price is Rs. 160. The accounting value of the shares being:

$$500 \times (160-40) = 500 \times 120 = 60,000$$

The accounting entry would be as follows:

1/4/1999

Cash	20,000
Employee Compensation Expense	60,000
Paid Up Equity Capital	5,000
Share Premium Account	75,000

(Issue of 500 shares under ESPS at a price of Rs. 40 each when market price is Rs. 160)

SCHEDULE III
(Clause 2.1)

- (i) The fair value of a stock option is the price that shall be calculated for that option in an arm's length transaction between a willing buyer and a willing seller.
- (ii) The fair value shall be estimated using an option-pricing model (for example, the Black-Scholes or a binomial model) that takes into account as of the grant date the exercise price and expected life of the option, the current price in the market of the underlying stock and its expected volatility expected

dividends on the stock, and the risk-free interest rate for the expected term of the option.

- (iii) The fair value of an option estimated at the grant date shall not be subsequently adjusted for changes in the price of the underlying stock or its volatility, the life of the option, dividends on the stock, or the risk-free interest rate.
- (iv) Where the exercise price is fixed in Indian Rupees, the risk-free interest rate used shall be the interest rate applicable for a maturity equal to the expected life of the options based on the zero-coupon yield curve for Government Securities.
- (v) The expected life of an award of stock options shall take into account the following factors:
 - (a) The expected life must at least include the vesting period.
 - (b) The average lengths of time similar grants have remained outstanding in the past. If the company does not have a sufficiently long history of stock option grants, the experience of an appropriately comparable peer group may be taken into consideration.
 - (c) The expected life of ESOSs should not be less than half of the exercise period of the ESOSs issued until and unless the same is supported by historical evidences with respect to ESOSs issued by the company earlier.
- (vi) If the company does not have a sufficiently long history of traded stock prices to estimate the expected volatility of its stock, it may use an estimate based on the estimated volatility of stocks of an appropriately comparable peer group.
- (vii) The estimated dividends of the company over the estimated life of the option may be estimated taking into account the company's past dividend policy as well as the mean dividend yield of an appropriately comparable peer group.
- (viii) Justification shall be given for significant assumptions. If at the time of further issue of ESOS/ESPS there are any changes in the assumptions reasons for the same shall be given.

SCHEDULE IV

Disclosure Document

(Clause 5.1)

Part A: Statement of Risks

All investments in shares or options on shares are subject to risk as the value of shares may go down or go up. In addition, employee stock options are subject to the following additional risks:

1. **Concentration:** The risk arising out of any fall in value of shares is aggravated if the employee's holding is concentrated in the shares of a single company.
2. **Leverage:** Any change in the value of the share can lead to a significantly larger change in the value of the option as an option amounts to a levered position in the share.

3. **Illiquidity:** The options cannot be transferred to anybody, and therefore the employees cannot mitigate their risks by selling the whole or part of their options before they are exercised.
4. **Vesting:** The options will lapse if the employment is terminated prior to vesting. Even after the options are vested, the unexercised options may be forfeited if the employee is terminated for gross misconduct.

Part B: Information about the company

1. **Business of the company:** A description of the business of the company on the lines of item V(a) of Part I of Schedule II of the Companies Act.
2. **Abridged financial information:** Abridged financial information for the last five years for which audited financial information is available in a format similar to that required under item B(1) of Part II of Schedule II of the Companies Act. The last audited accounts of the company should also be provided unless this has already been provided to the employee in connection with a previous option grant or otherwise.
3. **Risk Factors:** Management perception of the risk factors of the company in accordance with item VIII of Part I of Schedule II of the Companies Act.
4. **Continuing disclosure requirement:** The option grantee should receive copies of all documents that are sent to the members of the company. This shall include the annual accounts of the company as well as notices of meeting and the accompanying explanatory statements.

Part C: Salient Features of the Employee Stock Option Scheme

This Part shall contain the salient features of the employee stock option scheme of the company including the conditions regarding vesting, exercise, adjustment for corporate actions, and forfeiture of vested options. It shall not be necessary to include this Part if it has already been provided to the employee in connection with a previous option grant, and no changes have taken place in the scheme since then. If the option administrator (whether the company itself or an outside securities firm appointed for this purpose) provides advisory services to the option grantees in connection with the exercise of options or sale of resulting shares, such advice must be accompanied by an appropriate disclosure of concentration and other risks. The option administrator should conform to the code of conduct appropriate for such fiduciary relationships.

SCHEDULE V

(Clause 22.1)

***INFORMATION REQUIRED IN THE STATEMENT TO BE FILED
WITH STOCK EXCHANGE***

Description of Stock Option Scheme

1. Authorized Share Capital of the Company:
2. Issued Share Capital of the Company as on date of Institutional of the Scheme/amending of the Scheme.

3. Date of Institution of the Scheme/amending of the Scheme
4. Validity period of the Scheme
5. Date of notice of AGM/EGM for approving the Scheme/for amending the Scheme/for approving grants under Clause 6.3(a) or (b) of the SEBI (ESOS and ESPS) Guidelines.
6. Date of AGM/EGM approving the Scheme/amending the Scheme/approving grants under Clause 6.3(a) or (b) of the SEBI (ESOS and ESPS) Guidelines.
7. Kind of security granted as Options under the Scheme
8. Identity of classes of persons eligible under the scheme.
 - Permanent employees
 - Permanent employees outside India
 - Permanent employees of subsidiary
 - Permanent employees of holding
 - Whole-time directors
 - Independent directors
9. Total number of securities reserved under the scheme:
10. Number of securities entitled under each option
11. Total number of options to be granted:
12. Maximum number of Options to be granted per employee in each grant and in aggregate:
13. Exercise price or pricing formula:
14. Whether any amount payable at the time of grant of the Options? If so, quantum of such amount.
15. Lock-in period under the Scheme
 - Lock-in period between grant and vesting
 - Lock-in period after exercise
16. Vesting period under the Scheme
17. Maximum period within which the options shall be vested.
18. Exercise Period under the plan:
19. Whether employee can exercise all the Options Vested at one time? Yes/No
20. Whether employee can exercise vested Options at various points of time within the exercise period? Yes/No

21. Whether scheme provides for the procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of right issues, bonus issues and other corporate actions? Clause in Scheme describing such adjustment:
22. Description of the appraisal process for determining the eligibility of employees under the scheme.
23. The specified time period within which vested options are to be exercised in the event of termination or resignation of an employee.
24. The specified time period within which options are to be exercised in the event of the death of the employee:
25. Whether Plan provides for conditions under which option vested in employees may lapse in case of termination of employment for misconduct? Clause in Scheme describing such adjustment:
26. Whether Plan provides for conditions for the grant, vesting and exercise of option in case of employees who are on long leave? Clause in scheme describing such adjustment.
27. Whether amount paid/payable by the employee at the time of the grant of the Option will be forfeited if the employee does not exercise the option within the exercise period? Clause in scheme describing such adjustment:
28. Details of approval of shareholders pursuant to Clause 6.3 of the SEBI (ESOS and ESPS) Guidelines with respect to:
 - Grant of options to employees of subsidiary or holding company.
 - Grant of options to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of the option:
29. Details of the variation made to the scheme along with the rationale therefore and details of the employees who are beneficiary of such variation:

Company Secretary

Place:

Date:

Documents to be filed with registration statement

- Copy of Stock Option Scheme/Amended Stock Option Scheme, certified by company secretary.
- Copy of Notice of AGM/EGM for approving the Scheme/for amending the Scheme/for approving grants under Clause 6.3(a) or (b) of the SEBI (ESOS and ESPS) Guidelines, certified by the company secretary.
- Copy of resolution of shareholders for approving the Scheme/for amending the scheme/for approving grants under Clause 6.3(a) or (b) of the SEBI (ESOS and ESPS) Guidelines, certified by the company secretary.
- List of Promoters as defined under the SEBI (ESOS and ESPS) Guidelines.
- Copy of latest Annual Report.
- Certificate of Auditor on compliance with SEBI (ESOS and ESPS) Guidelines.
- Specimen copy of Share certificate.
- Any other relevant documents.

Undertakings

- A. The undersigned company hereby undertakes:
- (1) To file, a post-effective amendment to this statement to include any material information with respect to the scheme of distribution not previously disclosed in the statement or any material change to such information in the statement.
 - (2) To notify, the concerned stock exchanges on which the securities of the company are listed, of such issue of securities pursuant to the exercise of options under the scheme mentioned in this statement, in the prescribed form, as amended from time to time.
 - (3) That the company shall conform to the accounting policies specified in clause 13.1 of the SEBI (ESOS and ESPS) Guidelines.
 - (4) That the Scheme conforms to the SEBI (ESOS and ESPS) Guidelines.
 - (5) That the company has in place systems/codes/procedures to comply with the SEBI (Insider Trading) Regulations.

Signatures

Pursuant to the requirements of the SEBI Act/guidelines, the company certifies that it has reasonable grounds to believe that it meets all the requirements for the filing of this form and has duly caused this statement to be signed on its behalf by the undersigned, thereunto, duly authorized.

Name of the company

Sd/-

Name of the Compliance Officer

Designation

Date:

Place:

Certification by Registered Merchant Bankers, pursuant to clause 22.8 of SEBI (ESOS & ESPS) Guidelines, 1999:

Certified that the scheme conforms to the SEBI (Employee Stock Option Scheme & Employee Stock Purchase Scheme) Guidelines, 1999.

Authorised Signatory
Name of Merchant Banker

Date:

Place:

SCHEDULE VI
(Clause 22.1)

Format of Notification for Issue of Shares under the Stock Option Plans

1. Company Name and Address of Registered Office :
2. Name of the Exchanges on which the company's shares are listed :
3. Filing date of the Statement referred in clause 22.1.b of guidelines with stock exchange :
4. Filing Number, if any :
5. Title of the Stock Option Scheme pursuant to which shares are issued, if any :
6. Kind of Security to be listed :
7. Par value of the shares :
8. Date of issue of shares :
9. Number of shares issued :
10. Share Certificate no., if applicable :
11. Distinctive number of the share, if applicable :
12. ISIN Number of the shares if issued in Demat :
13. Exercise Price per share :
14. Premium per share :
15. Total Issued Shares after this issue :
16. Total Issued Share capital after this issue :
17. Details of any lock-in on the shares :
18. Date of expiry of lock-in :
19. Whether shares identical in all respects to existing shares. If not, when will they become identical? :
20. Details of Listing fees, if payable :

Signature of Company Secretary/Compliance Officer

Date:

Place:

SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF SWEAT EQUITY) REGULATIONS, 2002

S.O. No. 1031(E).—In exercise of the powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) read with clause (d) of Sub-section (1) of Section 79A of the Companies Act, 1956 (1 of 1956) as inserted by Companies (Amendment) Act, 1999 (1 of 1999), the Board, hereby, makes the following regulations, namely:

CHAPTER I
PRELIMINARY

1. Short title and commencement

(a) These regulations shall be called the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

(b) These regulations shall come into force on the date of their publication in the Official Gazette.

2. Definitions

(1) In these regulations, unless the context otherwise requires:

- (a) 'Act' means the Securities and Exchange Board of India Act, 1992;
- (b) 'associate' includes a person,
 - (i) who directly or indirectly by himself or in combination with relatives, exercises control over the company; or,
 - (ii) whose employee, officer or director is also a director, officer or employee of another company;
- (c) 'Board' means the Board as defined in clause (a) of Sub-section (1) of Section 2 of the Act;
- (d) 'control' shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders or voting agreements or in any other manner;
- (e) 'company' means a company as defined in the Companies Act, 1956;
- (f) 'director' means, a director as defined in Sub-section (13) of Section 2 of the Companies Act, 1956;
- (g) 'employee' means:
 - (i) a permanent employee of the company working in India or abroad or
 - (ii) a director of the company, whether a whole time director or not.
- (h) 'ESOS' means an Employees Stock Option Scheme as defined in Securities and Exchange Board of India (Employees Stock Option

Scheme and Employees Stock Purchase Scheme) Guidelines, 1999;

- (i) 'insider' means an insider as defined in clause (e) of regulation 2 of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
- (j) 'merchant banker' means a merchant banker registered under Section 12 of the Act;
- (i) 'promoter' means promoter as defined in clause (h) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997;
- (l) 'registrar' means a registrar to an issue and includes a share transfer agent registered under Section 12 of the Act;
- (m) 'securities' means securities as defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (n) 'statutory auditor' means an auditor appointed by a company under Section 224 of the Companies Act, 1956 (1 of 1956);
- (o) 'Recognised Stock Exchange' means a stock exchange which has been granted recognition under Section 4 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (p) 'sweat equity shares' means sweat equity shares as defined in Explanation II of Sub-section (1) of Section 79A of the Companies Act, 1956;
- (q) "Schedule" means a schedule to these Regulations;
- (r) 'valuer' means a Chartered Accountant or a merchant banker appointed to determine the value of the intellectual property rights or other value addition;

(2) Words and expressions not defined in these regulations shall have the same meaning as have been assigned to them under the Act or the Securities Contracts (Regulation) Act, 1956 or the Companies Act, 1956, or any statutory modification or re-enactment thereof, as the case may be.

3. Applicability

Nothing contained in these regulations shall apply to an unlisted company.

Provided the unlisted company coming out with initial public offering and seeking listing of its securities on the stock exchange, pursuant to issue of sweat equity shares, shall comply with the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000.

CHAPTER II

ISSUE OF SWEAT EQUITY BY A LISTED COMPANY

4. Sweat equity shares may be issued to employee promoter

A company whose equity shares are listed on a recognised stock exchange may issue sweat equity shares in accordance with Section 79A of Companies Act, 1956

and these Regulations to its:

- (a) Employees
- (b) Directors

5. Special Resolution

(1) For the purposes of passing a special resolution under clause (a) of Sub-section (1) of Section 79A of the Companies Act, 1956 the explanatory statement to be annexed to the notice for the general meeting pursuant to Section 173 of the Companies Act, 1956 shall contain disclosures as specified in the Schedule.

(2) The issue of sweat equity shares to promoters shall be subject to the requirements specified in Regulation 6 of these Regulations.

6. Issue of Sweat Equity Shares to Promoters

(1) In case of issue of sweat equity shares to promoters, the same shall also be approved by simple majority of the shareholders in General Meeting.

Provided that for passing such resolution, voting through postal ballot as specified under Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 shall also be adopted.

Provided further that the promoters to whom such Sweat Equity Shares are proposed to be issued shall not participate in such resolution.

(2) Each transaction of issue of Sweat Equity shall be voted by a separate resolution.

(3) The resolution for issue of Sweat Equity shall be valid for a period of not more than twelve months from the date of passing of the resolution.

(4) For the purposes of passing the resolution, the explanatory statement shall contain the disclosures as specified in the Schedule.

7. Pricing of Sweat Equity Shares

(1) The price of sweat equity shares shall not be less than the higher of the following:

- (a) The average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date; or
- (b) The average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

Explanation: "Relevant date" for this purpose means the date which is thirty days prior to the date on which the meeting of the General Body of the shareholders is convened, in terms of clause (a) of Sub-section (1) of Section 79A of the Companies Act.

(2) If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on the given date, then the price on that stock exchange shall be considered.

(3) If the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.

(4) If shares are not quoted on the given date, then the share price on the next trading day shall be considered.

8. Valuation of intellectual Property

(1) The valuation of the intellectual property rights or of the know-how provided or other value addition mentioned in Explanation II of Sub-section (1) of Section 79A of the Companies Act, 1956 shall be carried out by a merchant banker.

(2) The merchant banker may consult such experts and valuers, as he may deem fit having regard to the nature of the industry and the nature of the property or other value addition.

(3) The merchant banker shall obtain a certificate from an independent Chartered Accountant that the valuation of the intellectual property or other value addition is in accordance with the relevant accounting standards.

9. Accounting Treatment

(1) Where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company:

- (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or
- (b) where clause (a) is not applicable, it shall be expensed as provided in the relevant accounting standards.

10. Placing of Auditors Certificate Before Annual General Meeting

In the general meeting subsequent to the issue of sweat equity, the Board of Directors shall place before the shareholders, a certificate from the auditors of the company that the issue of sweat equity shares has been made in accordance with the Regulations and in accordance with the resolution passed by the company authorizing the issue of such Sweat Equity Shares.

11. Ceiling on Managerial Remuneration

The amount of Sweat Equity shares issued shall be treated as part of managerial remuneration for the purposes of Sections 198, 309, 310, 311 and 387 of the Companies Act, 1956 if the following conditions are fulfilled:

- (i) the Sweat Equity shares are issued to any director or manager; and,
- (ii) they are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards.

12. Lock-in of sweat equity shares

(1) The Sweat Equity shares shall be locked in for a period of three years from the date of allotment.

(2) The Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, on public issue in terms of lock-in and computation of promoters' contribution shall apply if a company makes a public issue after it has issued sweat equity.

13. Listing

The Sweat Equity issued by a listed company shall be eligible for listing only if such issue are in accordance with these regulations.

14. Applicability of Takeover

Any acquisition of Sweat Equity Shares shall be subject to the provision of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

CHAPTER III GENERAL OBLIGATIONS

15. Obligations of the Company

(1) The company shall ensure that—

- (a) The Explanatory Statement to the notice for general meeting shall contain certain disclosures as are specified under clause (b) of Sub-section (1) of Section 79A of the Companies Act, 1956 and sub-regulation (1) of Regulation 5.
- (b) Auditor's certificate as required under Regulation 10 shall be placed in the general meeting of shareholders.

(2) The company shall within seven days of the issue of sweat equity, issue or send statement to the recognized stock exchange, disclosing:

- (i) number of sweat equity shares;
- (ii) price at which the sweat equity shares are issued;
- (iii) total amount invested in sweat equity shares;
- (iv) details of the persons to whom sweat equity shares are issued; and,
- (v) the consequent changes in the capital structure and the shareholding pattern after and before the issue of sweat equity.

16. Action against intermediaries

The Board may, on failure of the merchant banker to comply with the obligations under these regulations or failing to observe due diligence in respect of valuation of intellectual property or value addition, initiate action against the merchant banker in terms of Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

CHAPTER IV PENALTIES AND PROCEDURE

17. Power of the Board to order inspection or investigation

(1) The Board may, *suo-motu* or upon information received by it, cause an inspection to be made of the books of account or other books and papers of any

company or an investigation to be made in respect of the conduct and affairs of any person associated with the process of Sweat Equity, by appointing an officer of the Board not below the rank of Assistant General Manager for the purpose of conducting inspection and not below the rank of Division Chief for the purpose of conducting on investigation.

Provided that no such inspection or investigation shall be made except for the purposes specified in sub-regulation (2).

(2) The purposes referred to in sub-regulation (1) are the following, namely:

- (a) to ascertain whether there are any circumstances which would render any person guilty of having contravened any of these regulations or any directions issued thereunder;
- (b) to investigate into any complaint of any contravention of the regulation, received from any investor, or any other person;

(3) An order passed under the sub-regulation (1) shall be sufficient authority for the Inspecting or Investigating Officer to undertake the inspection or investigation, as the case may be and on production of an authenticated copy of the order, the person concerned shall be bound to carry out the duty imposed in Regulation 18.

18. Duty to produce records, etc.

(1) It shall be the duty of every person in respect of whom an inspection or investigation has been ordered under regulation 17, to produce before the Inspecting or the Investigating Officer such book, accounts and other documents in his custody or control and furnish him with such statements and information as the said officer may require from the purposes of the inspection or investigation.

(2) Without prejudice to the generality of the provisions of sub-regulation (1), such person shall—

- (a) extend to the Inspecting or Investigating Officer reasonable facilities for examining any books, accounts and other documents in his custody or control (whether kept manually or in computer or in any other form) reasonably required for the purposes of the inspection or investigation;
- (b) provide such Inspecting or Investigating Officer copies of such books, accounts and records which, in opinion of the Officer, are relevant to the inspection or investigation or, as the case may be, allow him to take out computer printouts thereof.
- (c) provide such assistance and co-operation as may be required in connection with the inspection or investigation and furnish information relevant to such inspection or investigation as may be sought by such officer.

(3) The Inspecting or Investigating Officer shall for the purpose of inspection or investigation, have the full powers:

- (a) of summoning and enforcing the attendance of persons;
- (b) to examine orally and to record on oath the statement of the persons concerned, any director, partner, member or employee of such person.

19. Submission of Report to the Board

(1) The Inspecting or Investigating Officer shall, on completion of the inspection or Investigation after taking into account all relevant facts and circumstances, submit a report to the Board.

(2) On the receipt of report under sub-regulation (1), the Board may initiate such action as it may be deemed fit to do in the interests of investors and the securities market.

20. Power of the Board to issue directions

The Board may in the interests of the securities market and without prejudice to its right to initiate action including criminal prosecution under Section 24 of the Act or Section 621 of Companies Act, 1956 give such directions as it deems fit including:

- (a) directing the person concerned not to further deal in securities in any particular manner;
- (b) directing the person concerned to sell or divest the sweat equity shares acquired in violation of the provisions of these Regulations or any other law or regulations;
- (c) prohibiting the persons concerned, from accessing the securities market;
- (d) directing the disgorgement of any ill-gotten gains or profit or avoidance of loss.;
- (e) restraining the company from making a further offer for sweat equity.

SCHEDULE

[Under Regulation 6(4)]

The explanatory statement to the notice and the resolution proposed to be passed in the general meeting for approving the issuance of sweat equity shall, *inter alia*, contain the following information:

- (a) The total number of shares to be issued as sweat equity.
- (b) The current market price of the shares of the company.
- (c) The value of the intellectual property rights or technical know how or other value addition to be received from the employee or director along with the valuation report/basis of valuation.
- (d) The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company.
- (e) The consideration to be paid for the sweat equity.
- (f) The price at which the sweat equity shares shall be issued.
- (g) Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity.

- (h) A statement to the effect that the company shall conform to the accounting policies as specified by the Board.
- (i) Diluted Earning Per Share pursuant to the issue of securities to be calculated in accordance with International Accounting Standards/standards specified by the Institute of Chartered Accountants of India.

**UNLISTED COMPANIES (ISSUE OF SWEAT EQUITY SHARES) RULES, 2003—
GSR 923(E), DATED 4.12.2003**

In exercise of the powers conferred by proviso to Sub-section (1) of Section 79A of the Companies Act, 1956 (1 of 1956) read with sub-section (1) of Section 642 of the said Act, the Central Government hereby makes the following rules, namely:

1. Short title and commencement

(a) These regulations shall be called the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003.

(b) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions

In these rules, unless otherwise defined,—

- (i) “Asset” means a resource controlled by the company and from which future economic benefits are expected to flow to the company;
- (ii) “employee” means:—
 - (a) a permanent employee of the company working in India or out of India; or
 - (b) a director of the company, employed as a whole-time director or executive director of a company;
- (iii) “intangible Asset” means an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes;
- (iv) “share price” means price of a share on a given date arrived on the net worth basis;
- (v) “value addition” means anticipated economic benefits derived by the enterprise from expert and/or professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is issued for which the consideration is not paid or included in—
 - (a) the normal remuneration payable under the contract of employment, in the case of an employee and/or
 - (b) monetary consideration payable under any other contract, in the case of non-employee.

3. Applicability

These Rules shall be applicable to issue of sweat equity shares by all unlisted companies.

4. Special resolution

(1) For the purpose of passing a special resolution under Clause (a) of Sub-section (1) of Section 79A of the Companies Act, 1956 (1 of 1956); the explanatory statement to be annexed to the notice for the general meeting pursuant to Section 173 of the said Act shall contain particulars as specified below:

- (i) the date of the meeting at which the proposal for issue of sweat equity shares was approved by the Board of Directors of the company;
- (ii) the reasons/justification for the issue;
- (iii) the number of shares, consideration for such shares and the class or classes of persons to whom such equity shares are to be issued;
- (iv) the value of the sweat equity shares alongwith valuation report/basis of valuation and the price at which the sweat equity shares will be issued;
- (v) the names of persons to whom the equity will be issued and the person's relationship with the company;
- (vi) ceiling on managerial remuneration, if any, which will be affected by issuance of such equity;
- (vii) a statement to the effect that the company shall conform to the accounting policies specified by the Central Government; and
- (viii) diluted earning per share pursuant to the issue of securities to be calculated in accordance with the Accounting Standards specified by the Institute of Chartered Accountants of India.

(2) Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of grant of shares to identified employees and promoters, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversion) of the company at the time of grant of the sweat equity shares.

5. Register of shares

The company shall maintain a Register of Sweat Equity Shares issued under Section 79A in the Form specified in Schedule annexed to these rules.

6. Restriction on issue of sweat equity shares

The company shall not issue sweat equity shares for more than 15% of total paid up equity share capital in a year or shares of the value of 5 crores of rupees, whichever is higher except with the prior approval of the Central Government.

7. Disclosure in the Director's Report

The Board of Directors, shall, *inter alia*, disclose either in the Directors' Report or in the annexure to the Director's Report, the following details of issue of sweat equity shares:

- (a) Number of shares to be issued to the employees or the directors;

- (b) conditions for issue of sweat equity shares;
- (c) the pricing formula;
- (d) the total number of shares arising as a result of issue of sweat equity shares;
- (e) money realised or benefit accrued to the company from the issue of sweat equity shares;
- (f) diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

8. Pricing of Sweat Equity Shares

The price of sweat equity shares to be issued to employees and directors shall be at a fair price calculated by an independent valuer.

9. Issue of Sweat Equity Shares for consideration other than cash

Where a company proposes to issue sweat equity shares for consideration other than cash, it shall comply with following:

- (a) The valuation of the intellectual property or of the know-how provided or other value addition to consideration at which sweat equity capital is issued, shall be carried out by a valuer;
- (b) the valuer shall consult such experts as he may deem fit, having regard to the nature of the industry and the nature of the property or the value addition;
- (c) the valuer shall submit a valuation report to the company giving justification for the valuation;
- (d) a copy of the valuation report of the valuer shall be sent to the shareholders with the notice of the general meeting;
- (e) the company shall give justification for issue of sweat equity shares for consideration other than cash, which shall form part of the notice sent for the general meeting; and
- (f) the amount of Sweat Equity shares issued shall be treated as part of managerial remuneration for the purposes of Sections 198, 309, 310, 311 and 387 of the Companies Act, 1956 if the following conditions are fulfilled:
 - (i) the Sweat Equity shares are issued to any director or manager; and
 - (ii) they are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards.

10. Lock-in of sweat equity shares

Sweat equity shares issued to employees or directors shall be locked in for a period of three years from the date of allotment.

11. Certificate from auditors

In the case of every company that has allotted shares under these Rules, the Board of Directors shall at each annual general meeting place before the shareholders a certificate from the auditors of the company/practising company secretary that sweat equity shares have been allotted in accordance with the resolution of the company in the general meeting and these Rules.

12. Accounting policies

(1) Where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company:

- (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or
- (b) where clause (a) is not applicable, it shall be expensed as provided in the relevant accounting standards.

(2) In respect of sweat equity shares issued during accounting period, the accounting value of sweat equity shares shall be treated as another form of compensation to the employee or the director in the financial statement of the company.

SCHEDULE
Register of Sweat Equity Shares
[Pursuant to Rule 5]

The register of sweat equity shares issued by the company to be kept in the following format:

<i>S. No.</i>	<i>Folio No./ certificate No.</i>	<i>Date of passing of resolution</i>	<i>Date of issue of sweat equity shares</i>
1	2	3	4

<i>Name of the allottee</i>	<i>Status of the allottee – whether director or employee</i>	<i>Reference to entry in register of members</i>	<i>Number of sweat equity shares issued</i>
5	6	7	8

<i>Face value of the shares</i>	<i>Price at which shares issued</i>	<i>Total consideration paid by employee/ director</i>	<i>Lock in period till which date</i>
9	10	11	12

ANNEXURE**Unlisted Public Companies (Preferential Allotment) Rules, 2011 as issued by MCA Notification No GSR 879(E) published on 14-12-2011**

GSR_879(E). – In exercise of the powers conferred by sub-section (1A) of section 81 of the Companies Act, 1956 read with section 642 of the said Act, the Central Government hereby makes the following rules, namely:-

1. Short title and commencement.-

(1) These rules may be called Unlisted Public Companies (Preferential Allotment) Rules, 2011.

(2) They shall come into force on the date of their publication in the official gazette.

2. Applicability.-

These rules shall be applicable to all unlisted public companies in respect of preferential issue of equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments, which would be convertible into or exchanged with equity shares at a later date.

3. Definitions.-

(1) **“Preferential allotment”** means allotment of shares or any other instrument convertible into shares including hybrid instruments convertible into shares on preferential basis made pursuant to the provisions of subsection (1A) of section 81 of the Companies Act, 1956; Provided that the name, father’s name, address and occupation of persons to whom such allotment is proposed to be made shall be mentioned in the resolution passed by the members under that sub-section: Provided further that persons to whom such offer is proposed, shall not be more than forty-nine as per the first proviso to sub-section (3) of section 67 of the Companies Act, 1956

(2) **“Promoter”** means –

- (a) the person or persons who are in over-all control of the company; and
- (b) the person or persons who hold themselves as promoters.

Explanation: Where a promoter of a company is a body corporate, the promoters of that body corporate shall also be deemed to be promoters of the company.

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

4. Special Resolution.-

(1) No issue of Shares or any other instruments convertible into shares including hybrids convertible into shares on a preferential basis can be made by a company

unless authorised by its articles of association and unless a special resolution passed by the member in a general meeting authorising the Board of Directors to make such issue.

(2) The special resolution referred to in sub-rule (1) shall be acted upon within a period of twelve months.

5. Pricing.-

Where warrants are issued on a preferential basis with an option to apply for and get the shares allotted, the issuing company shall determine before hand the price of the resultant shares.

6. Disclosures.-

The explanatory statement to the notice for the general meeting as required by section 173 of the Companies Act, 1956 shall contain the following particulars:

- (a) the price or price band at which the allotment is proposed;
- (b) the relevant date on the basis of which price has been arrived at;
- (c) the object/s of the issue through preferential offer;
- (d) the class or classes of persons to whom the allotment is proposed to be made;
- (e) intention of promoters/directors/key management persons to subscribe to the offer;
- (f) shareholding pattern of promoters and others classes of shares before and after the offer;
- (g) proposed time within which the allotment shall be completed;
- (h) whether a change in control is intended or expected.

7. Audit Certificate.-

In case of every issue of shares/warrants/fully convertible debentures/partly convertible debentures or other financial instruments with conversion option, the statutory auditors of the issuing company / company secretary in practice shall certify that the issue of the said instruments is being made in accordance with these Rules. Such certificate shall be laid before the meeting of the shareholders convened to consider the proposed issue.

8. Invitation and allotment of securities.-

(1) No fresh offer or invitation shall be made unless the allotment with respect to any offer or invitation made earlier have been completed in terms of sub-section (9) of section 60B of the Companies Act, 1956.

(2) Any offer or invitation not in compliance with sub-section (1A) of Section 81 read with sub-section (3) of section 67 of the said Act, shall be treated as a public offer and the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) shall be complied with.

(3) All monies payable on subscription of securities shall be paid through cheque or demand draft or other banking channels but not by cash.

(4) Any allotment of securities shall be completed within sixty days from the receipt of application money and in case the company is not able to allot the securities within the said period of sixty days, it shall repay the application money within fifteen days thereafter, failing which it will be required to be re-paid with interest at the rate of twelve percent per annum: Provided that the monies received on such application shall be kept in a separate bank account and shall not be utilised for any purpose other than—

- (i) for adjustment against allotment of securities; or
- (ii) for the repayment of monies where the company is unable to allot securities.

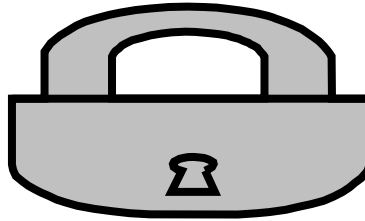
(5) No company offering securities shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

LESSON ROUND-UP



- Share capital of a company can be classified as
 - (a) nominal, authorized or registered capital;
 - (b) issued and subscribed capital;
 - (c) called up and uncalled capital;
- A share is defined as a share in the share capital of a company, including stock except where a distinction between stock and shares is expressed or implied.
- The Companies Act, 1956 permits a company limited by shares to issue two classes of shares, namely equity share capital and preference share capital.
- A preference share or preference share capital is that part of share capital which carries a preferential right with respect to both dividend and capital.
- Preference shares may be of various types, namely participating and non-participating, cumulative and non-cumulative shares, redeemable and irredeemable preference shares.
- Equity share capital means all share capital which is not preference share capital.
- Equity share capital can be issued with differential rights as to dividend, voting or otherwise in accordance with Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001.
- Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

- There are various sources of capital such as raising of capital from promoters, from public, from existing shareholders and raising of capital through public issue of shares.
- SEBI has issued SEBI (Disclosure and Investor Protection) Guidelines, 2000, a compendium containing consolidated Guidelines, circulars, instructions relating to issue of capital effective from January 27, 2000.
- A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value. Such securities premium account can be utilized for (1) issuing fully paid bonus shares to members (2) writing off the balance of the preliminary expenses of the company (3) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company (4) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company
- A company may issue shares at a price less than the nominal value of shares i.e. at a discount. However, following conditions are required to be fulfilled by a company for issuing shares at discount – (1) the shares must be of the class already issued (2) at least one year must have elapsed since the company became entitled to commence business (3) the issue must be authorized by resolution of the general meeting of the company specifying maximum rate of discount at which shares are to be issued (4) the resolution must be confirmed by the Company Law Board. (5) the rate of discount cannot exceed 10 per cent or such higher percentage as is permitted by the Company Law Board in special cases (6) the shares must be issued within two months of the sanction by the Company Law Board or within such extended time as the Company Law Board may allow (7) every prospectus relating to the issue of shares must contain the particulars of the discount allowed on the issue of the shares, or of so much of that discount as has not been written off at the time of issue of the prospectus.
- The Companies Act provides for the issue of rights shares. Accordingly, whenever at any time after expiry of two years from the incorporation of a company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital by allotment of further shares, such shares shall be offered to the existing holders of equity shares in proportion to the capital paid-up on their shares at the time of further issue.
- A company can issue further shares to persons other than existing shareholders in accordance with relevant provisions provided under the Companies Act.
- A company may, if its Articles provide, capitalize its profits by issuing fully paid bonus shares. There are no guidelines on issuing bonus shares by private or unlisted companies. However, the SEBI has issued guidelines for Bonus Issue which are contained in Chapter XV of the SEBI (Disclosure and Investor Protection) Guidelines, 2000 with regard to bonus issues by listed companies. A company issuing bonus shares should ensure that the issue is in conformity with these guidelines.
- Employee stock option means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price. In respect of these, SEBI has issued SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines.

SELF-TEST QUESTIONS

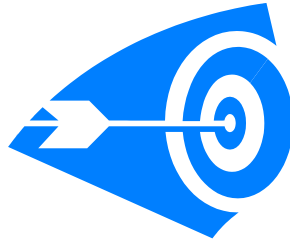
(These are meant for recapitulation only. Answers to the questions are not be submitted for evaluation).

1. Discuss the various kinds of share capital. How is the preference share capital distinguished from equity share capital?
 2. Define and explain the term share. What are the different classes of shares which a company may issue?
 3. State the provisions of the Companies Act, 1956, relating to issue of shares at premium and at discount.
 4. Discuss in brief SEBI Guidelines for Public Issue of Shares?
 5. Discuss the procedure for issue of further shares to existing shareholders under Section 81(1) of the Companies Act.
 6. What is the difference between Reserve Capital and Capital Reserve?
 7. Can a company issue shares with differential voting rights? If so, how?
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FINANCIAL STRUCTURE AND MEMBERSHIP - II

ALTERATION OF SHARE CAPITAL

LEARNING OBJECTIVES



This lesson explains the alteration of share capital of a company and the powers of the company to do so. It defines stock and differentiates it from a share. It also discusses reduction of share capital and various circumstances when it can be done. The lesson gives provisions regarding buy-back of shares by a company, conditions under which it can be done and prohibitions in respect of it.

At the end of the lesson, you should be able to understand:

- Alteration of company and power of alteration to company.
- Nature of stock and difference between stock and share.
- Reduction of share capital and types of reduction of capital commonly adopted.
- Reduction of share capital without sanction of the court, reduction when company is defunct, reduction when company is unlimited.
- Diminution of share capital not treated as reduction of share capital.
- Creditor's right to object to reduction and liability of members in respect of reduced share capital.
- Power of company to purchase its own securities (buy-back of securities) and conditions for buy-back.
- Prohibition for buy-back in certain circumstances.
- SEBI (Buy-Back of Securities) Regulations, 1998.
- Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999.

1. ALTERATION OF SHARE CAPITAL

Section 94 of the Companies Act, 1956 provides that a company limited by shares or guarantee and having a share capital may, if so authorised by its articles, alter, by an ordinary resolution, its share capital in the following ways:

- (a) It may increase the share capital by such amount, as it thinks expedient, by issuing new shares;
- (b) It may consolidate and divide, all or any of its existing shares into a larger denomination than of its existing shares e.g., by consolidating ten shares of Rs. 10 each into one share of Rs. 100 each;

- (c) It may convert all or any of its fully paid-up shares into stock or reconvert stock into fully paid-up shares of any denomination.
- (d) It may sub-divide its existing shares into smaller denomination than fixed by its Memorandum but it must keep the existing proportion between the paid-up and unpaid-up amount e.g., one share of Rs. 100 each, Rs. 60 paid up and be sub-divided into ten shares of Rs. 10 each, Rs. 6 paid-up per share
- (e) It may cancel shares which have not been taken up or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. However, such cancellation of shares will not be deemed to be a reduction of share capital, within the meaning of Section 100 of the Companies Act, 1956. In other words, it is cancellation of unissued share capital not being taken or agreed to be taken up by any person.

In order to alter its capital clause in the Memorandum, the company requires authority in its articles. But if the articles give no power to this effect, the articles must be amended by a special resolution before the power to alter the capital clause can be exercised by the company [*Re. Patent Invert Sugar Co. (1885) 31 Ch. D. 166*]. Further, the power to alter capital clause should be exercised *bona fide* and in the interest of the company and not for the benefit of any group. An ordinary resolution will be enough for altering capital clause in the Memorandum of Association.

Notice of alteration of capital must be given to the Registrar of Companies in e-Form No. 5 within thirty days of such alteration who will register the change and make necessary alterations in the Memorandum. Default in this case will make the company and every officer of the company liable to a fine extending up to Rs. 500 per day during which the default continues (Section 95).

Where the nominal capital in a company stands altered by order of the Central Government under Section 94A, the company shall file the necessary forms (5 & 21) with the Registrar of Companies for the increase in capital along with the fees for such increase.

Under Section 94A of the Act, the share capital of a company stands automatically increased in the following two situations:

- (i) When the Central Government, by its order made under Section 81(4) of the Act, directs that any debentures issued to, or the loans obtained from the Government by a company or any part thereof shall be converted into shares in the company, on such terms and conditions as are considered reasonable in the circumstances; and
- (ii) Where the Central Government, on an application made by the public financial institutions, directs that the debentures issued for loans raised by the company or any part thereof should be converted into shares of the company in pursuance of the exercise of the option attached to such debentures or loans issued to or granted by the Financial Institutions.

2. Judicial Pronouncement about a company's power to alter its share capital

1. The powers under Section 95 of the Act can be exercised by the members only if authorised by the articles.. In *Re North Cheshire Brewery Co., 1920 WN 149. Re Metropolitan Cementry Co., (1934) SC 65*

2. The power should be exercised bona fide in the interest of the company and not for benefiting any group. [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 1 Com Cases 743 (SC)].
3. The consent of meeting of classes of shareholders will not be required as the increase of any kind of share capital cannot be said to 'vary' or 'affect' class rights. The increased capital may consist of preference shares, provided that this is not inconsistent with rights given by the Memorandum of Association. [*Andrews v. Gas Meter Co.* (1897) 1 Ch 361: (1895) All Eng. Rep 1280 (CA)].
4. The notice convening the meeting to pass the resolution for increase must specify the amount of the proposed increase [*Mac Connell v. E. Prill & Co. Ltd.*, (1916) 2 Ch 57 : (1916-17) All Eng. Rep Ext 1344].
5. Where shares were issued beyond the authorised amount and a resolution was subsequently passed at a general meeting ratifying the issue, it was held that although the original issue was not in accordance with the articles, the ratification was effective and the allottees were bound [*Sewell's case* (1868) 3 Ch App 131].
6. Consolidation and sub-division may be effected by the same resolution [*North Cheshire Borewery Co. Ltd.*]
7. In this case it was held that cancellation of unissued shares or of shares issued but not taken up by any person, may be effected without seeking confirmation of the Court. *Castiglione Erskine & Co. Ltd.*, (1958) 2 All ER 455 : (1958) 28 Com Cases 452 (Ch D),
8. Under Section 94(1) it is open to a limited company to cancel shares which have not been taken or agreed to be taken by any person but a resolution for such cancellation is required to be passed by the company in general meeting under Section 94(2) [*Surendra Maganlal Mehta v. Reliance Textile Ind. Ltd.*, (1982) 3 Comp LJ 103 (Bom)].
9. It is not the function of the Court to interfere with the Company's power to consider a resolution for cancelling the unissued portion of its share capital. The exercise of power by a company to cancel the unissued shares cannot be restrained by an injunction [*Swindon Town Football Co. Ltd.*, 1990 BCLC 467 (Ch D)].
10. Fee paid to the ROC for registering increase of capital is in the nature of capital expenditure irrespective of the fact whether an increased capital will lead to increase in profits. [*Punjab State Industrial Development Corpn. Ltd. v. CIT*, (1997) 26 Corpt LA 333 : (1997)10 SCC 184]

TEST YOUR KNOWLEDGE

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

Under Section 95, the nominal capital in a company stands altered by order of the Central Government.

- True
- False

Correct answer: False

3. NATURE OF STOCK

Section 94 allows the company to convert its fully paid-up shares into stock, and it is, therefore, important to understand the nature of stock and the advantages which it may have.

Section 2(46) of the Act in defining a share, states that “share includes stock except where a distinction between stock and shares is expressed or implied”. Thus by converting shares into stock, a shareholder is known as a stockholder. A stockholder has the same rights as to dividends as a shareholder.

It should be noted that (i) only fully paid-up shares can be converted into stock, and (ii) no direct issue of stock by a company is lawful. It is only the conversion of fully-paid shares into stock, that is allowed by Section 94(1)(c) and not a direct issue of stock.

After shares are converted into stock, the stockholder may own Rs. 1,000 worth of stock where formerly he held one hundred shares of Rs. 10 each. Thus, though his investment in the company remains the same, the interest of the stockholder in the company is described differently.

Difference between Share and Stock

S.No	Share	Stock
1	Shares in physical form bear distinct numbers	stocks are the consolidated value of share capital
2	Shares may or may not be fully paid-up	Stock is always fully paid-up
3	Shares have a nominal value	stock does not have any nominal value
4	All shares are of equal denomination	Denomination of stocks varies.
5	It is not possible to transfer shares into fraction	Stock is divisible into any amount required. Thus, it is possible to transfer even into fractions
6	Shares comes into existence before the stock and it is issued initially	Stock comes into existence after conversion of shares into stock and on conversion of shares into stock, the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock

TEST YOUR KNOWLEDGE

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

Only fully paid-up shares can be converted into stock.

- True
- False

Correct answer: *True*

4. REDUCTION OF SHARE CAPITAL

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company. The share capital of a company may be reduced u/s 100 only if the articles of the company authorize so. If there is no such clause in the articles, the articles must be amended by a special resolution for giving the power of reducing the share capital.

As per Section 100 of the Companies act, 1956 Subject to confirmation by the court, A company limited by shares or a company limited by guarantee and having a share capital may, if authorized by its articles, by special resolution, reduce its share capital in any way and in particular and without prejudice to the generality of the forgoing power, may :-

1. Reduce or extinguish the liability on any of its shares in respect of share capital not paid up e.g., where the shares are of Rs. 100 each with Rs. 75 paid-up reduce them to Rs. 75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of Rs. 25 per share;
2. Either with or without extinguishing or reducing liability on any of its shares, cancels any paid up share capital which is lost , or is unrepresented by available assets or
3. Either with or without extinguishing or reducing liability on any of its shares, pay of any paid up share capital which is in excess of the wants of the company where the shares are fully paid-up, reduce them to Rs. 75 each and pay back, Rs. 25 per share
4. by following a combination of any of the preceding methods

Judicial Pronouncement about reduction of Share capital of a company

1. ***SIEL Ltd., In re. [(2008) 144 Comp Cas 469 (Del)]***, the view was that reduction of the share capital of a company is a domestic concern of the company and the decision of the majority would prevail. If the majority by special resolution decides to reduce the share capital of the company, it has the right to decide to reduce the share capital of the company and it has the right to decide how this reduction should be effected. While reducing the share capital, the company can decide to extinguish some of its shares without dealing in the same manner with all other shares of the same class. A selective reduction is permissible within the frame work of law for any company limited by shares.
2. ***Indian National Press (Indore) Ltd., In re. (1989) 66 Com Cases 387, 392 (MP)*** The need for reducing capital may arise in various circumstances for example trading losses, heavy capital expenses and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a capital may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.
3. ***Elpro International Ltd., In re [(2009) 149 Comp Cas 646 (Bom.)]***, a company proposed to extinguish and cancel 8,89,169 shares held by shareholders constituting 25 per cent, of the issued and paid up share capital and return capital to such shareholders at Rs. 183 per equity share of Rs. 10

each so cancelled and extinguished in accordance with Section 100 of the Act. According to the scheme as approved by the shareholders, the reducing of 25 percent, of the issued and paid up capital was to take place from amongst 3,835 share holders which included 112 shareholders who voted for the resolution, and 3,723 shareholders who did not object to the resolution. It was held that a selective reduction of share capital is legally permissible. The shareholders who did not cast their votes were those who had abstained from voting at the meeting. Moreover, there was no objection from any of the shareholders to the proposed reduction.

4. ***British and American Trustee and Finance Corpn. v. Couper, (1894) AC 399, 403: (1991-4) All ER Rep 667.*** The Act does not prescribe the manner in which the reduction of capital is to be effected. Nor is there any limitation of the power of the Court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured
5. ***British and American Trustee Corpn. v. Couper, (1894) (ibid)*** When exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short the Court shall consider the following, while sanctioning the reduction:
 - (i) The interests of creditors must be safeguarded;
 - (ii) The interests of shareholders must be considered; and
 - (iii) Lastly, the public interest must be considered as well.
6. ***Borough Commercial and Bldg. Society, (1893) 2 Ch 242. Reduction in shares capital of an unlimited company*** : An unlimited company to which Section 100 does not apply, can reduce its capital in any manner that its Memorandum and Articles of Association allow It is not governed by Sections 94 and 100 of the Act. Section 13 does not provide that its capital shall be stated in the Memorandum. However, even if its capital is stated in the Memorandum, the Companies Act impliedly gives power to the member to alter it.
7. ***Great Universal Stores Ltd., Re (1960) 1 All ER 252: (1960) Reduction of capital when company is defunct*** The Registrar of Companies has been empowered under Section 560 to strike off the name of the company from register on the ground of non-working. Therefore, where the company has ceased to trade, and Registrar exercises his power under Section 560 a reduction of capital cannot be prevented
8. ***Marwari Stores Ltd. v. Gouri Shanker Goenka, (1936) 6 Com Cases 285. Equal Reduction of Shares of One Class*** Where there is only one class of shares, prima facie, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalising the amount so paid-up. The same principle is to be followed where there are different classes of shares [Bannatyne v. Direct Spanish Telegraph Co., (1886) 34 Ch D 287].
9. ***Asian Investments Ltd. Re, (1992) 73 Com Cases 517, 523 (Mad).*** It is, however, not necessary that extinguishment of shares in all cases should

necessarily result in reduction of share capital. Accordingly where reduction is not involved Section 100 would not be attracted

Reduction of share capital without sanction of the Court

The following are cases which amount to reduction of share capital and where no confirmation by the Court is necessary:

- (a) **Surrender of shares** — “Surrender of shares” means the surrender to the company on the part of the registered holder of shares already issued. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad v. Equity Insurance Co. Ltd.*, (1948) 18 Com Cases 309: AIR 1948 Oudh 197]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from further liability on shares.

The Companies Act contains no provision for surrender of shares. Thus surrender of shares is valid only when Articles of Association provide for the same and:

- (i) Where forfeiture of such shares is justified; or
- (ii) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. But in the former case, it is at the initiative of company and in the latter case at the initiative of member or shareholder.

- (b) **Forfeiture of shares** — A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Court.

Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised *bona fide* and in the interest of the company.

Note: Detailed procedure regarding forfeiture has been discussed in Study Lesson-XI.

- (c) **Diminution of capital** — As per section 94(1)(3) of the companies act Diminution of capital is the cancellation of the unsubscribed part of the issued capital . it can be effected by an ordinary resolution provided articles of the company authorises to do so . It does not need any confirmation of Court
- (d) Redemption of redeemable preference shares.
- (e) Purchase of shares of a member by the Company under Section 402.
- (f) Buy-back of its own shares under Section 77A.

Difference in Alteration of share capital and reduction of share capital

<i>S.No.</i>	<i>Alteration of share capital</i>	<i>Reduction of share capital</i>
1	Alteration of share capital is governed by the provisions of section 94 of the Companies Act, 1956.	Reduction of share capital is governed by the provisions of section 100 of the Companies Act, 1956.
2	Alteration of share capital is required to be done by ordinary resolution.	Reduction of share capital is required to be done by special resolution
3	Alteration of share capital is not required to be confirmed by the court	Reduction of share capital is to be confirmed by the court
4	Alteration of share capital may be done in the following manner <ol style="list-style-type: none"> 1. Increasing its nominal capital by issuing new shares 2. Consolidating and dividing all or any of its share capital into shares of large denomination 3. Converting fully paid up shares into stock or vice versa 4. Sub dividing its shares or any of them into shares of smaller amount 5. Canceling shares which have not been taken up and diminishing the amount of share capital by the amount of the shares so cancelled. 	Reduction of share capital may be done in the following manner <ol style="list-style-type: none"> 1. Extinguishing or reducing the liability of members in respect of the capital not paid up 2. Writing off or canceling any paid up capital which is in excess of the needs of the company 3. Paying off any paid up share capital which is in excess of the needs of the company

Creditors' Right to Object to Reduction

After passing the special resolution for the reduction of capital, the company is required to apply to the Court by way of petition for the confirmation of the resolution under Section 101. Where the proposed reduction of share capital involves either (i) diminution of liability in respect of unpaid share capital, or (ii) the payment to any shareholder of any paid-up share capital, or (iii) in any other case, if the Court so directs, the following provisions shall have effect:

The creditors having a debt or claim admissible in winding up are entitled to object. To enable them to do so, the Court will settle a list of creditors entitled to object. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured. The Court, in deciding whether or not to confirm the reduction will take into consideration the minority shareholders and creditors.

A Company might decide to return a part of its capital when its paid-up share capital is in excess of its needs. It is not simply handed over to shareholders in proportion to their holdings. Their class rights will be considered with the Court treating the reduction as though it was analogous to liquidation. Therefore, the preference shareholders who have priority to return of capital in liquidation will be the first to have their share capital returned to them in a share capital reduction, even if they prefer to remain members of the company.

Confirmation and Registration of reduction of share capital

Section 102 of the Act states that if the Court is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been determined, discharged, paid or secured, it may confirm the reduction. The Court may also direct that the words "and reduced" be added to the company's name for a specified period, and that the company must publish the reasons for the reduction, and the causes which led to it, with a view to giving proper information to the public.

The Court's order confirming the reduction together with the minutes giving the details of the company's share capital, as altered, should be delivered to the Registrar who will register them. The reduction takes effect only on registration of the order and minutes, and not before. The Registrar will then issue a certificate of registration which will be a conclusive evidence that the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be altered accordingly.

Conclusiveness of certificate for reduction of capital

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd.*, (1903) 88 LT 792 (Ch D)]. Similarly, in a case the special resolution for reduction was an invalid one, but the company had gone through with the reduction. It was held that the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook*, (1900) 2 QB 376].

Diminution of share capital is not a reduction of capital

In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

- (i) Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 94(1)(e)];
- (ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 80;

- (iii) Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital.
- (iv) Where the company buys-back its own shares under Section 77A of the Act.

In all these cases, the procedure for reduction of capital as laid down in Section 100 is not attracted.

Liability of Members in respect of Reduced Share Capital

On the reduction of share capital, the extent of the liability of any past or present member on any call or contribution shall not exceed the difference between the amount already paid on the share, or the reduced amount, if any, which is deemed to have been paid thereon by the member, and the amount of the shares fixed by the scheme of the reduction.

If, however any creditor entitled to object to the reduction of share capital is not entered in the list of creditors by reason of his ignorance of the proceedings for reduction and after the reduction, the company is unable to pay his debt or claim, then:

- (a) every member at the time of registration of the Court's order for reduction is liable to contribute for the payment of that debt or claim, an amount not exceeding the amount which he would have contributed on the day before registration of the order and minutes; and
- (b) if the company is wound up, the Court on the application by the creditor and on proof of his ignorance, may settle a list of contributories and make and enforce calls and orders on the contributories, settled on the list, as if they were ordinary contributories in a winding up.

It is further provided that, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction; or knowingly misrepresents the nature or amount of the debt or claim of any creditor; or abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable to be punishable with imprisonment up to one year, or with fine or with both (Section 105).

5. COMPANY PROHIBITED TO BUY ITS OWN SHARES OR TO FINANCE THEIR PURCHASE UNDER SECTION 77

No company limited by shares, or by guarantee and having a share capital shall have power to buy its own shares unless the consequent reduction of capital is effected and sanctioned in pursuance of section 100 to 104 or of section 402.

No public company and no private company which is a subsidiary of a public company shall give directly or indirectly and whether by means of a loan guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or in its holding company. There are, however, certain exceptions to this rule. The exceptions are:

- (A) A company may redeem its redeemable preference shares under Section 80 of the Act.
- (B) A banking company may lend money in the ordinary course of business.

- (C) A company may provide financial assistance:
- (a) where it is provided, in accordance with a scheme, for the purchase of fully-paid shares in the company or its holding company, being a purchase by trustees of or for shares to be held by or for the benefit of employees of the company including directors holding salaried posts;
 - (b) Where the loan is advanced to the bona fide employees of the company, other than directors or manager, to enable them to purchase fully paid-up shares for amounts not exceeding six months' salary or wages of such employees.
- (D) A company may buy its own shares from any member in pursuance of a Court's order under Section 402 of the Companies Act.

If a company acts in contravention of the section 77, the company and every officer of the company who is in default shall be punishable with a fine which may extend to Rs 10, 000

6. POWER OF COMPANY TO PURCHASE ITS OWN SECURITIES (BUY-BACK OF SECURITIES)

The Companies (Amendment) Act, 1999 had introduced the provisions which allow the companies to buy-back their own shares. For this purpose, Sections 77A, 77AA and 77B were inserted in the Companies Act, 1956.

Section 77A (1) provides that:

Notwithstanding anything contained in this Act, but subject to the provisions of Sub-section (2) of this section and Section 77B, a company may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of:

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

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The buy-back of shares or securities may be in any one or more of the following modes:

- (i) Purchasing from existing security holders on a proportionate basis (tender offer method).
- (ii) Purchasing from the open market (through Stock Exchanges).
- (iii) Purchasing from odd-lot holders.
- (iv) Purchasing from securities issued to employees under Scheme of Stock Option or Sweat Equity

Negotiated buy-back transactions are not permitted i.e. all shareholders must have same right of participation in the buy-back operations and it cannot be restricted to any shareholder or group of shareholders.

Conditions for Buy-back

The conditions for buy-back of shares are as under:

- (a) The buy-back is authorised by its articles;
- (b) a special resolution has been passed in general meeting of the company authorizing the buy-back;

However, the said special resolution shall not be required to be passed if the following conditions are satisfied:

- (i) The buy back is less than 10% of the total paid up equity capital and free reserves of the company, and
- (ii) A resolution authorizing the buy back is passed at a meeting of the Board.

Provided that no company can come out with a fresh proposal to buy back its shares within a period of 365 days from the date of the preceding offer of buy back.

- (c) the buy-back is or less than twenty-five per cent of the total paid-up capital and free reserves of the company:

Provided that the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year;

- (d) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back:

Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.

Explanation: For the purposes of this clause, the expression "debt" includes all amounts of unsecured and secured debts;

Vide Notification GSR No. 479(E) dated 12th June, 2003, the Central Government has notified that the debt equity ratio of Listed Housing Finance Companies for the purposes of Section 77A(2)(d) of the Companies Act, 1956 as amended shall be such as may be specified by the National Housing Bank.

- (e) All the shares or other specified securities for buy-back are fully paid-up;
- (f) The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;
- (g) The buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

The other provisions to be complied with are as under:

- (1) The explanatory statement accompanying the notice convening the general meeting at which this special resolution will be passed should contain all the relevant particulars of the buy-back such as:
 - (a) a full and complete disclosure of all material facts;
 - (b) the necessity for the buy-back;
 - (c) the class of security intended to be purchased under the buy-back;

- (d) the amount to be invested under the buy-back;
 - (e) the time limit for completion of buy-back.
- (2) The buy-back operations should be completed within 12 months of the date of passing of the special resolution or a resolution passed by the Board.
 - (3) A declaration of solvency in the prescribed Form No. 4A of Companies (Central Government's) General Rules and Forms, 1956 verified by an affidavit and signed by two directors, one of whom must be the Managing Director, where there is one, has to be filed with the Registrar of Companies and SEBI. In case of unlisted companies, the declaration is required to be filed only with the Registrar of Companies.
 - (4) After completion of buy-back operation the securities must be extinguished and physically destroyed within 7 days of the last date of completion of buy-back.
 - (5) After completion of buy-back, the company shall not make a further issue of shares or other specified securities for a period of 6 months except by way of bonus issue or in discharge of subsisting obligations such as conversion of options/obligations already given.
 - (6) A prescribed return in e-Form No. 4C has to be filed with the Registrar of Companies and SEBI within 30 days after completion of the buy-back operations. In the case of unlisted companies, the same is required to be filed only with the Registrar of Companies.
 - (7) The company has to maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.
 - (8) For contravention of the provisions of Section 77A or any rules made thereunder, the company or any officer thereof is punishable with fine upto Rs. 50,000 and/or imprisonment upto two years.
 - (9) For the purposes of this section:
 - (a) "Specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.
 - (b) "Free reserves" shall have the meaning assigned to it in Clause (b) of Explanation to Section 372A.

Explanation to Section 372A provides that "Free reserves" means those reserves which, as per latest audited balance-sheet of the company, are free for distribution as dividend and shall include balance to the credit of securities premium account but shall not include share application money.
 - (10) Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account referred to in clause (d) of the proviso to Sub-section (1) of Section 80 and details of such transfer shall be disclosed in the balance-sheet. (Section 77AA)

In *D-Link (India) Ltd. v. SEBI* [(2008) 85 SCL 385 (SAT)], the shareholders of a company passed a special resolution authorizing the company to buy-back its fully paid-up equity shares. However, the appellant took no further steps to buy-back the

equity shares. It was held that the first question was as to whether the company was under any obligation to go ahead with the buy-back after its shareholders had passed a special resolution in the EGM authorizing it to buy-back its fully paid-up equity shares. On a reading of the provisions of section 77A and the relevant provisions of the buy-back regulations it is clear that a company is under no obligation to buy-back its securities even if its shareholders have passed a special resolution authorizing it to buy-back on the terms and conditions mentioned in the resolution. Section 77A is only an enabling provision and all that it mandates is that no company shall buy-back its own securities unless it is authorized by its articles and also by its shareholders. But even where the shareholders pass a special resolution, it does not become obligatory for the company to buy-back the shares. The passing of a special resolution by the shareholders is the first step by which they authorize the company and the second step would be the decision of the company to buy-back by making an offer to its shareholders.

For listed companies, SEBI has framed SEBI (Buy-back of Securities) Regulations, 1998.

For Private Limited Companies and Unlisted Public Companies, the Central Government has issued Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

7. PROHIBITION FOR BUY-BACK IN CERTAIN CIRCUMSTANCES

Section 77B provides that, no company shall directly or indirectly purchase its own shares or other specified securities:

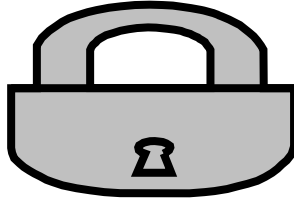
- (a) Through any subsidiary company including its own subsidiary companies; or
- (b) Through any investment company or group of investment companies; or
- (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures, or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting; or
- (d) if the company has not complied with provisions of Sections 159, 207 and 211.

LESSON ROUND-UP



- A company limited by shares or guarantee and having a share capital may alter its share capital in any of the ways provided under the Companies Act. These powers can be exercised by the members only if authorized by the articles.
- The Companies Act allows a company to convert its fully paid-up shares into stock. Share includes stock except where a distinction between stock and shares is expressed or implied. A stockholder has the same rights as to dividends as a shareholder.

- Reduction of capital means reduction of issued, subscribed or paid-up capital of the company. Various modes of reduction have been laid down in the Companies Act.
- A company limited by shares or a company limited by guarantee and having a share capital may, if authorized by its articles and subject to its confirmation by the Court/Tribunal on petition, reduce its share capital. While sanctioning such reduction, interests of creditors, shareholders and public should be safeguarded.
- Surrender of shares, forfeiture of shares, diminution of capital, redemption of preference shares, purchase of shares by member, buy-back of own shares amount to reduction of share capital but no confirmation by the Court/Tribunal is necessary.
- Where the company has ceased to trade and Registrar exercises his power to strike off the name of the company from the register on the ground of non-working, a reduction of capital cannot be prevented.
- Where there is only one class of shares, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalizing the amounts so paid-up. The same principle is to be followed where there are different classes of shares.
- Where the directors are required to hold qualification shares, care must be taken that the effect of a reduction does not disqualify any director.
- The creditors having a debt or claim admissible in winding up are entitled to object in reduction. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured.
- The Registrar will then issue a certificate of registration which will be conclusive evidence that the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be altered accordingly.
- In certain cases, diminution of share capital is not to be treated as reduction of the capital.
- On the reduction of share capital, the extent of the liability of any past or present member on any call or contribution shall not exceed the difference between the amount already paid on the share, or the reduced amount, if any, which is deemed to have been paid thereon by the member, and the amount of the shares fixed by the scheme of the reduction.
- A company limited by shares, or by guarantee and having a share capital cannot buy its own shares as that would involve a reduction of share capital without the court's consent; nor may a company do so indirectly, by getting another person to buy the shares on its behalf.
- A public company or its subsidiary must not finance the purchase by any other person of its own shares or those of its holding company. There are, however, certain exceptions to this rule.
- Certain provisions introduced in the Companies Act allow the companies to buy-back their own shares, subject to the conditions and in any of the modes provided therein. They also provide for prohibition for buy-back in certain circumstances.

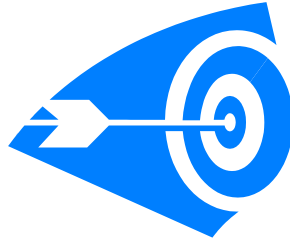
SELF-TEST QUESTIONS

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

1. Distinguish between share and stock.
 2. What are the methods for reduction of share capital of a company?
 3. How can a company reduce its share capital without sanction of the court/tribunal?
 4. Write short notes on:
 - (i) Diminution of share capital
 - (ii) Surrender of shares
 - (iii) Forfeiture of shares
 5. Explain in detail, the provisions as regards buy-back of securities by the companies.
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STUDY VIII
FINANCIAL STRUCTURE AND MEMBERSHIP - III
PROSPECTUS

LEARNING OBJECTIVES



The lesson explains the meaning and definition of prospectus, shelf prospectus, information memorandum and red-herring prospectus along with relevant provisions under the Companies Act and SEBI guidelines. The lesson also discusses abridged prospectus and letter of offer and abridged letter of offer.

At the end of the lesson, you should be able to understand:

- Meaning and definition of prospectus.
- When Prospectus is not required to be issued.
- Statement in lieu of Prospectus.
- Dating and Registration of Prospectus.
- Shelf Prospectus, Information Memorandum and Red-herring prospectus.
- Contents and disclosures in prospectus as per Companies Act and SEBI Guidelines.
- Abridged Prospectus and disclosures therein.
- Letter of offer and Abridged letter of offer and its contents.
- Golden Rule or Golden Legacy.
- Deemed Prospectus.
- Liability for untrue statement.
- Remedies for misrepresentation in prospectus.
- Penalty for fraudulently inducing to invest money.
- Prohibition of allotment of shares in fictitious name.

1. MEANING AND DEFINITION OF PROSPECTUS

Section 2(36) of the Companies Act, 1956 defines a prospectus as “any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.”

On the basis of aforesaid definition, it may be said that a document should have

following ingredients to constitute a prospectus:

- (a) There must be an invitation to the public;
- (b) The invitation must be made “by or on behalf of the company or in relation to an intended company”;
- (c) The invitation must be “to subscribe or purchase”;
- (d) The invitation must relate to shares or debentures or such other instrument.

2. INVITATION TO PUBLIC

There must be an invitation to the public

In essence, it means that a prospectus is an invitation issued to the public to offer for purchase/subscribe shares or debentures of the company. A document is deemed to be issued to the public, if the invitation to subscribe for share capital is such as to be open to any one who brings his money and applies in prescribed form, whether the prospectus was addressed to him or not. The test is not who receives the document, but who can apply for shares in response to the invitation contained in it.

However, an issue will not be “Public” if-

- (i) It is directed to a specified person or a group of persons, and
- (ii) It is not calculated to result in the shares or debentures becoming available to other persons.

Some important judicial pronouncement about an invitation to be termed as an invitation to public

- (A) Advertisement in news paper to invite application for purchase of remaining shares of a company is prospectus (*Pramatha Nath Sanyal v. Kali Kumar Dutt*, A.I.R. 1925 Cal. 714). In this case directors were penalized for not complying with the requirements of filing a copy thereof with Registrar of Companies
- (B) A single private communication does not satisfy the term “issue” [*Nash v. Lynde* (1929) A.C. 158]. In this case, several copies of a document marked “strictly confidential” and containing particulars of a proposed issue of shares, were sent accompanied by application form by the managing director who, in turn, gave it to a client who passed it on to a relation. Thus, the document was passed on privately through a small circle of friends of the directors. The House of Lords held that there had been no issue to the public and any action for compensation by the allottee for loss sustained by reason of an omission in the document, failed.
- (C) In *Rattan Singh v. Managing Director, Moga Transport Co. Ltd.* (1959) 29 Comp. Case 165 it was held that offer to buy one’s kith and kin cannot be considered to be an invitation to public. Offer to buy shares made to an individual as such is not within the definition of the word public’ as used in Section 67
- (D) In the case of *Govt. Stock and Other Securities Investment Co. Ltd. v. Christopher*, (1956) I.W.L.R. 237 it was held that a circular issued by a company to the shareholders of other companies to acquire their shares held

in those companies and issue its own shares in exchange of those shares did not amount to be a prospectus, as there is no public issue. It was pointed out that the circular did not involve an offer for the purchase of any shares. The shares in question were unissued shares of new company, so that they could not be the subject of an offer for purchase. Thus, the circular was not a prospectus, but only the communication of an offer to exchange shares in the new company for shares in the other existing companies

- (E) In *Re. South of England Natural Gas and Petroleum Co. Ltd.*, (1911) 1 Ch. 573 it was held that "Public" is a general word, and includes any section of the public. If a document inviting persons to buy shares is issued, for example, to all advocates, or to all doctors, or to all foreigners living in India, or to all Indian citizens, or to all shareholders in a particular company, it will still be deemed to be issued to the public within the meaning of the Act. In the aforesaid case, 3,000 copies of a document in the form of a prospectus were sent out and distributed among the members of certain gas companies only. It was held that the document so sent and distributed was a prospectus issued to the public.

Provisions of Companies Act, 1956 with respect to invitation to public

One of the ingredients of a prospectus is to make invitation to the public to subscribe for shares in or debentures of a body corporate which is construed as including a reference to any section of the public, whether selected as members or debenture-holders of the company or as clients of the person issuing the prospectus. (Section 67). However, exceptions have been provided under Sub-section (3) of Section 67.

Section 67(3) of the Companies Act, 1956 provides that no offer or invitation shall be treated as made to the public by virtue of Sub-section (1) or Sub-section (2) as the case may be, if the offer or invitation can properly be regarded in all the circumstances—

- (a) As not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or
- (b) Otherwise as being a domestic concern of the persons making and receiving the offer or invitation;

A proviso to Section 67(3) had been inserted by the Companies (Amendment) Act, 2000 according to which an offer or invitation to subscribe for shares or debentures made to fifty or more persons shall be treated as an offer or invitation made to the public. In such a case the company has to comply with all the provisions contained in the Act and the SEBI's guidelines for making a public issue. The newly inserted proviso to Sub-section (3) of Section 67 will make private placement under the purview of 'public issue' if such offer or invitation is made to or subscribed for by fifty persons or more. However this proviso to Section 67(3) does not apply to the non-banking financial companies or public financial institutions specified in Section 4A of the Companies Act, 1956.

3. WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED?

In the following cases although the shares are offered and application forms

issued, a prospectus containing all the details required under Section 56 is not necessary:

- (i) Where a person is a *bona fide* invitee to enter into an underwriting agreement with regard to shares or debentures; [Section 56(3)].
- (ii) Where the shares or debentures are not offered to public; [Section 56(3)].
- (iii) Where the issue relates to shares or debentures uniform in all respects, with the shares or debentures already issued and dealt in or quoted at a recognised stock exchange; [Section 56(5)].
- (iv) Where the shares or debentures are offered to the existing holders of shares or debentures respectively; [Section 56(5)].
- (v) where any prospectus is published as a newspaper advertisement ordinarily called prospectus announcement, it shall not be necessary to specify the contents of the memorandum, or the names etc. of the signatories to the memorandum, or the number of shares subscribed for by them (Section 66). However, the guidelines issued by SEBI as to the code of advertisement must be adhered to.

As per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, a 'Letter of Offer' has to be filed as offer document in case of a rights issue.

It further provides that no listed issuer company shall make any rights issue of securities, where aggregate value of such securities, including premium, if any, exceeds Rs. 50 lacs, unless a draft letter of offer has been filed with the Board such draft letter of offer has to be filed through a Merchant Banker, at least 30 days prior to the filing of offer with the Designated Stock Exchange (DSE). The contents of a specimen 'Letter of Offer' are given later in the study.

As per Section 56(5)(a) of the Companies Act, 1956, the issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require registration of a prospectus. The offer of further shares with right of renunciation is a personal decision of the persons receiving the offer. Renouncing the offer is not made by the company with intent to inform the public and, therefore, the letter of offer to shareholder with right of renunciation does not require registration with the Registrar of Companies.

4. STATEMENT IN LIEU OF PROSPECTUS

All public companies either issue a prospectus or file a statement in lieu of prospectus. A private company as such does not produce either document. But when a private company converts itself into a public company it must either file a prospectus if issued or file statement in lieu of prospectus.

Section 70(1) states that a public company having a share capital which:

- (a) Does not issue a prospectus on or with reference to its formation; or
- (b) has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or debentures unless at least 3 days before the first allotment of either shares or

debentures, it has delivered to the Registrar a statement in lieu of prospectus in accordance with Schedule III of the Act duly signed by every person named therein as a director or proposed director of the company or by his agent authorised in writing.

The provisions of this section do not apply to private companies.

The statement in lieu of prospectus should contain similar particulars as are required for a prospectus and it should also fulfill similar conditions as applicable for issue of prospectus. No minimum subscription is required to be given for issue of statement in lieu of prospectus, as this document does not relate to an offer to issue a fixed number of shares at a fixed price to the subscribers.

If a statement in lieu of prospectus is not delivered, the company and every director shall be liable to a fine up to Rs. 10,000. Section 70(5) imposes exactly the same criminal liability, penalties and defences as applicable for prospectus. The common law remedy of damages for deceit and equitable remedy of recession also apply in the same way.

5. DATING AND REGISTRATION OF PROSPECTUS — AS PER PROVISIONS CONTAINED IN COMPANIES ACT, 1956

Various provisions are provided in the Companies Act, 1956 in respect of this basic document which is the primary source for the investor to ascertain the soundness or otherwise of the company. These are as follows:

1. **Prospectus must be dated:** According to Section 55 of the Companies Act, 1956, every prospectus must be dated. It states unless the contrary is proved, date of prospectus shall be the date of the publication of the prospectus. The date of issue is the date on which the prospectus first appears as an advertisement
2. **A copy of prospectus must be filed with the Registrar on or before its publication:** The copy sent for registration must be signed by every person who is named in the prospectus as a director or a proposed director of the company or by his agent authorised in writing. The expert's consent, a copy of every contract under clause 16 of Schedule II and adjustment under clause 32 of the said Schedule should be attached to the prospectus. Where the prospectus is issued in more than one language, a copy of it as issued in each language should be delivered to the Registrar (*Emperor v. Bengal Salt Co.*, 40 C.W.N. 320: A.I.R. 1936 Calcutta 33).
3. **The following documents must be attached to the copy of prospectus filed with the Registrar:**
 - (a) the consent of the expert mentioned in the prospectus, if his report is included in the prospectus;
 - (b) a copy of every contract relating to the appointment or remuneration of a managing director or manager;
 - (c) a copy of every material contract not being a contract entered into in the ordinary course of business of the company entered into within two years of the issue of the prospectus;
 - (d) a written statement relating to the adjustments, if any, in respect of

figures of any profits or losses, and assets and liabilities.

- (e) the consent in writing of the person, if any, named in the prospectus as the auditor, legal adviser, attorney, solicitor, issue house, banker, managers to the issue or broker of the company to act in that capacity;
 - (f) the consent of director under Section 266 in respect of new directors, if any, named therein;
 - (g) a copy of the underwriting agreement if any, should also be filed as required by Section 76(1)(b)(v).
4. The prospectus must contain a statement that a copy has been delivered for registration, also indicating the requisite documents (giving names) delivered with it.
 5. The prospectus must be issued within 90 days of its registration either by newspaper advertisement or otherwise.
 6. **The consent of the expert should be obtained:** If the prospectus includes a statement purporting to be made by an expert, consent in writing of that expert should be obtained and this fact should be stated in the prospectus. It should also state that the consent given has not been withdrawn.
 - (a) The expert should not be one who is himself engaged or interested in the formation, promotion, or management of the company. He should be unconnected with the formation or management of the company.
 7. The company and every person who knowingly issues a prospectus without delivering a copy thereof to the Registrar for the registration shall be punishable with fine up to Rs. 50,000.

6. WHEN REGISTRAR MUST REFUSE REGISTRATION

Section 60(3) provides that the Registrar shall not register a prospectus if —

- (a) It is not dated — Section 55;
- (b) It does not comply with the requirements of Section 56 as to the matters and reports to be set out in it;
- (c) it contains statements or reports of experts engaged or interested in the formation or promotion or management of the company — Section 57;
- (d) it includes a statement purported to be made by an expert without a statement that he has given and has not withdrawn his consent to the manner of its inclusion therein;
- (e) it does not contain consent in writing of directors, a copy of the documents mentioned in Section 60(1) has been filed or does not comply with regard to the fact that a copy of it has been filed with Registrar;
- (f) it is not accompanied by the consent in writing of the auditor, legal adviser, attorney, solicitor, Issue House, banker, managers to the issue or broker, if named in prospectus to act in that capacity — Section 60(3).

7. SHELF PROSPECTUS

According to Section 60A, 'Shelf prospectus' means a prospectus issued by any

public financial institution or bank for one or more issues of securities or class of securities specified in the prospectus. Accordingly as per Section 60A—

1. Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a shelf prospectus. 'Financing' for this purpose means making loans to, or subscribing in the capital of a private industrial enterprise engaged in infrastructural financing or such other company as the Central Government may notify in this behalf.
2. A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within the period of validity of such shelf prospectus, which is one year from the date of opening of the first issue of securities.
3. A company filing a shelf-prospectus shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and succeeding offer of securities within such time as may be prescribed by the Central Government prior to making of second or subsequent offer of securities under the shelf prospectus. For this purpose of Section 60A(3), Rule 4CCA of the Companies (Central Government's) General Rules and Forms, 1956 prescribes a period of three months. [Notification No. GSR 96(E) dt. 14.2.01].
4. An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities under that prospectus:

Provided that where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

The concept of shelf prospectus will save expenditure and time of the companies in issuing a new prospectus every time they wish to issue securities to the public within a period of one year.

ICDR Guidelines about shelf prospectus

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 provides following conditions relating to self prospectus:

- (1) Regulation 6 provides that the issuer shall file Shelf Prospectus with the SEBI at least thirty days prior to registering the shelf prospectus with the Registrar of Companies.
- (2) Regulation 11 provides that in case of shelf prospectus, the first issue may be opened within three months of issuance of observations by the SEBI.
- (3) Regulation 57 provides that shelf prospectus shall contain:
 - A. the disclosures specified in Schedule II of the Companies Act, 1956; and
 - B. the disclosures specified in Part A of Schedule VIII, subject to the provisions of Parts B and C thereof.

8. INFORMATION MEMORANDUM

Section 60B of the Companies Act, 1956 speaks about Information

Memorandum. It is a kind of prospectus which has its relevance in the book building process. A company going for a public issue has to issue a draft prospectus to publicize the issue in the form of a circular, advertisement or a prospectus. This prospectus is called an information memorandum and shall contain all particulars that are required to be included in a prospectus except the number and price of issues. This prospectus is required to be filed with SEBI which may incorporate some changes to it. After that, a company has to file a red-herring prospectus to the Registrar and SEBI at least three days prior to the opening of the issue. Both the red-herring prospectus and the information memorandum shall contain all the particulars that are required to be given in the prospectus except the number and price of issue. If there is any variation between the red-herring prospectus and the information memorandum, the same has to be highlighted and has to be individually intimated to the persons invited to subscribe to the issue of securities.

9. RED-HERRING PROSPECTUS

"Red-herring prospectus" means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered. The information memorandum and red-herring prospectus carry same obligations as are applicable in the case of prospectus. Every variation between the information memorandum and the red-herring prospectus shall be highlighted by the issuer company and shall be individually intimated to the persons invited to subscribe to the securities.

Section 60B(7) provides that the applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.

The company or underwriters or bankers shall not encash subscription moneys or post-dated cheques or stock-invest received in advance, before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of the subscription paid.

If a company or underwriter or banker to the issue acts contrary to this stipulation i.e. without giving enough information of any variations or the particulars of withdrawing the offer or opportunity for cancelling the post-dated cheques or stock invest, such action shall be void and the applicant shall be entitled to receive a refund or return of his post-dated cheques or stock invests or subscription money or cancellation of application. The applicants are entitled to receive back their original applications and interest at the rate of 15% from date of encashment till payment or realisation.

Once the offer for securities is closed, a final prospectus stating therein the total capital raised whether by way of debt or share capital, the closing price of the securities and any other details which are not complete in the red-herring prospectus shall be filed with SEBI in the case of listed public company and in any other case with the Registrar of companies only.

10. MANNER OF DISCLOSURES IN THE OFFER DOCUMENTS

The offer document shall contain all material disclosures which are true and

adequate so as to enable the applicants to take an informed investment decision.

In this respect, the red-herring prospectus, shelf prospectus and prospectus shall contain:

- (i) the disclosures specified in Schedule II of the Companies Act, 1956; and
- (ii) the disclosures specified in Part A of Schedule VIII of SEBI (Issue and Capital and Disclosure Requirements), Regulations, 2009 subject to the provisions of Parts B and C thereof.

The letter of offer shall contain disclosures as specified in Part E of Schedule VIII of SEBI (Issue and Capital and Disclosure Requirements), Regulations, 2009.

Further, the abridged prospectus shall contain the disclosures of the memorandum prescribed under sub-section (3) of section 56 of the Companies Act, 1956 and additional disclosures as specified in Part D of Schedule VIII of SEBI (Issue and Capital and Disclosure Requirements), Regulations, 2009.

Also, the abridged letter of offer shall contain the disclosures as specified in Part F of Schedule VIII of SEBI (Issue and Capital and Disclosure Requirements), Regulations, 2009.

Students are advised to refer the Bare Act of Corporate Laws for Schedule II of the Companies Act, 1956 and Schedule VIII of SEBI (Issue and Capital and Disclosure Requirements), Regulations, 2009.

11. APPLICATION WITH PROSPECTUS

Section 56(3) states that no application form can be issued for shares or debentures unless it is accompanied by a memorandum containing such salient features of prospectus as may be prescribed. There are, however, four exceptions to this rule:

- (a) where the offer is made in connection with the *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures;
- (b) where the shares or debentures are not offered to the public;
- (c) where the offer is made only to the existing members or debenture holders of the company with or without a right to renounce;
- (d) where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognised stock exchange.

The Department of Company Affairs (Now, Ministry of Corporate Affairs) vide its circular no. 3/92 dated 10/4/92 has allowed companies and their Merchant Bankers to print two application forms, accompanying the abridged prospectus, being attached to it along the perforated line bearing separate printed numbers. The Department however directed that care should be taken that the abridged prospectus is printed in such a way that it is easily readable. Contravention of Section 56(3) is punishable with fine which may extend to Rs. 50,000.

12. ABRIDGED PROSPECTUS

The Central Government has simultaneously with the revision of Schedule II prescribed that salient features of prospectus for the purposes of Section 56(3) of the Act. For the purpose, Rule 4CC has been inserted in the Companies (Central Government's) General Rules and Forms, 1956. As per rule 4CC, the salient features required to be included in the abridged prospectus shall be in Form 2A.

Form 2A requires information to be given under nine heads detailed below besides the statements on refund of application money in the event the minimum subscription is not received or on payment of interest if there is delay in refund of excess application money.

I. General Information

Under the head general information, the name and address of registered office of the company, name(s) of the Stock Exchange(s) at which the issue is listed, opening, closing and earliest closing dates of the issue, name and address of lead managers, name and address of trustees under debentures trust deeds (in case of debenture/issue), Rating for the debenture/preference shares, if any, obtained from CRISIL or any recognised rating agency are required to be given.

II. Capital Structure of the Company

Under this head, particulars of issued, subscribed and paid-up capital, size of present issue giving separately reservations for preferential allotment to promoters and others and paid-up capital after the present issue and after conversion of debentures, if applicable, are required to be stated.

III. Terms of the Present Issue

Under this head, the authority for the issue, terms of payment and procedure, time schedule for allotment and issue of certificates, procedure for applying including availability of forms, prospectus and mode of payment and special tax benefits to company and shareholders under the Income-tax Act are required to be stated.

IV. Particulars of the Issue

Under the head, objects of the issue, the project cost and means of financing including contribution of promoters are to be specified.

V. Company, Management and Project

Under this head, the following information is required to be stated.

- (a) History, main objects and present business of the company.
- (b) Background of the promoters, managing director/whole-time director and names of nominees of institutions, if any, on the Board of directors.
- (c) Location of the project.

- (d) Plant and machinery, technology, process, etc.
- (e) Collaboration, performance guarantee, if any, or assistance in marketing by the collaborators.
- (f) Infrastructure facilities for raw materials and utilities like water, electricity, etc.
- (g) Schedule of implementation of the project and progress made so far, giving details of land acquisition, execution of civil works, installation of plant and machinery, trial production, date of commercial production, if any.
- (h) The products —
 - (i) Nature of Product(s) — Consumer, industrial and end users.
 - (ii) Existing, licensed and installed capacity of the product, demand of the product-existing and estimated in the coming years as estimated by a Government authority or by any other reliable institution, giving the source of information.
 - (iii) Approach to marketing and proposed marketing set up.
In case of company providing services, relevant information in regard to nature/extent of services, etc. are to be furnished.
- (i) Future prospects — The expected year when the company would be able to earn net profit, declare dividend.

VI. Financial performance of the Company for the last 5 years

Under the head “financial performance of the company”, information based on the audited annual accounts is required to be given under the following heads for the last five years:

- (a) Balance sheet data: equity capital, reserves (state revaluation reserve, the year of revaluation and its monetary effect on assets) and borrowings.
- (b) Profit & Loss data: Sales, gross profit, net profit, dividend paid, if any.
- (c) Any change in accounting policies during the last three financial years and their effect on the profits and the reserves of the company.
- (d) Stock market quotation of shares/debentures of the company, if any (high/low price in each of the last three years and monthly high/low price during the last six months).

VII. Payments/Refunds

Under this head, the company is required to disclose whether all payments specifically as to refunds, debentures, fixed deposits, interest on fixed deposits, debenture interest, institutional dues have been paid up to date. In case, payments/refunds have not been made, details of the arrears, if any, are required to be stated.

VIII. Particulars of Companies under the Same Management

Under this, the following particulars in regard to the listed companies under the same management within the meaning of Section 370(1B) which made any capital issue in last three financial years as required to be stated:

- (a) Name of the Company; (b) Year of issue; (c) Type of issue (public/right/

composite); (d) Amount of issue; (e) Date of closure of issue; (f) Date of dispatch of share/debenture certificate completed; (g) Date of completion of the project, where object of the issue was financing of project; and (h) Rate of dividend paid.

IX. Management's Perception of Risk Factors

Under this head, the company is required to specify the risk factors which the management perceives, e.g., sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/time overrun.

Declaration

Lastly the directors are required to make declaration as under:

"If the company does not receive application money for at least 90 per cent of the issued amount, the entire subscription will be refunded within ninety days from the date of closure of the issue. If there is delay in the refund of application money for more than 8 days after the company becomes liable to pay the excess amount, the company will pay interest for the delayed period at the prescribed rates in Sub-sections (2) and (2A) of Section 73. No statement made in this form shall contravene any of the provisions of the Companies Act, 1956 and the rules made thereunder".

13. VOLUNTARY STATEMENT IN PROSPECTUS

In addition to the compulsory particulars, a company may voluntarily disclose some significant development/facts in the prospectus, red herring prospectus or a statement in lieu of prospectus. In addition to the compulsory particulars, any other information may be, and usually is, volunteered. This information may relate to the terms of the issue of shares of the company on the Stock Exchange. The intending buyer of shares is entitled to all true disclosures in the prospectus. A prospectus must therefore, tell the truth, the whole truth and nothing but the truth. Also, it must not conceal any fact which ought to be disclosed. In brief, the true nature of the company's venture and the position should be disclosed. This is called the golden rule as to the framing of prospectus.

It is thus obligatory on the part of those responsible for the issue of prospectus not only to state accurately all the relevant facts but also not to omit any fact which may be relevant for the prospective investor to know about the company.

14. THE GOLDEN RULE OR GOLDEN LEGACY

It is the duty of those who issue the prospectus to be truthful in all respects. This Golden Rule was pronounced by Kindersley, V.C. in *New Brunswick, etc., Co. v. Muggerridge*, (1860) 3 LT 651, and has come to be known as the "golden legacy". "Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representation contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as a fact which is not so and no fact should be omitted, the existence of which might in any degree affect the nature or quality of the privileges and advantages which the prospectus holds out as inducement to take shares. In short, the true nature of the company's venture should be 'disclosed'. If concealment of any material fact has prevented an adequate appreciation of what was stated, it would amount to misrepresentation.

Thus, even if every specific statement is literally true, the prospectus may be false if by reason of the suppression of other material facts, it conveys a false impression”.

In *R.V. Kylsant* (1932) K.B. 442, all statements in the prospectus were literally true but it failed to disclose that the dividends stated in it as paid, were not paid out of trading profits, but out of realized capital profits (secret reserves). The statement that the company had paid dividends for a number of years was true. But the company has incurred losses for all those years (1921-27) and no disclosure was made of this fact. The prospectus was held to be false in material particulars and the managing director and chairman, who knew that it was false, were held guilty of fraud.

15. DEEMED PROSPECTUS — OFFER FOR SALE OF EXISTING SHARES

In general, the provisions of the Companies Act are restricted to cases where the invitation is made by or on behalf of the company for subscription of its shares. As such it was possible at one time for a company to evade the statutory provisions relating to prospectus by allotting shares or debentures to the public by issuing a document inviting the public to purchase shares or debentures from them; but no document or prospectus as such, was issued by the company.

Section 64 now covers such a document also and it is treated as a prospectus issued by the company. Accordingly, an offer for sale is a prospectus, within the meaning of the Act, and it is deemed to have been issued by the company. Section 64(1) provides that where a company allots or agrees to allot any existing shares or debentures with a view to their being offered for sale to the public, any document by which the offer of sale to the public is made shall for all purposes be deemed to be a prospectus issued by the company. It may be noted that such offer of sale is made by existing shareholders to disinvest their whole or part of shareholding.

Under Section 64(2) it will be presumed, unless the contrary is proved, that an allotment of shares or debentures was made with a view to their being offered for sale to the public if:

- (a) the offer to the public (by the Issue House) was made within 6 months of allotment or agreement to allot (to the Issue House); or
- (b) the whole consideration was not received by the company at the time when the offer was made by the Issue House.

The offer for sale must set out all the details required to be inserted in a prospectus. It should also state the net amount of consideration received by the company on the shares or debentures to which the offer relates; and state the place and time at which the relevant contracts may be inspected [Section 62(3)].

Since all the provisions which apply to prospectus issued by a company apply to such a document, it must disclose everything truthfully. A person who makes the offer will be liable for any mis-statement in that document in the same manner as persons who authorise the issue of a false prospectus. The persons who accept the offer in respect of those shares or debentures are deemed to be subscribers. The persons making the offer will be deemed to be persons named in prospectus of a company for fulfilling the requirements relating to registration of prospectus under Section 60.

16. LIABILITY FOR UNTRUE STATEMENT

It is now clear that a prospectus must be complete and perfect in all details or in other words nothing should be omitted and nothing must be untrue in a prospectus.

Where an untrue statement occurs in a prospectus, there may arise (i) civil liability (ii) criminal liability. Every person who is a director of the company at the time of the issue of the prospectus, every promoter of the company and every person, including an expert, who has authorised the issue of a prospectus, shall be liable. Since the liability of these persons is to the allottee of shares, we may discuss this matter under the heading remedies for mis-statements in a prospectus.

What is an Untrue Statement?

It is essential to know as to what constitutes an untrue statement. To protect the interests of prospective investors in the shares or debentures of a company, the law ascribes a wider meaning to this term. Whether a statement is untrue or not is to be judged by the context in which it appears and the totality of impression it would create. Thus, Section 65 of the Act provides that a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included.

It also provides that where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included.

The expression "Included" with reference to a prospectus means included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith. Even if every word included in the prospectus is true, the suppression of material facts may cause the prospectus to be fraudulent. In *Ren v. Kysant* (1932) 1 K B 422, one of the Statements in a prospectus disclosed that dividend was paid for a number of years which was true but the prospectus did not mention that dividends was paid out of capitalized profits. This being a material fact, the prospectus was held to be false.

Onus for Proof of Mis-statement

The burden of proof in a suit by an allottee that he has been misled by the mis-statement in the prospectus lies on the allottee. He must prove the following:

- (i) The misrepresentation was of a fact;
- (ii) It was in respect of a material fact. What is a material statement of fact will depend upon the circumstances of each case.
- (iii) He acted on the misrepresentation; and
- (iv) He suffered damages in consequence.

17. REMEDIES FOR MISREPRESENTATION IN PROSPECTUS

A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company, e.g., the Board of directors. The company is also liable for misstatement in prospectus even though the prospectus is issued by the promoters & the Board ratifies and adopts the issue of prospectus

The first remedy against the company is to rescind the contract. A person who takes shares on the faith of a prospectus containing false statements, may apply to the Court for setting contract aside, and striking off his name from the register of members. He may also claim his money back. But the allottee must act within a reasonable time, before any proceedings to wind up the company have been

commenced, and before he does anything after notice of misrepresentation which is inconsistent with the right to rescind. He will lose his right to rescind if he attempts to sell the shares or attends a general meeting of the company, or receives dividends.

The second remedy against the company is to sue for damages for deceit. This suit is founded on the tort of deceit, and is not a case of fraud on the part of directors or promoters. The allottee may recover damages from the company for any loss he may have suffered if the invitation to take shares is emanating from the company and the persons making it on behalf of the company have fraudulently mis-represented material facts. The allottee cannot both retain the shares and get damages against the company. In actual practice, however, suits for damages against the company are rarely filed. Damages are generally claimed from the directors, promoters and other persons who authorised the issue of the prospectus.

Remedies against Directors or Promoters

A person who subscribed for shares on the faith of a false prospectus may claim from directors or promoters:

- (i) damages for fraudulent misrepresentation,
- (ii) Compensation under Section 62 of the Act,
- (iii) Damages for non-compliance with the requirements of Section 56 of the Act.

(i) Damages for fraudulent misrepresentation

An allottee may sue the director for damages for deceit, if there are fraudulent misrepresentations in the prospectus. But the directors will not be liable for damages for mis-statement if they believed them to be true [*Derry v. Peek*, (1889) 14 AC 337].

A tramway company incorporated by a Special Act had power to move its tramways by animal power and with the consent of the Board of Trade by steam power. A prospectus was issued by the directors stating that the company, under the Special Act, had the right to use steam power. P took shares on the strength of this statement. Afterwards, the Board of Trade refused its consent, and the company was wound up. P sued the directors for damages for fraud. Held, the directors were not liable, since the statement as to steam power had been made in the honest belief that it was true. The promoters were under the impression that once the Act of Parliament authorised the use of steam, the consent of the Board of Trade would be practically concluded.

(ii) Compensation for untrue Statement (Section 62)

An allottee is also entitled to claim compensation from directors, promoters and any other persons who authorised the issue of the false prospectus, for damages sustained by reason of any untrue statement in it. The following persons are liable to pay compensation for loss or damage sustained by reason of untrue statement included in a prospectus:

- (i) every person who is a director of the company at the time of issue of prospectus;
- (ii) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time;

- (iii) every person who is a promoter of the company; and
- (iv) every person who has authorised the issue of the prospectus;
 Provided where a person named in the prospectus has given a consent in the manner required for the issue of prospectus, shall not, by reason of having given such consent, be liable as a person who has authorised the issue of prospectus except in respect of untrue statement, if any, purporting to be made by him as an expert [Section 62(1)].

When civil liability of a Director can be avoided [Section 62(2)]

No person shall be liable for civil action if he proves:

- (i) That having consented to become a director he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- (ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or
- (iii) that after the issue of prospectus and before allotment there-under, he on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and of the reason therefore; or
- (iv) that as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did up to the time of allotment of shares or debentures believe, that the statement was true; and
- (v) that as regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was correct and fair representation of the statement, or a correct copy and fair extract from the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that person had given the consent required by Section 58, to the issue of prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration, or, before allotment thereunder; and
- (vi) that as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct copy of or correct and fair extract from the document:

Provided that the exceptions mentioned above shall not apply in the case of a person liable, by reason of his having a consent required of him by Section 58, as a person who has authorised the issue of the prospectus in respect of an untrue statement purporting to be made by him as an expert.

When an expert is not liable [Section 62(3)]

A person who, would be liable by reason of his having given a consent required of him by Section 58 as a person who has authorised the issue of a prospectus in respect of an untrue statement purporting to be made by him as an expert, shall not

be so liable, if he proves that:

- (a) having given his consent under Section 58 to the issue of the prospectus he withdrew it in writing before delivery of a copy of the prospectus for registration; or
- (b) after delivery of a copy of the prospectus for registration and before allotment thereunder, he, on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reason therefor; or
- (c) he was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, believe, that the statement was true.

When directors entitled to indemnify

Section 62(4) provides that where:

- (a) the prospectus specifies the name of a person as a director of the company, or as having agreed to become a director thereof, and he has not consented to become a director, or has withdrawn his consent before the issue of the prospectus, and has not authorised or consented to the issue thereof; or
- (b) the consent of a person is required under Section 58 to the issue of the prospectus and he either has not given that consent or has withdrawn it before the issue of the prospectus;

the directors of the company excluding those without whose knowledge or consent the prospectus was issued, and every other person who authorised the issue thereof, shall be liable to indemnify the person referred to in clause (a) or clause (b), as the case may be, against all damages, costs and expenses to which he may be made liable by reason of his name having been inserted in the prospectus or of the inclusion therein of a statement purporting to be made by him as an expert, as the case may be, or in defending himself against any suit or legal proceeding brought against him in respect thereof;

Provided that a person shall not be deemed for the purposes mentioned above to have authorised the issue of a prospectus by reason only of his having given the consent required by Section 58 to the inclusion therein of a statement purporting to be made by him as an expert.

- (c) *Section 62(5) provides that every person who becomes liable to make any payment as aforesaid may recover contribution, as in cases of contract, from any other person, who, if sued separately, would have been liable to make the same payment, unless the former person was, and the latter person was not guilty of fraudulent misrepresentation.*

(iii) Liability under Section 56

An omission from a prospectus of a matter required to be stated under Section 56 may give rise to an action for damages at the instance of a subscriber for shares, who has suffered loss thereby, even if the omission does not make the prospectus false or misleading. But the plaintiff must prove that he has sustained damage by reason of the omission of a matter required to be stated in the prospectus.

A director or other person sued under Section 56 may defend himself by showing:

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

TEST YOUR KNOWLEDGE

Choose the correct answer

A person who subscribed for shares on the faith of a false prospectus may claim directors or promoters the following damages:

- (a) Damages for fraudulent misrepresentation
- (b) Compensation for untrue statement.
- (c) Damages for non-compliance with the requirements of section 56 of the Act.
- (d) All of the above

Correct answer: d

Criminal Liability for Mis-statement in Prospectus

According to Section 63 of the Companies Act, 1956, where a prospectus includes any untrue statement, every person who has authorised the issue of the prospectus shall be punishable with:

- (a) Imprisonment for a term which may extend to two years; or
- (b) Fine which may extend to Rs. 50,000; or
- (c) Both (a and b).

However, where a person who has authorised the issue of prospectus proves, either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of issue of prospectus believe, that the statement was true, may be relieved from the criminal liability.

According to Sub-section (2) of Section 63, an expert who has given the consent as required by Section 58 shall not be deemed for the purpose of Section 63, to have authorised the issue of prospectus.

Who is entitled to remedies?

The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has "subscribed" for shares or debentures on the faith of the prospectus containing untrue statement. The word 'subscribed' denotes that the shares were acquired directly from the company by allotment. A subsequent purchaser of shares in the open market has no remedy against the company or the directors or promoters. Also, a subscriber to the memorandum cannot seek relief, as the company cannot be said to be in existence when he signed the memorandum, and he cannot be said to have been influenced by any statement, in the prospectus. Again, liability under a prospectus can only arise when the prospectus has been issued, and only in favour of persons who subscribe for shares in response to it and relied upon the statement made therein.

If, however, a prospectus is issued with the object of inducing persons to buy shares in the open market, any person who buys on the strength of the false representation made in it, has a right of action for fraudulent misrepresentation against the company. But the purchaser must have been directly induced by the false statement in the prospectus and nothing else. Two cases may be noted:

- (i) In *Peek v. Gurney* (1873) 43 L.J. Ch. 19, a deceitful prospectus was issued by the directors on behalf of the company. P received a copy of it but did not take any shares originally in the company. The allotment of shares to applicants was completed, and several months afterwards he bought 2,000 shares on the stock exchange. His action against the directors for deceit was rejected. It was observed by the Court that the office of a prospectus is to invite persons to become allottees, and, allotment having been completed, such office is exhausted and liability to allottees does not follow the shares into the hands of subsequent transferees.
- (ii) In *Andrews v. Mockford* (1869) I.Q.B. 372, the directors sent to A, a prospectus of the company which they knew would be a sham in order to induce A to purchase shares therein. A did not subscribe for the shares at that time. The prospectus, having produced but a scanty subscription for shares, the directors thereupon fraudulently published a telegram in newspaper. A believing in the truth of the telegram was induced to purchase shares in the open market. The directors were held liable for the systematic fraud. "The function of the prospectus was not exhausted, and the false telegram was brought into play by defendants to reflect back upon and countenance the false statements in the prospectus."

Further, by reason of the decision of the House of Lords in *Hedley Byrne Co. v. Hellers & Partners*, (1964) A.C. 465, a person may become liable for holding out a false statement to any one whom he knew or ought to have known would act in reliance upon the statement.

TEST YOUR KNOWLEDGE

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

The allottee can retain the shares and get damages against the company.

- True
- False

Correct answer: False

The allottee cannot both retain the shares and get damages against the company.

18. PENALTY FOR FRAUDULENTLY INDUCING TO INVEST MONEY (SECTION 68)

Any person who either knowingly or recklessly making any False, deceptive or misleading statement or make false Promise or forecast or dishonestly conceal some material fact, inducing another person to enter into or to offer to enter into:

- (a) Any agreement for or with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures; or
- (b) Any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures or by reference to fluctuations in the value of shares or debentures.

shall be Punishable with imprisonment up to 5 years or fine up to Rs 1, 00, 000 (One Lakhs) or both

Additional criminal liability of imprisonment up to 5 years or fine up to Rs. 1,00,000 or both is provided by Section 68 against any person who, either knowingly or recklessly has made a false, deceptive or misleading statement, promise or forecast or had by dishonestly concealing material facts, induced another person to enter into, or to offer to enter into:

- (a) Any agreement for or with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures; or
- (b) Any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures or by reference to fluctuations in the value of shares or debentures.

19. PROHIBITION OF ALLOTMENT OF SHARES IN FICTITIOUS NAME [SECTION 68A (1)]

Any person who

- (a) Makes an application to a company for acquiring or subscribing for any shares therein under fictitious name; or
- (b) Induces a company to allot, or register any transfer of shares therein to him, or to any other person in a fictitious name.

Shall be punishable with imprisonment for a term which may extend to 5 years:

Section 68A (2)

The provisions of section 68A (1) must be prominently reproduced in every issue of a prospectus as well as in the forms of application for shares. This provision has been provided so as to disseminate the consequences of getting the shares allotted under fictitious name

Impersonation for the acquisition of shares has been made an offence punishable with imprisonment. Section 68A makes the following acts punishable with imprisonment for a term extending to 5 years:

- (a) Making an application to a company for acquiring or subscribing for any shares therein under fictitious name; or
- (b) Inducing a company to allot, or register any transfer of shares therein to him, or to any other person in a fictitious name.

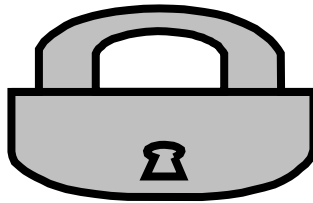
It is obligatory for every company to prominently display these provisions in every issue of a prospectus as well as in the forms of application for shares. The object of this penal provision is to eradicate the practice of allotting shares to fictitious or non-existing persons.

LESSON ROUND-UP

- Prospectus has been defined as any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.
- One of the ingredients of a prospectus is to make invitation to the public to subscribe for shares in or debentures of a body corporate which is construed as including a reference to any section of the public, whether selected as members or debenture-holders of the company or as clients of the person issuing the prospectus. However, there are exceptions to it.
- All public companies either issue a prospectus or file a statement in lieu of prospectus. A private company as such does not produce either document.
- Companies Act provides provisions for dating and registration of prospectus.
- Shelf prospectus means a prospectus issued by any financial institution or bank for one or more issues of securities or class of securities specified in the prospectus.
- Red-herring prospectus means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.
- Companies Act and SEBI guidelines provide for contents and disclosures required in a prospectus.
- No application form can be issued for shares or debentures unless it is accompanied by a memorandum containing such salient features of prospectus as may be prescribed. There are, however, certain exceptions to this rule.
- The Companies (Central Government's) General Rules and Forms, 1956 provide for the salient features required to be included in the abridged prospectus. The Securities and Exchange Board of India (SEBI) have modified its guidelines regarding disclosure in the Abridged Prospectus and Letter of Offer to include certain additional items.
- In addition to the compulsory particulars, any other information may be, and usually is, volunteered.
- It is the duty of those who issue the prospectus to be truthful in all respects.
- An offer for sale is a prospectus, within the meaning of the Act, and it is deemed to have been issued by the company.
- A prospectus must be complete and perfect in all details or in other words nothing should be omitted and nothing must be untrue in a prospectus. Where an untrue statement occurs in a prospectus, there may arise (i) civil liability (ii) criminal liability. Every person who is a director of the company at the time of the issue of the prospectus, every promoter of the company and every person, including an expert, who has authorised the issue of a prospectus, shall be liable.

- The burden of proof in a suit by an allottee that he has been misled by the misstatement in the prospectus lies on the allottee.
- A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company. The company is also liable if though the prospectus is issued by the promoters, the Board ratifies and adopts the issue.
- A person who subscribed for shares on the faith of a false prospectus may claim from directors or promoters damages for fraudulent misrepresentation, compensation, damages for non-compliance with the requirements of the Act.
- Where a prospectus includes any untrue statement, every person who has authorised the issue of the prospectus shall be punishable with imprisonment, fine or both.
- The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has subscribed for shares or debentures on the faith of the prospectus containing untrue statement.
- Additional penalty is also leviable under the Act for fraudulently inducing to invest money.
- Impersonation for the acquisition of shares has been made an offence under the Companies Act, punishable with imprisonment.

SELF-TEST QUESTIONS



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

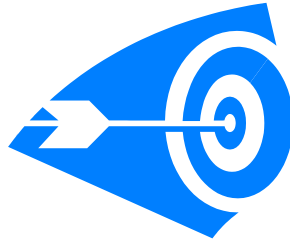
1. What is a prospectus? Is the issue of a prospectus compulsory on the part of a company?
2. What amounts to a misstatement in a prospectus? What are the remedies available to a subscriber who has taken shares on the basis of a misstatement in a prospectus?
3. Discuss the liability of a company for untrue statements or omissions in its prospectus.
4. Discuss the civil as well as criminal liability of persons who authorise the issue of a false prospectus.
5. Explain the legal provisions relating to issue and registration of a prospectus?
6. What are the remedies open to an allottee of shares who have had applied for them on the faith of a false and misleading prospectus and what are the

defenses available to the directors of the company who have issued such a prospectus?

7. Discuss in detail the contents and the form of a prospectus.
 8. Who is deemed to be an expert in relation to the prospectus of a company? What conditions must be satisfied before a report by an expert can be published therein? Is there any remedy available to the allottee of the shares who has been induced to take shares on the faith of an untrue statement of an expert in the prospectus?
 9. 'Prospectus is the window through which company is displayed without distortion'. — Comment. Distinguish a prospectus from statement in lieu of prospectus.
 10. Write short notes on:
 - (a) Statement in lieu of prospectus;
 - (b) Registration of a prospectus.
 - (c) Shelf prospectus.
 - (d) Information Memorandum.
 - (e) Red-herring prospectus.
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STUDY IX
FINANCIAL STRUCTURE AND MEMBERSHIP-IV
DEBT CAPITAL

LEARNING OBJECTIVES



This lesson explains the borrowing powers of the company and the various types of charges on the company's property. Work involved in raising of working capital from banks and raising loans from financial institutions and debentures, their characteristics and issues and redemptions, along with reissue of redeemed debentures is also discussed herein. The lesson also lists out the Developments in Corporate Debt Financing and the new instruments in Money Market.

At the end of this lesson, you should be able to understand:

- Borrowing power of the company.
- Unauthorized or ultra vires borrowing.
- Intra vires borrowing but outside the scope of agent's authority.
- Charge on uncalled capital, book debts.
- Promissory notes and bills of exchange.
- Types of borrowing.
- Work involved in relation to raising of working capital from banks and raising loans from financial institutions.
- Debentures: characteristics, kinds, debenture stock, debenture trust deed, debenture redemption reserve, issue of debentures.
- SEBI guidelines pertaining to issue of debentures.
- Register of debenture holders.
- Remedies open to debenture holders.
- Distinction between debenture and shares.
- Redemption of debentures and re-issue.
- Public sector bonds and foreign bonds, brokerage.
- Developments in corporate debt financing.
- New instruments in money market.

1. BORROWING

In order to run a business effectively/successfully, adequate amount of capital is

necessary. In some cases capital arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. External Commercial borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits, grant of annuities (Article 366(4) of the Constitution of India] etc.

Thus Borrowing is a mechanism used whereby the money is arranged through external resources with an implied or expressed intention of returning money.

Power of Company to Borrow

A company, like an individual, may have to borrow for the exigencies of its business. In practice, Articles of association of company give express power to a company for borrowing money by charging the assets of company as security to the lender. . The power of a company to borrow money is implied in the case of all trading companies. Non-trading companies, however, must be expressly authorized to borrow by their memorandum

Section 149(1) of the Companies Act provides that in case of a public company, borrowing powers are not exercisable until the company is entitled to commence business. In case of a private company, this is not the case. The power of the company to borrow is exercised by its directors, who cannot borrow more than the sum authorized. The powers to borrow money and to issue debentures can only be exercised by the Directors at a duly convened meeting. Pursuant to Section 292(1) (b) & (c) directors have to pass resolution at a duly convened Board Meeting to borrow moneys. The power can, however, be delegated by a resolution passed at a duly convened meeting of the directors to a committee of directors, managing director, manager or any other officer of the company. The resolution must specify the total amount up to which the moneys may be borrowed by the delegates Often the power of the company to borrow is unrestricted, but the authority of the directors acting as its agents is limited to a certain extent. For example, Section 293(1)(d) of the Act prohibits the Board of directors of a public company from borrowing a sum which exceeds the aggregate of the paid-up share capital of the company and its free reserves unless they have received the prior sanction of the company in general meeting.

It is further provided in Section 293(4) that the acceptance of deposits by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, shall not be deemed to be borrowing of moneys by the banking company within the meaning of clause (d) of Sub-section (1) of Section 293. It is important at this stage to distinguish between, borrowing which is *ultra vires* the company and borrowing which is *intra vires* the company but outside the scope of the director's authority.

The provisions of Sub-section (5) of Section 293 clearly lay down that debts incurred in excess of the limit fixed by clause (d) of Sub-section (1) shall not be valid unless the lender proves that he lent his money in good faith and without knowledge of the limit imposed by Sub-section (1) being exceeded.

Unauthorized or *Ultra Vires* Borrowing

Where a company borrows **without the authority conferred** on it by the articles or **beyond the amount set out in the Articles**, it is an *ultra vires* borrowing. **Any act**

which is ultra vires the company is void. In such a case the contract is void and the lender cannot sue the company for the return of the loan. The securities given for such ultra-vires borrowing are also void and inoperative. Ultra vires borrowings cannot even be ratified by a resolution passed by the company in general meeting. However, equity assists the lender where the common law fails to do so. If the lender has parted with his money to the company under an ultra vires borrowing, and is, therefore, unable to sue for its return, or enforce any security granted to him, he nevertheless has, in equity, the following remedies:

- (A) **Injunction and Recovery**_Under the equitable doctrine of restitution he can obtain an injunction provided he can trace and identify the money lent, and any property which the company has bought with it. Even if the monies advanced by the lender cannot be traced, the lender can claim repayment if it can be proved that the company has been benefited thereby.
- (B) **Subrogation:** Where the money of an ultra vires borrowing has been used to pay off lawful debts of the company, he would be subrogated to the position of the creditor paid off and to that extent would have the right to recover his loan from the company. Subrogation is allowed for the simple reason that when a lawful debt has been paid off with an ultra vires loan, the total indebtedness of the company remains the same. By subrogating the ultra vires lender the Court is able to protect him from loss, while debt burden of the company is in no way increased
- (C) **Suit against Directors**_In case of ultra vires borrowing, the lender may be able to sue the directors for breach of warranty of authority, especially if the directors deliberately misrepresented their authority [Executors v. Himphreys (1866) QBD 64].

***Intra vires* Borrowing but outside the Scope of Agents' Authority**

A distinction should always be made between a company's borrowing powers and the authority of the directors to borrow. Where the directors borrowed money beyond their authority and the borrowing is not ultra vires to the company, such borrowing is called *Intra vires* Borrowing but outside the Scope of Agents' Authority. The company will be liable to such borrowing if the borrowing is within the directors' ostensible authority and the lender acted in good faith or if the transaction was ratified by the company.

Where the borrowing is *intra vires* the company but outside the authority of the directors e.g. where the articles provide that the directors shall have the power only up to Rs.100 lacs and prior approval of the shareholders would be required to borrow beyond Rs. 100 lacs; any borrowing beyond Rs. 100 lacs without shareholders approval i.e. ultra vires the directors can be ratified by the company and become binding on the company. The company would be liable, particularly if the money has been used for the benefit of the company. Here the legal position is quite clear. The company has power or capacity to borrow, but the authority of the directors is restricted either by the articles of the company or by the statute, and they have exceeded it. The company may, if it wishes, ratify the agent's act in which case the loan binds the company and the lender as if it had been made with company's authority in the first place.

On the other hand, the company may refuse to ratify the agent's act. Here the

normal principles of agency apply. The doctrine of Indoor Management (also known as rule in *Royal British Bank v. Turquand* (1856) CI & B 327) shall protect the lender, provided he can establish that he advanced the money in good faith. A third-party who deals with an agent knowing that the agent is exceeding his authority has no right of action against the principal. Bearing in mind that the memorandum and articles are public documents, the contents of which the third-party is deemed to know, he will obviously have no right of action against the company if the agent's lack of authority is obvious from reading them. But a third-party is not effected by secret restrictions on the agent's authority, as the lack of authority is not clear from the public documents and the lender can not be aware of it from some other source. Therefore, the company will be liable.

Judicial Pronouncement relating to borrowing power of a company

- (A) '**Borrowing**' necessarily implies repayment at some time and under some circumstances [*Re. Southern Brazilian Rio* (1905) 2 Ch. 78].
- (B) Where the directors mortgaged the company's property exceeding the limits of their authority, it was held that the lending bank was entitled to retain possession and to claim institution before it could be compelled to surrender possession [*Deonarayan Prasad Bhadani v. Bank of Baroda Ltd.* (1957) 27 Com. Cases 223, 239 (Bom.)].
- (C) The behaviour of the directors, as the company's agents, can have no effect whatsoever on the validity of the loan for no agent can have more capacity than his principal. No agent can have a power which is not with the principal. If, therefore, the borrowing is ultra vires the company so that the company has no capacity to undertake it, the lender can have no rights at common law. No debt is created and any security which may have been created in respect of the borrowing is also void. The lender cannot sue the company for the repayment of the loan. [*Sinclair v. Brouguham* (1914) 88 LJ Ch 465].
- (D) The power of a company to borrow money is implied in the case of all trading companies. [*General Auction Estate Co. v. Swith* (1891) Ch 432].
- (E) A power to borrow money cannot be implied [*Baronness Wenlork v. River Dee* (1885) 10 App Cas 354].
- (F) If the borrowing by the directors is ultra vires their powers, the directors may, in certain circumstances, be personally liable for damages to the lender, on the ground of the implied warranty given by them, that they had power to borrow [*Firbank's Executors v. Humphreys*, (1886) 18 QBD 54; *Garrard v. James*, 1925 Ch. 616].
- (G) Sometimes It happens that a power to borrow exists but is restricted to a stated amount, in such a case if by a single transaction an amount in excess is borrowed, only the excess would be ultra vires and not the whole transaction [*Deonarayan Prasad Bhadani v. Bank of Baroda*, (1957) 27 Com Cases 223 (Bom.)].
- (H) The acquiescence of all shareholders in excess loans contracted by directors beyond their powers but not ultra vires the powers of the company would be sufficient to validate such excess debts. [*Sri Balasaraswathi Ltd. v. Parameswara Aiyar*, (1956) 26 Com Cases 298, 308: AIR 1957 Mad 122].

- (I) If the borrowing is unauthorized, the company will be liable to repay, if it is shown that the money had gone into the company's coffers [*Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.*, (1957) 27 Com Cases 660: AIR 1957 All 311].
- (J) In *V.K.R.S.T Firm v. Oriental Investment Trust Ltd.*, AIR 1944 Mad 532 under the authority of the company, its managing director borrowed large sums of money and misappropriated it. The company was held liable stating that where the borrowing is within the powers of the company, the lender will not be prejudiced simply because its officer have applied the loan to unauthorised activities provided the lender had no knowledge of the intended misuse.
- (K) In *T.R. Pratt. (Bom) Ltd. v. E.D. Sassoon and Co. Ltd.*, (1936) 6 Comp. Cas. 90, there was no limit on the borrowing for business in the memorandum of the company. But the directors could not borrow beyond the limit of the issued share capital of the company without the sanction of the general meeting. The directors borrowed money from the plaintiff beyond their powers. It was held that the money having been borrowed and used for the benefit of the principal either in paying its debts, or for its debts, or for its legitimate business, the company cannot repudiate its liability on the ground that the agent had no authority from the company to borrow. When these facts are established a claim on the footing of money had been received would be maintainable. It was also held that under the general principle of law when an agent borrows money for a principal without the authority of the principal, but if the principal takes benefit of the money so borrowed or when the money so borrowed have gone into the coffers of the principal, the law implies a promise to repay. In that connection it was observed that there appears to be nothing in law which makes this principle inapplicable to the case of a joint stock company and even in cases where the directors or the managing agent had borrowed money without there being authorization for the company, if it has been used for the benefit of the company, the company cannot repudiate its liability to pay.
- (L) In *Equity Insurance Co. Ltd. v. Dinshaw & Co.*, AIR 1940 Oudh 202, it was held that "where the managing agent of a company who is not authorised to borrow, has borrowed money which is not necessary, neither bona fide, nor for the benefit of the company, the company is not liable for the amount borrowed".
- (M) In *Suraj Babu v. Jaitly & Co.* AIR 1946 All 372, P & Co., were the managing agents of L & Co., which was in liquidation. P the manager borrowed a sum of money from J in his own name. In one letter to J he indicated that the loan was for a requirement of L & Co. and that company had actually benefited. It was held that there was no intention to bind the company. "The mere fact that the company had benefited was not in itself sufficient to bind the company".
- (N) In *Krishnan Kumar Rohatgi and Others v. State Bank of India and Others*, (1980) 50 Comp. Cas 722, the company borrowed an amount of Rs. 5 lakhs from the Bank under a Promissory Note. The repayment was guaranteed by a person by executing a guarantee in favour of the company. The company used to make payments towards loan and the promissory note used to be

renewed from time to time. In the suit for recovery, the company contended that the pro- note was executed by the Chairman without there being a resolution of the Board of directors authorizing the Chairman to execute the pro-note as required under Section 292(1)(c) of the Act. Rejecting these contentions the Patna High Court held that in cases where the directors borrow funds without their having authorization from the company and if the money has been used for the benefit of the company, the company cannot repudiate its liability to repay. Under the general principles of law, when an agent borrows money for a principal without the authority of the principal but the principal takes the benefit of the money so borrowed or when the money so borrowed has gone into the coffers of the principal, the law implies a promise to be paid by the principal.

TEST YOUR KNOWLEDGE

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

Ultra vires borrowings can be ratified by a resolution passed by the company in a general meeting.

- True
- False

Correct Answer: False

Ultra vires borrowings cannot even be ratified by a resolution passed by the company in a general meeting.

TYPES OF BORROWINGS

A company uses various kinds of borrowing to finance its operations. The various types of borrowings can generally be categorized into: 1) Long term/short term borrowing, 2) Secured/unsecured borrowing, 3) Syndicated/ Bilateral borrowing and Private/Public borrowing

- 1A. **Long Terms Borrowings** - Funds borrowed for a period ranging for five years or more are termed as long-term borrowings. A long term borrowing is made for getting a new project financed or for making big capital investment etc. generally Long term borrowing is made against charge on fixed Assets of the company
- 1B. **Short Term Borrowings** - Funds needed to be borrowed for a short period say for a period up to one year or so are termed as short term borrowings. This is made to meet the working capital need of the company. Short term borrowing is generally made on hypothecation of stock and debtors.
- 1C. **Medium Term Borrowings** - Where the funds to be borrowed are for a period ranging from two to five years, such borrowings are termed as medium term borrowings. The commercial banks normally finance purchase of land, machinery, vehicles etc.
- 2A **Secured/unsecured borrowing:** A debt obligation is considered secured, if creditors have recourse to the assets of the company on a proprietary basis or otherwise ahead of general claims against the company.

- 2B **Unsecured debts comprise** financial obligations, where creditors do not have recourse to the assets of the company to satisfy their claims.
- 3A **Syndicated borrowing** if a borrower requires a large or sophisticated borrowing facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. The borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate loans, each with different terms and conditions.
- 3B **Bilateral borrowing** refers to a borrowing made by a company from a particular bank/financial institution. In this type of borrowing, there is a single contract between the company and the borrower.
- 4A **Private borrowing** comprises bank-loan type obligations whereby the company takes loan from a bank/financial Institution
- 4B **Public borrowing** is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter, with few if any restrictions i.e. Debentures, Bonds etc.

Borrowing on Security of Property

The power to borrow includes the power to give security, which may take the form of a mortgage, a charge, hypothecation, lien, guarantee, pledge etc. The creditor's position becomes safer when security is given, for he will not only be able to sue the company for the amount of money which he has lent to it, but he will also be able to enforce his security, i.e., claim that the property charged belongs to him to the extent of the total amount due to him.

A loan taken by a company may be secured by any of the following:

- (a) A legal mortgage of specific part of its property;
- (b) An equitable mortgage by deposit of title deeds;
- (c) A mortgage of movable property;
- (d) Issuing Bonds;
- (e) Issuing Promissory notes and bills of exchange;
- (f) A charge on uncalled capital;
- (g) A charge on calls made but not paid;
- (h) A floating charge on the assets of the company;
- (i) Issuing Debentures or debenture stock;
- (j) A mortgage of book debts (but not of book);
- (k) A charge on a ship or any share in a ship;
- (l) A charge on goodwill or a patent or a license under a patent, or a trade mark, or on a copyright;
- (m) A pledge of goods.

Charge on Uncalled Capital

A company does not have implied power of charging its uncalled share capital and

a company may charge its uncalled capital if its articles or memorandum authorise it to charge it. The memorandum may give an express power to charge uncalled capital, or the power may be so wide that it can be inferred by implication. For example, in *Newton v. Debenture holders of Anglo-Australian Investment Co.*, (1895) A.C. 224, the memorandum authorised the company to borrow “upon any security of the company”. It was held that the power was wide enough to include a charge on uncalled capital. However, a company cannot mortgage or charge any part of its “reserve capital”, i.e., such portion (if any) of its uncalled capital as is incapable of being called up except in the event of winding up of the company (Sections 98 and 99).

TEST YOUR KNOWLEDGE

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

A company has implied power to mortgage its uncalled capital.

- True
- False

Correct Answer: False

3. DEBENTURES

A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan and most commonly (but not necessarily) secured by a charge. A document which, either creates a debt or acknowledges it, is a debenture. It is an evidence of a debt to the holder, which is normally but not necessarily secured by a charge over the property. It is an acknowledgement of (or an instrument) a debt by a company to some person or persons. It does not carry any voting rights at any general meeting of the company (Section 117).

Characteristics of Debentures

The usual features of a debenture are as follows:

1. A debenture is usually in the form of a certificate (like a share certificate) issued under the common seal of the company.
2. The certificate is an acknowledgement by the company of its indebtedness to a holder.
3. A debenture usually provides for the payment of a specified principal sum at a specified date. But that is not essential. A company may issue perpetual or irredeemable debentures with no undertaking to pay. Section 120 of the Act states that debentures are not invalid simply because they are made irredeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long.
4. A debenture usually provides for payment of interest until the principal sum is paid back.
5. A debenture is, as a rule, one of a series, although a single debenture is not uncommon. There may be a single debenture issued to one person.
6. A debenture generally contains a charge on an undertaking of the company, or

on some class of its assets or on some part of its profits. Again, this is not an essential element. A debenture which creates no such charge is perfectly valid.

7. The debentures carry no voting rights at any meeting of the company (Section 117).
8. Fixed deposit is not debenture — The Department of Company Affairs has clarified that a fixed deposit receipt may be regarded as a security but not as a debenture within the meaning of this sub-section [Department's Letter No. 8/2/58-PR, dated 10-12-1958].

Judicial Pronouncement about Debentures

The following kinds of documents have been held to be treated as debentures

- (A) A legal mortgage of freehold and leasehold land, [*Knightsbridge Estates Trust Ltd. v. Byrne*, 1940 AC 613: (1940) 2 All 401];
- (B) A series of income-bonds by which a loan to the company was repayable only out of its profits [*Lemon v. Austin Friars Investment Trust Ltd.* 1926 Ch 1 (CA)];
- (C) A note by which a company undertook to pay a loan but gave no security, [*British India Steam Navigation Co. v. IRC*, (1881) 7 QBD 165];
- (D) A receipt or a certificate for a deposit made with a company (other than a bank) when the deposit was repayable after a fixed period after it was made, [*United Dominions Trust Ltd. v. Kirkwood*, (1966) 2 QB 43].
- (E) The definition of debenture is so wide as to include any security of a company whether constituting a charge on the company's assets or not [*Cf. Pearl Assurance Co. Ltd. v. West Midlands Gas Board*, (1950) 2 All ER 844 (ChD)].

TEST YOUR KNOWLEDGE

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

A debenture is necessarily secured by a charge.

- True
- False

Correct Answer: *False*

TEST YOUR KNOWLEDGE

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

A fixed deposit receipt may be regarded as a security as well as a debenture.

- True
- False
- Correct Answer: *False*

The Department of Company Affairs has clarified that a fixed deposit receipt may be regarded as a security but not as a debenture.

***Pari Passu* Clause in case of Debentures**

Debentures are usually issued in a series with a *pari passu* clause and it follows that they would be on an equal footing as to security and should the security be enforced, the amount realised shall be divided pro-rata, i.e. they are to be discharged rateably. In the event of deficiency of assets, they will abate proportionately. The expression '*pari passu*' implies with equal step, equally treated, at the same rate, or at par with. When it is said that existing debentures shall be issued *pari passu* clause, it implies that no difference will be made between the old and new debentures.

If the words *pari passu* are not used, the debentures will be payable according to the date of issue, and if they are all issued on the same day, they will be payable accordingly to their numerical order. However, a company cannot issue a new series of debentures so as to rank *pari passu* with prior series, unless the power to do so is expressly reserved and contained in the debentures of the previous series.

Kinds of Debentures

Debentures are generally classified into different categories on the basis of: (1) convertibility of the instrument (2) Security of the Instrument, (3) Redemption ability (4) Registration of Instrument

1. On the basis of convertibility Debentures may be classified into following categories:
 - (A) **Non Convertible Debentures (NCD):** These instruments retain the debt character and can not be converted in to equity shares.
 - (B) **Partly Convertible Debentures (PCD):** A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.
 - (C) **Fully convertible Debentures (FCD):** These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.
 - (D) **Optionally Convertible Debentures (OCD):** The investor has the option to either convert these debentures into shares at price decided by the issuer/agreed upon at the time of issue.
2. On basis of Security, debentures are classified into:
 - (A) **Secured Debentures:** These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails on payment of either the principal or interest amount, his assets can be sold to repay the liability to the investors
 - (B) **Unsecured Debentures:** These instrument are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor has to be along with other unsecured creditors of the company. they are also said to be naked debentures

3. On basis of Redeemability, debentures are classified into:
 - (A) **Redeemable Debentures:** It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice, or under a system of periodical drawings. Debentures are generally redeemable and on redemption these can be reissued or cancelled. The person who has been re-issued the debentures shall have the same rights and priorities as if the debentures had never been redeemed.
 - (B) **Perpetual or Irredeemable Debentures:** A Debenture, in which no time is fixed for the company to pay back the money, is an irredeemable debenture. The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation.
4. On the basis of Registration, debentures may be classified as
 - (A) **A Registered Debentures:** Registered debentures are made out in the name of a particular person, whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders. Such debentures are transferable in the same manner as shares by means of a proper instrument of transfer duly stamped and executed and satisfying the other requirements specified in Section 108 of the Act.
 - (B) **Bearer debentures:** Bearer debentures on the other hand, are made out to bearer, and are negotiable instruments, and so transferable by mere delivery like share warrants. The person to whom a bearer debenture is transferred become a "holder in due course" and unless contrary is shown, is entitled to receive and recover the principal and the interest accrued thereon. [*Calcutta Safe Deposit Co. Ltd. v. Ranjit Mathuradas Sampat* (1971) 41 Comp. Cas 1063].

4. PUBLIC COMPANIES (TERMS OF ISSUE OF DEBENTURES AND OF RAISING OF LOANS WITH OPTION TO CONVERT SUCH DEBENTURES OR LOANS INTO SHARES) RULES, 1977

In exercise of the powers conferred by Section 642 read with clause (a) of the proviso to sub-clause (3) of Section 81 of the Companies Act, 1956 the Central Government hereby makes the following rules, namely:

1. Short title and commencement:
 - (i) These rules may be called the Public Companies (Terms of and issues of Debentures and Raising of Loans with Option to Convert such Debentures or Loans into Shares) Rules, 1977.
 - (ii) They shall come into force on the date of their publication in the Official Gazette.
2. Definitions:

In these rules, unless the context otherwise requires:

 - (a) 'Act' means the Companies Act, 1956;

- (b) "Public financial institution" means:
 - (i) Any of the financial institutions specified in Sub-section (1) of Section 4A of the Act;
 - (ii) Any of the other institutions specified by the Central Government to be public financial institutions under Sub-section (2) of the said Section 4A.
- (c) 'Scheduled Bank' means a bank included in the Second Schedule to the Reserve Bank of India Act, 1934, but does not include co-operative banks, regional rural banks and foreign banks.*

3. Particulars regarding the terms of issue of debentures or the terms of raising of loans by a public company.

The terms of issue of debentures or the terms of raising of loans by a public company which include a term providing for an option to convert such debentures or loans or any part thereof into shares in the company or to subscribe for shares in the company shall not require the approval of the Central Government under clause (a) of the proviso to Sub-section (3) of Section 81 of the Act, if such terms conform to the following requirements, namely:

- (a) the debentures or loans may be issued or raised either through private subscription or through the issue of a prospectus to the public;
- (b) a public financial institution or scheduled bank either underwrites or subscribes to or sanctions the whole or part of the issue of debentures or the raising of loans, as the case may be;
- (c) When and where necessary, the consent of the Central Government under the provisions of the Capital Issues (Control) Act, 1947 (20 of 1947), is obtained for the issue of shares consequent upon the conversion of debentures or loans into equity capital; [Consequent upon abolition of controller of capital issues and deletion of the CIC Act, 1947, and establishment of the Securities and Exchange Board of India under the Securities and Exchange Board of India, Act, 1992, the SEBI (Disclosure and Investor Protection) Guidelines should be followed and complied with for issuing shares consequent upon the conversion of debentures or loans into equity capital.
- (d) Having regard to the financial position of the company the terms of the issue of the debentures or the terms of the loans, as the case may be, the rate of interest payable on the debentures or loans, the capital of the company, its loans, liabilities, its reserves, its profits during the immediately preceding five years and the current market price of the shares of the company, as may be applicable, the public financial institutions or scheduled banks as the case may be, provide for the terms including the term providing for an option to convert such debentures or loans or any part thereof, into shares in the company or to subscribe for shares therein, either at par or at a premium not exceeding twenty-five percent of the face value of the shares.

Provided that a public financial institution or a scheduled bank shall not convert all or any part of such debentures or loans unless:

- (a) The company that has issued the debentures or raised the loan, has defaulted in the repayment/redemption of, or payment of interest on, such loans or debentures; and

- (b) Such scheduled bank or public financial institution has given the company notice of its intention to convert such loans or debentures atleast 30 days prior to the intended date of conversion.

Public Financial Institutions

The following institutions have been specified as public financial institutions under Section 4A(1) of the Companies Act, 1956, and are relevant for the purposes of Rules 2(b) and 3 of the Public Companies (Terms of Issue of Debentures and Raising of Loans with option to Convert such Debentures into Shares) Rules:

1. The Industrial Credit and Investment Corporation of India Limited, a company formed and registered under the Companies Act, 1913 (7 of 1913);
2. The Industrial Finance Corporation of India established under Section 3 of the Industrial Finance Corporation Act, 1948 (15 of 1948);
3. The Industrial Development Bank of India, established under Section 3 of the Industrial Development Bank of India Act, 1964 (18 of 1964);
4. The Life Insurance Corporation of India, established under Section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);
5. The Unit Trust of India, established under Section 3 of the Unit Trust of India Act, 1963 (52 of 1963);
6. The Infrastructure Development Finance Company Ltd., a company formed and registered under this Act;

Besides, various other public financial institutions are specified by the Central Government under Section 4A (2) from time to time.

Debenture Stock

A company, instead of issuing debentures, each in respect of separate and distinct debt, may raise one aggregate loan fund or composite stock known as 'debenture stock'. Accordingly, a debenture stock is a borrowed capital consolidated into one mass for the sake of convenience. Instead of each lender having a separate bond or mortgage, he has a certificate entitling him to a certain sum being a portion of one large loan. It is generally secured by a trust deed. As in the case of shares, a person may subscribe for, or transfer any amount even a fraction amount. Debenture stock is the indebtedness itself, and the debenture stock certificate furnishes evidence of the title or interest of the holder in the indebtedness. Debenture is the document which furnishes evidence of the debt. Debenture stock must be fully paid, while debenture may or may not be fully paid.

Difference between Debenture and Debenture Stock - 'Debenture' is the description of an instrument, while 'debenture stock' is the description of a debt or sum secured by an instrument. In the words of LORD LINDLEY, it is "borrowed capital consolidated into one mass for the sake of convenience".

Distinction between Debenture and Loan - A debenture means a document which creates or acknowledges a debt. A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money [*Ram Ratan Karmarkar v. Amulya Charan Karmarkar*, 56 CWN 728 at p. 729].

5. Debenture Trust Deed

The Companies (Amendment) Act, 2000 had inserted Section 117A after Section 117 of the Companies Act, 1956, which provides that—

- (1) A trust deed for securing any issue of debentures shall be in such form and shall be executed within such period as may be prescribed.
- (2) A copy of the trust deed shall be open to inspection to any member or debenture holder of the company and he shall also be entitled to obtain copies of such trust deed on payment of such sum as may be prescribed.
- (3) If a copy of the trust deed is not made available for inspection or is not given to on demand by, any member or debenture holder, the company and the officer of the company who is in default shall be punishable for each offence, with fine which may extend to five hundred rupees for every day during which the offence continues.

A trust deed is one of several instruments required to be executed to secure redemption of debentures and payment of interest on due dates. The trust deed should be in the form and be executed within such period as may be prescribed. Besides, the SEBI (Debenture Trustees) Rules 1993 and the SEBI (Debenture Trustees) Regulations 1993 are applicable to the listed companies; the aforesaid Rules provide that a debenture trustee should be registered with SEBI by obtaining a certificate of registration in accordance with the conditions provided therein. The aforesaid Regulations 'inter alia' provide procedure for registration, responsibilities and obligations of debenture trustees and also prescribe contents of trust deed.

When a series of debentures are issued to numerous debenture holders, a trust deed is drawn up. Under the terms of the deed the company undertakes to pay the debenture holders their principal and interest, and normally charge its property as security and declares a trust in favour of the debenture holders. The properties of the companies are mortgaged or charged to trustees. When a trust deed is executed, many of the conditions endorsed on the debenture are embodied in the trust deed and the security is enforced by the trustee instead of by the debenture holders. The trustees are bound to exercise due care and diligence to protect the interests of the debenture holders.

Under Section 119 of the Act, trustees of the trust deed for debenture holders are made liable for breach of trust where they do not exercise due care and diligence required of them as trustees. Therefore, any term in the trust deed which exempts the trustee from his liability to indemnify for breach of trust is void and has no legal effect.

Advantages of Trust Deed

The trust deed has some advantages as follows:

- (a) If the company makes default, the trustees are then ready to take necessary steps, instead of leaving it to the initiative of some debentureholders.
- (b) The trustee is normally given the power to sell and thus realize the security without the aid of the Court.
- (c) The legal estate is vested in the trustee, and where necessary, the mortgage or charge is registered. This prevents a subsequent legal mortgage from priority.

- (d) The title deeds of the mortgaged property are deposited with trustees and the company is prevented from misusing these title deeds for any purpose.
- (e) The trustees ensure that the mortgaged property is kept insured and maintained in proper condition.

Appointment of Debenture Trustees and Duties of Debenture Trustees

Section 117B was inserted by Companies (Amendment) Act, 2000. As per this Section, no company shall issue a prospectus or a letter of offer to the public for subscription of its debentures, unless the company has, before such issue, appointed one or more debenture trustees for such debentures and the company has, on the face of the prospectus or the letter of offer, stated that the debenture trustee or trustees have given their consent to the company to be so appointed.

Provided that no person shall be appointed as a debenture trustee, if he —

- (a) Beneficially holds shares in the company;
- (b) Is beneficially entitled to moneys which are to be paid by the company to the debenture trustee;
- (c) Has entered into any guarantee in respect of principal debts secured by debentures or interest thereon.

The functions of the debenture trustees shall generally be to protect the interest of holders of debentures (including the creation of securities within the stipulated time) and to redress the grievances of holders of debentures effectively [Sub-section (2)]

As per Sub-section (3) in particular, and without prejudice to the generality of the foregoing functions, a debenture trustee may take such other steps as he may deem fit—

- (a) To ensure that the assets of the company issuing debentures and each of the guarantors are sufficient to discharge the principal amount at all times;
- (b) To satisfy himself that the prospectus or the letter of offer does not contain any matter which is inconsistent with the terms of the debentures or with the trust deed;
- (c) To ensure that the company does not commit any breach of covenants and provisions of the trust deed;
- (d) To take such reasonable steps to remedy any breach of the covenants of the trust deed or the terms of issue of debentures;
- (e) To take steps to call a meeting of holders of debentures as and when such meeting is required to be held.

Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Central Government and the Central Government may, after hearing the company and any other person interested in the matter, by an order, impose such restrictions on the incurring of any further liabilities as the Central Government thinks necessary in the interests of holders of the debentures [Sub-section 4)].

The duties of a debenture trustee has been described in detail in the Regulation 15 of the SEBI (Debenture Trustee) Regulations, 1993. On the appointment of a Debenture trustee, the above conditions are required to be complied with. Where the company is a listed company, the SEBI Regulations should also be followed.

Liability of Company to Create Security and Debenture Redemption Reserve

Section 117C was inserted by the Companies (Amendment) Act, 2000. According to this section —

- (1) Where a company issues debentures, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.
- (2) The amounts credited to the debenture redemption reserve shall not be utilized by the company except for the purpose aforesaid.
- (3) The company referred to in Sub-section (1) shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- (4) Where a company fails to redeem the debentures on the date of maturity, the Company Law Board may, on the application of any or all the holders of debentures shall, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.
- (5) If default is made in complying with the order of the Company law board under Sub-section (4), every officer of the company who is in default, shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than five hundred rupees for every day during which such default continues.

The debenture redemption reserve is required to be created for both, accrued and unaccrued debentures. In the case of partly-paid debentures, Debenture Redemption Reserve is to be created for non-convertible portion only.

Debenture Redemption Reserve (DRR)

- (i) Section 117C of the Act requires every company to create a DRR to which adequate amount shall be credited out of its profits every year until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only. There is no obligation on the part of the company to create DRR if there is no profit for that particular year. However, vide Circular No. 9/2002 dated 18th April, 2002, Department of Company Affairs (Now Ministry of Company Affairs) has clarified that:
 - (a) No DRR is required for debentures issued by AIFIs (All India Financial Institutes) regulated by Reserve Bank of India and banking companies for both public as well as privately placed debentures. For other FIs within the meaning of Section 4A of the Act, DRR will be as applicable to NBFCs registered with RBI.
 - (b) For NBFCs registered with the RBI under Section 45-IA of the RBI Act,

1997, the adequacy of DRR will be 50 per cent of the value of debentures issued through public issue as per present SEBI guidelines and no DRR is required in the case of privately placed debentures

- (c) For manufacturing and infrastructure companies, the adequacy of DRR will be 50 per cent of the value of the debentures issued through public issue and 25 per cent for privately placed debentures.
 - (d) Section 117C will apply to debentures issued and pending to be redeemed and as such DRR is required to be created for debentures issued prior to 13th December 2000 and pending redemption subject to clarifications issued herein.
 - (e) Section 117C will apply to non-convertible portion of debentures issued whether they are fully or partly convertible.
- (ii) DCA (Now Ministry of Company Affairs) has clarified that for housing finance companies registered with the National Housing bank under Housing Finance Companies ("NHB") Directions, 2001 adequacy of DRR will be 50% of the value of debentures issued through public issues. No DRR is required in the case of privately placed debentures. (Circular No. 4/2003 dt. 16.2.03).

Issue of Debentures

The power to issue debentures is usually set out in the memorandum. The debentures can be issued in the same manner as shares in a company. But unlike shares, they can be issued at a discount without any restriction, if articles so authorise, the reason being that they do not form part of the capital of the Company. They can also be issued at a premium. The Companies Act, 1956 places no restriction in this regard. Interest payable on them is a debt and can be paid out of capital. There is no ceiling, minimum or maximum, for the rate of interest payable on debentures. Any rate of interest, though justifiable, can be paid on the debentures. Even zero rate of interest debentures can be issued. In the case of unsecured debentures which amount to be deposits, the rate of interest should be within the maximum limit prescribed by the Rules. All sums allowed by way of discount must be stated in every balance sheet of the company until written-off. Section 122 of the Act provides that specific performance of a contract to give debentures may be enforced by an order of the Court against the company and that the company may specifically enforce against anyone an agreement to take debentures. No company is permitted to issue debentures carrying voting rights at any general meeting of the company.

Where payment for debentures was to be made by instalments and on the debenture holder's failure to pay an instalment, the company had declared his debenture to be forfeited, the debenture ceased to be specifically enforceable. [*Kuala Pahi Rubber Estates v. Mowbray*, (1914) 111 LT 1072].

6. REGISTER OF DEBENTUREHOLDERS

Section 152 of the Act requires every company to keep a register of debenture holders giving the following particulars:

- (a) The name, address and occupation of each debenture holder;
- (b) The number of debentures held by each debenture holder together with their distinctive numbers except where such debentures are held with a depository and the amount paid or agreed to be considered as paid;

- (c) The date at which each person was entered in the register as a debenture holder; and
- (d) The date at which any person ceased to be a debenture holder.

Besides, face value, rate of interest, due date of payment of interest and redemption may also be stated.

As in the case of a register of members, a company having more than 50 debenture holders must keep an index of the names of the debenture holders unless the register is kept in such a form as to constitute itself an index. The register can be closed by the company after giving 7 days notice by advertisement for a period not exceeding 45 days in a year but not exceeding 30 days at a time. The register is open to inspection by the members and debenture holders and by any other person on payment of nominal charges.

7. REMEDIES OPEN TO DEBENTUREHOLDERS

Pursuant to Sub-section (3) of Section 117C, the company is bound to pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Under Sub-section (4) if a company fails to redeem the debentures on the date of maturity the Company law board may, on the application of anyone or all the holders of debentures, after hearing the parties concerned, direct by order, the company to redeem the debentures forthwith by the payment of principal and interest thereon.

Sub-section (5) provides that if default is made in complying with the order of the company law board, every officer of the company who is in default, shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than five hundred rupees for every day during which such default continues.

This remedy is made available to the holders of debentures whether they are secured or unsecured. Any debentureholder can apply to the Company Law Board for passing an order of payment the company which has defaulted. The Company Law Board shall, while issuing order to the company, take into account the circumstances under which it has failed to redeem the debentures and the order of the Company Law Board shall mention about the ways and means for redemption of the debentures by the company.

Besides, Section 274(1)(g) imposes a disqualification on the directors of a company which has failed to redeem its debentures on due date and such failure continues for one year or more. Such person shall not be eligible to be appointed as a director of any other public company for period of five years from the date from which the company has failed to redeem the debentures.

Secondly, the unsecured debentures amount to deposits under Section 58A of the Act. Section 372A(4) provides that the company, which has defaulted in complying with the provisions of Section 58A, shall not directly or indirectly (i) make any loan to any body corporate; (ii) give guarantee or provide security in connection with a loan made to a body corporate; and (iii) invest in securities of any other body corporate.

The remedies available to a debenture holder vary according to whether he is

secured or unsecured. Naturally, he will have wider protection if he is a secured creditor. Following remedies are available to debentureholders:

- (a) **Where the debentures are not secured:** If the principal or interest due in respect of any debenture which is not secured by a charge on any assets of a company is in arrears, the debentureholder as an unsecured creditor:
- (i) may sue the company for his principal and/or interest, obtain judgement, and, if the judgement debt is not paid, take execution proceedings against the company's property;
 - (ii) may, if he wishes, file petition under Section 439 for a winding up of the company by the Court.

- (b) **Where debentures are secured:** A secured debenture holder has both the above remedies. In addition, the following courses are also open to him:

- (i) He can exercise any of the powers which are given to him by the debentures trust deed, without applying to the court. Usually those powers include a power to appoint receiver, and a power to sell the company's property.
- (ii) He can apply to the court for the appointment of a receiver, if the conditions give him this power and those conditions are fulfilled.

A receiver can be appointed by a debentureholder when the document of appointment is handed to him by a person authorised to do so and the receiver accepts the appointment.

- (iii) He can apply to the court to foreclose the interest of the company in the assets charged. This order of foreclosure will terminate the interest of the company in the property and the debentureholder will become the owner. The order for foreclosure may extend even to the uncalled capital of the company [*Sadler v. Worley*, (1894) 2 Ch 170]. But this remedy is not usual, all the debentureholders of every class are parties to the action, *Continental Oxygen Co., Elias v. Continental Oxygen Co.*, (1897) 1 Ch 511.
- (iv) He can have the charged property sold through trustees if the debenture trust deed provides for such a sale and if the trustee has an express or implied power of sale out of court over the fixed assets.

The holder of one of a series of debentures cannot sell the property charged, unless the debentures contain an express power of sale [*Blanker v. Herts and Essex Waterworks Co.*, (1889) 41 Ch D 399].

A pledgee has a right to sell pledged property if the obligation secured by the pledge is not met [*Richardson Re* (1885) 30 Ch D 396 (CA); *Hardwick Re*, (1886) 17 QBD 690 (CA); *Morritt Re*, (1886) 18 QBD 222 (CA)].

A legal mortgagee of stocks and shares traded on the Stock Exchange has a right to sell them when the obligation secured by the mortgage is not met [*Wilson v. Tooker*, (1714) 5 Bro Parl Cas 193, HL L 2 EF 622];

- (v) If the company goes into winding up, the debenture holder can value his security and if it is insufficient, he can prove for the balance of his debt or he can give up the security and prove for the whole debt.

Debentureholder can present a petition for winding up as he is a creditor for the amount of his principal and interest, but not for any premium payable on redemption, unless the debenture expressly so provides. [*Consolidated Goldfields of South Africa v. Simmer and Jack East Ltd.*, (1913) 82 LJ Ch 214].

If a debentureholder owes a debt to the company which he is unable to pay, he cannot set off the debt against his claims with the company. He must first pay up everything he owes to the company and then claim his debts.

The rights of a debentureholder and the obligations, which the company has towards its debentureholders, depend essentially upon the terms of the agreement between the company and the trustees of such debentures. The debentureholders are beneficiaries under the debenture trust deed. In the circumstances although the remedy to enforce the debenture securities may vest in trustees, the debentureholders, as beneficiaries, would be entitled to enforce covenants [*Narotamdas T. Toprani v. The Bombay Dyeing & Mfg. Company Ltd. and Others*].

In *Four Maids Ltd. v. Dudley Marshal Properties Ltd.*, (1957) Ch 317 at 320, Harman J. observed "The mortgagee may go into possession before the ink is dry on the mortgage unless there is something in the contract, express or by implication, whereby he has contracted himself out of that right". The right of possession is exercisable whether or not the mortgage unless there is something in the contract, express or by implication whereby he has contracted himself out of that right. The legal chargeholder gets the legal title to the charged property and the right to possession is exercisable whether or not the mortgagor has defaulted. A mortgage in possession must account to the mortgagor for rents and profits which, but for the mortgagee's default or neglect he might have received. Therefore, a mortgagee is under very heavy liability when in possession of the mortgage property.

Debenture-holders' claim

A debentureholder can claim that:

- (1) the debentures are a charge on the assets;
- (2) that a receiver and manager be appointed;
- (3) that the debentures be enforced by sale or foreclosure.

The assets realised by a debentureholder's action are applied in the following order in case of a deficiency.

- (a) Costs incurred in realisation;
- (b) Remuneration of the receiver;
- (c) Trustees' remuneration;
- (d) Plaintiff's costs incurred in taking action;
- (e) Preferential creditors, if the debentures are secured by a floating charge; and the debentureholders.

Distinction Between Debentures and Shares

S. No	Debentures	Shares
1	Debentures constitute a loan.	Shares are part of the capital of a company
2	Debenture holders are creditors.	Shareholders are members/owners of the company
3	Debentures holder gets fixed Interest which carries a priorities over dividend	Shareholder gets dividends with a varying rate.
4	Debentures generally have a charge on the assets of the company	Shares do not carry any such charge.
5	Debentures can be issued at discount without restrictions	Shares can be issued at discount subject to some restrictions.
6	The rate of interest is fixed in the case of debentures	whereas on equity shares the dividend varies from year to year depending upon the profit of the company and the Board of directors decision to declare dividends or not
7	Debentureholders do not have any voting right.	Shareholders enjoy voting right
8	Interest on debenture is payable even if there are no profits i.e. even out of capital.	Dividend can be paid to shareholders only out of the profits of the company and not otherwise
9	Interest paid on debenture is a business expenditure and allowable deduction from profits	dividend is not allowable deduction as business expenditure
10	Return of allotment is not required for allotment of debentures	Return of allotment in e-Form No. 2 is to be filed for allotment of shares

Redemption of Debentures

The debentures which are redeemable are to be repaid by the company in accordance with the terms and conditions of issue. Debentures may be redeemed either out of the proceeds of a fresh issue of debentures or shares or by creating Debenture Redemption Reserve by setting aside certain sums out of annual profits of the company as provided under Section 117C of the Act. The debentures may be redeemed at the end of the period for which they are issued or they may be redeemed periodically by means of drawings by lots.

Re-issue of Redeemed Debentures

Under Section 121 of the Act, the company has powers to keep alive the redeemable debentures either by re-issuing the same debentures or by issuing fresh debentures in their place unless:

- (a) there is any provision to the contrary, whether express or implied contained in the articles/memorandum or in the conditions of issue or in any contract entered into by the company; or
- (b) the company has manifested its intention to cancel the debentures by a resolution to that effect or by some other act.

8. PUBLIC SECTOR BONDS

Pursuant to the announcement made by the Finance Minister in the Budget Session of Parliament in 1985, the Government evolved a scheme for flotation of bonds by telecommunication and power sector. Under the Scheme such of the Government corporate bodies as may be specified in area of telecommunication and power and any other section, as might be notified by the Government, were permitted to issue bonds for—

- (a) setting up of new projects; and/or
- (b) expansion or diversification of existing project; or
- (c) meeting normal capital expenditure for modernisation; or
- (d) for augmenting the long term resources of the company for working capital requirements.

In July 1986 the scheme was extended to other public sector enterprises. In pursuance of the announcement made by the Finance Minister in the Budget Session of Parliament in 1986, the Government introduced the scheme for issue of tax free bonds in addition to the earlier series of power and telecom bonds. In the new series the maximum rate of interest was 10% and the period of redemption upto 10 years which could be increased in suitable cases, as may be approved by the Government. The interest income from these bonds is completely free from income-tax. The bonds were also exempt from Wealth Tax without any limit. These bonds were also transferable by endorsement and delivery. The scheme provided for facility of buy back also. These bonds were required to be listed on Stock Exchanges.

The guidelines for issue of bonds as issued by Office of Controller of Capital Issues under the Ministry of Finance have now become obsolete in view of the repeal of Capital Issues Control Act. However, the SEBI guidelines for debentures equally apply to bonds as well. Besides, PSEs have to comply with the other administrative instructions issued by the Ministry of Finance from time to time.

As the bonds are transferable by endorsement and delivery, the provisions of Sub-section (1) of Section 108 of the Companies Act, 1956 in so far as the section requires a proper instrument of transfer to be duly stamped and executed by or on behalf of the transferor and by, on behalf of transferee do not apply to bonds issued by a Government company provided an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company alongwith the certificate relating to the Bond, and if no such certificate is in existence alongwith

letter of allotment of Bond [Deptt. of Company Affairs, Notification No. GSR 1294(E) dated 19.12.1986].

9. FOREIGN BONDS

Companies have now started floating issues in the Euro-bond market on borrowing instead of obtaining funds solely by issue of bonds in specific capital market.

Indian business enterprises can tap this source of raising foreign currency funds by issue of foreign bonds. In 1986, a new development in India's participation in global market was the floating of the India's Fund in the United Kingdom by the Unit Trust of India in collaboration with Merrill Lynch International Capital Managers. The India's fund was established to enable non-resident Indians and other persons or firms resident outside India to invest in the securities market in India through subscription to the shares of the fund.

Indian company can, with the approval of the Ministry of Finance, issue American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds.

10. DEVELOPMENTS IN CORPORATE DEBT FINANCING

The instruments used by the corporate sector to raise funds are selected on the basis of—

- (i) Investor's preference for a given instrument;
- (ii) the regulatory framework, where under the company has to issue the security.

Convertible debenture is the most popular instrument in the current scenario to raise funds from the markets. The tax liability of the company, the purpose for which the funds are required, debt servicing ability and willingness to broad base the shareholding of the company, all influence the choice of the instrument.

The salient features of new financial instrument which have emerged in the financial markets in recent years are given below:—

- (1) **Convertible capital issue:-** means the issue made in the form of partly or wholly convertible issue, with varying conversion terms and premium on par value of equity.
- (2) **Zero coupon bonds:-** refer to those bonds which are sold at a discount from its eventual maturity value and have zero interest rate.
- (3) **Shares with differential rights:-** signifies a share with differential right to vote dividend etc. The investor is compensated for renouncing the voting right through a higher rate of dividend than that on the conventional voting share.
- (4) **Secured Premium Notes with Detachable Warrants:-** SPN, which is issued along with detachable warrant, is redeemable after a notified period, say 4 to 7 years. The warrants attached to it ensure the holder the right to apply to get allotted equity shares, provided SPN is fully paid.
- (5) **Non-convertible Debentures with Detachable Equity Warrants:-** The

holder of NCDs with detachable equity warrants is given an option to buy a specific number of shares from the company at a predetermined price within a definite time frame.

- (6) **Zero Interest fully Convertible Debentures:-** The investors in zero interest fully convertible debentures will not be paid any interest.
- (7) **Equity Shares with Detachable Warrants:-** In this category, along with fully paid equity shares, detachable warrants are issued which will entitle the warrant holder to apply for a specified number of shares at a predetermined price.
- (8) **Fully Convertible Cumulative Preference Shares (Equipref):-** Equipref is a recent introduction in the market. It has two parts: A and B. Part A, is convertible into equity shares automatically and compulsorily on the date of allotment without any further act or application by the allottee and Part B will be redeemed at part-converted into equity shares after a lock-in-period at the option of the investors.
- (9) **Preference shares with warrants attached:-** Under this instrument, each preference share should carry certain number of warrants entitling the holder to apply for equity shares for cash at 'premium' at any time in one or more stages between the third and fifth year from the date of allotment. If the warrant holder fails to exercise his option, the unsubscribed portion will lapse.
- (10) **Secured zero interest Partly Convertible Debentures with Detachable and separately tradeable warrants:-** The instrument has two parts - Part A is convertible into equity shares at a fixed amount on the date of allotment and Part B - non-convertible to be redeemed at par at the end of a specific period from the date of allotment. Part B will carry a detachable and separately tradeable warrant which will provide an option to the warrant holder to receive equity share for every warrant held at a price as worked out by the company.
- (11) **Fully convertible Debentures with interest (optional):-** This instrument will not yield any interest for a short period, say 6 months. After this period, option is given to the holders of FCDs to apply for equities at 'premium' for which no additional amount needs to be payable. This option needs to be indicated in the application form itself. However, interest on FCDs payable at a determined rate from the date of first conversion to second/final conversion and in lieu of it equity shares will be issued.
- (12) **Deep discount bond:-** It refers to those bonds which are sold at discount value by the company and on maturity face value is paid to the investors.
- (13) **Option bonds:-** It covers those cumulative and non-cumulative bonds where interest is payable on maturity periodically and redemption premium is offered to attract investors.
- (14) **Global depository receipts:-** It is a form of depository receipt on certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investor against the issue of ordinary shares on foreign currency convertible bonds of issuing company.

It is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world.

- (15) **External Commercial borrowings:-** are defined to include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds etc. credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington, ADB, AFIC, CDC etc). It is permitted by the Government as a source of finance for Indian corporates for expansion of existing capacities and fresh investments.
- (16) **Derivatives:** Derivatives are contracts which derive their values from the value of one or more other assets known as underlying assets. Some of the most commonly traded derivatives are futures, options and swaps.
- (a) **Futures:** Futures is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.
- (b) **Options:** An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time. The right to buy is referred to as a call option whereas the right to sell is known as 'put option'.

New Instruments in Money Market

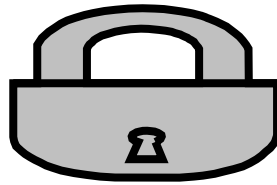
- (1) **Certificate of deposit:** Certificate of deposit is a document of title to a time deposit. Being a bearer document, CDs are readily negotiable and are attractive, both to the banker and to the investors in that, the banker is not required to encash the deposits prematurely, while the investor can sell the same in the secondary market. This ensures ready liquidity. Minimum size of issue of a CD is Rs. 1 lakh.
- (2) **Commercial paper:** CP refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis. It can be issued in denominations of Rs. 5 lakh or multiples thereof.

LESSON ROUND-UP



- All companies are given power to borrow by their articles which fix the maximum limit of borrowings. A public company cannot borrow money until it is entitled to commence business. But in case of a private company, it is not so. The power to borrow money and to issue debentures can only be exercised by the Directors at a duly convened meeting.
- Where the company borrows without the authority conferred on it by the Articles or beyond the amount set out in the Articles, it is an ultra vires borrowing and hence void. Ultra vires borrowings cannot even be ratified by a resolution passed by the company in general meeting. In case of ultra vires borrowings the lender has the following remedies: (a) Injunction and Recovery, (b) Subrogation, (c) Suit against Directors.

- Where the directors exceed their authority, the excess part may not be ultra vires and may be only irregular depending upon the facts and circumstances. The company will be bound if the excess is within the directors' ostensible authority and the lender acted in good faith or if the transaction was ratified by the company.
- The power to borrow includes the power to give security, which may take the form of a mortgage, a charge, hypothecation, lien, guarantee, pledge, etc. A company may charge its uncalled capital if its articles or memorandum authorize it to charge it. A company may also create a mortgage or a charge, including a floating charge, on any of its book-debts.
- In order to make a company liable on any promissory note or bills of exchange it must appear clearly on the face of the instrument that it was intended to be drawn, accepted, made or endorsed on behalf of the company.
- Working capital may be defined as the excess of current and liquid assets over current liabilities of a business, having regard to reasonable provision for contingencies so as to enable it to conduct its operations normally and free from financial embarrassment and to avoid losses consequent upon incurring commitments beyond its capacity in the ordinary course of events.
- A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge. Section 2(12) of the Act defines 'debenture' to include debenture stock, bonds and other securities of a company, whether constituting a charge on the assets of the company or not.
- Debentures may be of different kinds, viz. redeemable debentures, perpetual or irredeemable debentures, registered and bearer debentures, secured and unsecured or naked debentures, convertible debentures.
- A debenture stock is a borrowed capital consolidated into one mass for the sake of convenience.
- A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money.
- A debenture trust deed is one of the several instruments required to be executed to secure redemption of debentures and payment of interest on due dates.
- Section 117C of the Act required every company to create a debenture redemption reserve to which adequate amount shall be credited out of its profits every year until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only.
- SEBI has issued guidelines pertaining to Issue of Debentures.
- Brokerage is the amount paid to a middle man (called broker) who brings about a bargain between the seller and a purchaser of shares or debentures in the case of a company.
- Certificate of deposit is a document of title to a time deposit.
- Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis.

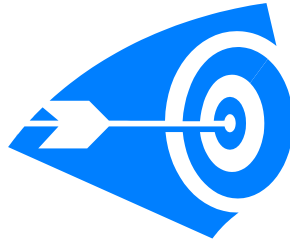
SELF-TEST QUESTIONS

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

1. What are the restrictions imposed on the borrowing powers of the Board of directors? If a company borrows beyond its powers, examine the remedies open to such creditor:
 - (i) When the money has not been spent;
 - (ii) When the money has been spent to pay the debts of the company.
 2. What is the difference between debenture and a loan? Is fixed deposit a Debenture or Loan?
 3. What is debenture? What are the kinds of debentures?
 4. What is a convertible debenture? What are the provisions of the Companies Act, 1956 regarding convertible debentures or loans?
 5. What is underwriting?
 6. Summarise the SEBI guidelines pertaining to the issue of Debentures.
 7. Is it compulsory to maintain a Debenture Redemption Reserve? If yes, how?
 8. Write short notes on the following:
 - (i) Ultra vires borrowings
 - (ii) Intra vires borrowings
 - (iii) Security for borrowings
 - (iv) Types of borrowings
 - (v) Raising loans from financial institutions.
 9. Who is a debenture trustee? Why is it compulsory to appoint a trustee in connection with the issuance of debentures? What are the duties of a trustee?
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STUDY X
FINANCIAL STRUCTURE AND MEMBERSHIP-V
CREATION AND REGISTRATION OF CHARGES

LEARNING OBJECTIVES



A charge is a right created by any person including a company referred to as “the borrower” on its assets and properties, present and future, in favour of a financial institution or a bank, referred to as “the lender”, which has agreed to extend financial assistance. The chapter covers the following topics:

- Definition and kinds of a charge
- Crystallization of floating charge
- Registration of charge
- Effect of Registration
- Satisfaction of charges
- Modification of charges
- Definition and nature of mortgage
- Mortgage vs. charge

1. DEFINITION OF A CHARGE

A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. As mentioned earlier, the power of the company to borrow includes the power to give security also. A company, like a natural person, can give security. Normally, the debentures and other borrowings of the company are secured by a charge on the assets of the company. Where property, both existing and future, is agreed to be made available as a security for the repayment of debt and creditors have a present right to have it made available, there is a charge. The present legal right of the creditor can only be enforced at some future date. The creditor gets no legal right to property either absolute or special. He only gets the right to have the security made available by an order of the Court.

According to Section 124 of the Act, charge includes a mortgage. Charge also includes a lien and an equitable charge whether created by an instrument in writing or by the deposit of title deed (*Dublin City Distillery Co. v. Deherty*, 1914 AC 823).

Kinds of Charges

A charge on the property of the company as security for debentures may be of the following kinds, namely:

- (i) Fixed or specific charge;
- (ii) Floating charge.

Fixed or Specific Charge

A charge is fixed or specific when it is made specifically to cover assets which are ascertained and definite or are capable of being ascertained and defined, at the time of creating charge e.g., land, building, or heavy machinery. A fixed charge, therefore, is against security of certain specific property, and the company loses its right to dispose off that property as unencumbered. In other words, the company can deal with such property, subject to the charge so that the charge holder gets priority over all subsequent transferees except a *bona fide* transferee for consideration without notice of the earlier charge. In the winding-up of the company, a debenture holder secured by a specific charge will be placed in the highest ranking class of creditors.

TEST YOUR KNOWLEDGE

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

A charge secured against stock-in-trade is called a fixed charge

- True
- False.

Correct answer: False

Floating Charge

A floating charge, as a type of security, is peculiar to companies as borrowers. A floating charge is not attached to any definite property but covers property of a fluctuating type e.g., stock-in-trade and is thus necessarily equitable. A floating charge is a charge on a class of assets present and future which in the ordinary course of business is changing from time to time and leaves the company free to deal with the property as it sees fit until the holders of charge take steps to enforce their security. “The essence of a floating charge is that the security remains dormant until it is fixed or crystallised”. But a floating security is not a future security. It is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder of such charge cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor i.e. the company can deal with them without the concurrence of the mortgagees.

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged. The company may sell, mortgage or lease such property in ordinary course of its business if it is authorised by its memorandum of association

Some Judicial pronouncement about different types of charges

1. **Lord Macnaghten in *Illingworth & Another v. Houldsworth & Another*, (1904) 73 L.J.CH. 739 observed that.** “A specific charge is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined”
2. ***Official Liquidator v. Sri Krishna Deo*, (1959) 29 Com Cases 476: AIR 1959 All 247 and *Roy & Bros. v. Ramnath Das*, (1945) 15 Com Cases 69, 75 (Cal)].** The plant and machinery of a company embedded in the earth or permanently fastened to things attached to the earth became a part of the company’s immovable property and therefore apart from the registration under the Companies Act, registration under the Indian Registration Act would also be necessary to make the charge valid and effective. [
3. ***Cosslett (Contractors) Ltd., Re*, (1996) 1 BCLC 407 (Ch D)** A construction company’s washing machine which was in use at the site was declared under the terms of the contract to be the employer’s property during the period of construction. This was held to have created a fixed charge and not a floating charge on the machine because the machine was only one fixed item and was not likely to change
4. A floating security”, observed **Lord Macnaghten in *Government Stock Investment Company Ltd. v. Manila Rly. Company Ltd.*, (1897) A.C. 81**, “is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes”.
5. ***Illingworth & Another v. Holdsworth & Another*, (ibid)** . “A floating charge is ambulatory and shifting in its nature hovering over and so to speak floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp
6. ***Maturi U. Rao v. Pendyala* A.I.R. 1970 A.P. 225** When the floating charge crystallises it becomes fixed and the assets comprised therein are subject to the same restrictions as the fixed charge
7. **In *Re. Borax Co.*, (1901) 1 CH 325.** It was held that a company may sell the whole of its undertaking if that is one of the objects specified in its memorandum.
8. ***Wheatly v. Silkstone & High Moor Coal Co. Ltd.*, (1885) 54 L.J. Ch 78.** Unless specifically precluded, the company can create fixed charge subsequent to floating charges over the same property
9. **[In *Smith v. Bridgend County Borough Council* (2002) 1 BCLC 77 (HC)**, the agreement was held to constitute a floating charge, in so far as it allowed the employer, in various situations of default by the contractor, to sell the contractor’s plant and equipment and apply the proceeds in discharge of its obligations. A right to sell an asset belonging to a debtor and appropriate the proceeds to payment of the debt could not be anything other than a charge. It was a floating charge because the property in question was a fluctuating

body of assets which could be consumed or removed from the site in the ordinary course of the contractor's business.

TEST YOUR KNOWLEDGE

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

The owner of a property secured against a floating charge can not deal with the property.

- True
- False.

Correct answer: False

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged.

2. CRYSTALLISATION OF FLOATING CHARGE

A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets having a floating charge till the happening of some event which determines this right. A floating charge crystallises and the security becomes fixed in the following cases:

- (a) when the company goes into liquidation;
- (b) when the company ceases to carry on the business;
- (c) when the creditors or the debenture holders take steps to enforce their security e.g. by appointing receiver to take possession of the property charged;
- (d) on the happening of the event specified in the deed.

In the aforesaid circumstances, the floating charge is said to become fixed or to have crystallised. Until the charge crystallises or attaches or becomes fixed the company can deal with the property so charged in any manner it likes. The company may even sell its whole undertaking if that is otherwise permissible as per the objects specified in the memorandum.

Although a floating charge is a present security, yet it leaves the company free to create a specific mortgage on its property having priority over the floating charge. In *Government Stock Investment Co. Ltd. v. Manila Railway Co. Ltd.*, (1897) A.C. 81, the debentures created a floating charge. Three months' interest became due but the debenture holders took no steps and so the charge did not crystallize but remained floating. The company then made a mortgage of a specific part of its property. Held, the mortgagee had priority. The security for the debentures remained merely a floating security as the debenture holders had taken no steps to enforce their security.

Effect of Crystallisation of a Floating Charge

On crystallisation, the floating charge converts itself into a fixed charge on the property of the company. It has priority over any subsequent equitable charge and

other unsecured creditors. But preferential creditors who have priority for payment over secured creditors in the winding-up get priority over the claims of the debenture holders having floating charge. Where a receiver is appointed on behalf of the holders of any debentures or possession is taken by or on behalf of those debenture holders of any property subject to charge then payment made in respect of such debt shall, be recouped, as far as may be, out of the assets available for payment of unsecured creditors. (Section 123).

3. POSTPONEMENT OF A FLOATING CHARGE

The creation of a floating charge leaves the company free to create a legal and equitable mortgage on the same property until the floating charge crystallises. Where such a mortgage is created it has priority over the floating charge which gets postponed. The floating charge is postponed in favour of the following persons if they act before the crystallization of the security:

- (a) a landlord who distrains for rent;
- (b) a creditor who obtains a garnishee absolute;
- (c) a judgement creditor who attaches goods of the company and gets them sold (But if the goods are not sold and the debenture holders take action in the meantime, the floating charge has priority);
- (d) the employees of the company, as well as other preferential creditors in the event of winding-up of the company;
- (e) the supplier of goods to the company under a hire-purchase agreement on terms that goods are to remain the property of the seller until they are paid for in full, has priority over the floating charge, whether such hire-purchase agreement is made before or after the issue of the debentures with a floating charge.

Debenture-holders with a floating charge do not, therefore, enjoy the same rights as the secured creditors, for claims against the company. The deed creating the floating charge may, however, contain a clause restricting the power of the company to create charges in priority to or *pari passu* with it. But even in such a case a person who takes mortgage without notice of floating charge gets priority. But such a contingency can be safeguarded by registering the charge. In terms of Section 126 of the Act, where a mortgage or charge required to be registered under Section 125 of the Act has been so registered, any person acquiring such property or any part thereof or any interest of share therein shall be deemed to have notice of the charge as from the date of such registration.

Restraint on the Power to Create Charges with Priority to a Floating Charge

As the floating charge allows wide powers to the company to deal with its property subject to floating charge, it is common to insert a clause restricting the powers of the company to create charge with priority to or *pari passu* with it. Thus if the company creates a mortgage in favour of any person who has notice of the floating charge and restriction, such person ranks after the floating charge. But a person who obtains a valid mortgage, and can show either (i) that he was not aware of the existence of the floating charge; (ii) that though he was aware of the charge, he was not aware of the restriction, is entitled to priority by virtue of the legal estate. Furthermore, where a specific charge is created expressly subject to a floating

charge, the specific charge is postponed as from the date when the floating charge crystallises by the appointment of a receiver.

Invalidity of Floating Charge

A floating charge remains afloat until a winding up commences, unless it has already crystallised through the intervention of the debenture holders or the creditors. Also, a floating charge is valid only against the unsecured creditors, whether in a winding-up or otherwise. But the Act prevents an unsecured creditor to get priority over the other creditors by obtaining a floating charge when he learns that the company's liquidation is imminent.

Accordingly, Section 534 of the Act provides that a floating charge which is created within 12 months immediately preceding the commencement of the winding up proceedings of a company shall be invalid, unless it is proved that the company was solvent immediately after the creation of the charge. But the charge will be valid to the extent of the amount of any cash paid to the company at the time of or after the creation of, and in consideration for the charge, together with interest on that amount at 5 per cent per annum or such other rate as may be fixed by the Central Government.

TEST YOUR KNOWLEDGE

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

In the case of claim settlement against a company, a debenture holder with a floating charge will get preference to secured creditors.

Correct answer: False

Debenture holders with a floating charge do not enjoy the same rights as the secured creditors for claims against the company.

4. REGISTRATION OF CHARGES

Section 125 of the Act requires a company to file, within 30 days after the date of the creation of a charge, with the Registrar, complete particulars together with the instrument, if any, creating, evidencing or modifying the charge, or a copy thereof verified in the prescribed manner for registration; otherwise the charge shall be *void* against the liquidator and creditors and on the charge becoming *void*, the money thereby shall immediately become payable.

However, the Registrar may allow the particulars and instrument or copy as aforesaid to be filed within thirty days next following the expiry of the said period of thirty days on payment of such additional fee not exceeding ten times the amount of fee specified in Schedule X as the Registrar may determine, if the company satisfies the Registrar that it had sufficient cause for not filing the particulars and instrument or copy within that period.

The charges which must be registered, are :

- (a) a charge for the purpose of securing any issue of debentures;
- (b) a charge on uncalled share capital of the company;

- (c) a charge on any immovable property, wherever situate or any interest therein;
- (d) a charge on any book debts of the company;
- (e) a charge, not being a pledge, on any movable property of the company;
- (f) a floating charge on the undertaking or any property of the company including stock-in-trade;
- (g) a charge on calls made but not paid;
- (h) a charge on a ship or any share in a ship; and
- (i) a charge on goodwill or a patent or a licence under a patent, or on a trade mark, or on a copyright or a licence under a copyright.

The holding of debentures entitling the holder to a charge on immovable property shall not, be deemed to be an interest in immovable property. [Section 125(8)]. Also, where a negotiable instrument has been given to secure the payment of any book debts of a company the deposit of the instrument for the purpose of securing an advance to the company, shall not be treated as a charge on those book debts. [Section 125(7)]

According to Section 125(6), where a charge is created in India, but comprises property outside India, the instrument creating or purporting to create the charge or a copy thereof verified in the prescribed manner, may be filed for registration, notwithstanding that further proceeding may be necessary to make the charge valid or effectual according to the law of the country in which the property is situated.

Companies are required to file particulars of charges for registration of charge created or modified with the concerned Registrar of Companies. Before the introduction of Companies (Amendment) Act, 2006, all transactions including filing of documents under the Act were conducted in physical form using the prescribed forms. The Ministry of Corporate Affairs has implemented an e-governance initiative through a project named as "MCA-21". The e-forms have been notified for electronic use.

Section 610B as inserted by Companies (Amendment) Act, 2006 and rules made thereunder specifies that particulars of charges shall be filed through e-form 8 in computer readable electronic form, in portable document format and authenticated by a managing director, director or secretary or person specified in the Act for such purpose by the use of a valid digital signature.

Under the system of e-filing, for registration or creation of charge, only one e-form 8 is required to be filed in place of old form 8 and 13.

The e-form 8 should be filed by the company or any person interested therein within 30 days from the date of creation or modification of charge. A further period of 30 days is allowed on payment of requisite fees as required by Schedule X to the Companies Act, 1956. Separate e-form 8 is to be filed for each charge. In case of acquisition of a property which is already subject to charge, then instrument evidencing creation or modification of charge is a mandatory attachment. In case of joint charge and consortium finance, particulars of other chargeholders should be attached. If more than one chargeholder is involved, then details of extent of charge, particulars of property charged, amount secured is required to be provided as attachment. Any other information can be provided as an optional attachment.

E-form 8 should be digitally signed by the chargeholder and in case of an Indian

company by the Managing Director or director or manager or secretary of the company authorised by the board of directors and in case of a foreign company, by an authorised representative. In case of charge created or modified outside India on the property situated outside India, the date of receipt of the document in India is required to be mentioned. Further, in case the amount secured by the charge is in foreign currency, rupee equivalent amount is required to be stated in the e-form.

If the charge is modified in favour of the asset reconstruction company (ARC) or assignee then, the e-form should also be digitally signed by such ARC or assignee. In such case, the digital signature of the company representative is optional.

Charge identification number is allotted at the time of registration of the charge.

A copy of every instrument or deed creating or evidencing any charge requiring registration is to be verified in the following manner as provided in Rule 6 of the Companies (Central Government's) General Rules and Forms, 1956:

- (i) Where the instrument or deed relates solely to property situate outside India, the copy shall be verified by a certificate either under the seal of the company, or under the hand of some person interested in the mortgage or charge on behalf of any person other than the company, stating that it is a true copy;
- (ii) Where the instrument or deed relates, whether wholly or partly, to property situate in India, the copy shall be verified by a certificate of a responsible officer of the company stating that it is a true copy or by a certificate of public officer given under and in accordance with the provisions of Section 76 of the Indian Evidence Act, 1872 (1 of 1872).

A charge created orally would also require registration. The registration of a charge with the Registrar itself would show that the charge is created even if no instrument is created. A Board resolution can also be taken to be the fact of creation of a charge.

As per the Madras High Court decision in *T.R. Thyagarajan v. Official Liquidator* (1960) 30 Comp. Cas 481, if a company acquires a property, subject to a charge and fails to deliver particulars of the charge to the Registrar, the validity of the charge is not affected. A charge by way of hypothecation of book debts requires registration. A charge on future debts will be void if it is not registered. [*Independent Automatic Sales Ltd. v. Knowles & Foster* (1962) 32 Comp Cas 1090 (C.D.)].

TEST YOUR KNOWLEDGE

Choose the correct answer

What is the period within which the particulars of the charge must be filed with the Registrar?

- (a) 30 days after the date of creation of the charge
- (b) 45 days after the date of creation of the charge
- (c) 60 days after the date of creation of the charge
- (d) days after the date of creation of the charge

Correct answer: (a)

TEST YOUR KNOWLEDGE

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

An oral charge need not to be registered with the Registrar

- True
- False.

Correct answer: False

A charge created orally would also require registration.

Particulars to be filed with the Registrar in case of series of Debentures

Under Section 128 of the Companies Act, 1956, where a series of debentures containing or giving by reference to any instrument any charge to the benefit of which debenture holders of the series are entitled *pari passu* is created by a company, it is sufficient, to file with the Registrar within 30 days after the execution of the deed containing the charge or, if there is no such deed, after execution of any debentures of the series, the following particulars:

- (i) the total amount secured by the whole series;
- (ii) the dates of resolutions authorising the issue of the series and the date of covering deed, if any, by which the security is created or defined;
- (iii) a general description of the property charged;
- (iv) the names of trustees, if any for the debenture holders.

The deed containing the charge, or a copy of the deed verified in the prescribed manner, or if there is no such deed, one of the debentures of the series must also be filed. If any commission, allowance or discount has been paid or made by the company to any person directly or indirectly for subscribing, agreeing to take, or procuring any or agreeing to procure, subscription for any debentures, the amount or rate per cent of the commission, discount or allowance so paid or made must also be indicated as required under Section 129 of the Companies Act, 1956. The particulars under Sections 128 and 129 are to be filed in e-form 10, as prescribed under the Companies (Central Government's) General Rules & Forms (Amendment) Rules, 2006. The omission to give these particulars does not, however, affect the validity of the debentures. The deposit of any debentures as security for any debt of the company does not amount to issue of debentures at a discount.

E-form 10 is required to be filed within a period of thirty days from the date of creation or modification of charge for debentures. A further period of thirty days is allowed on payment of requisite fees as required by Schedule X to the Companies Act, 1956.

The number and details of trustees for debentureholders are required to be entered. If there are more than one trustee, details of one trustee is to be given in the e-form and the rest can be given as an attachment.

Copy of the resolution authorizing the issue of the debenture series and instrument detailing creation or modification of charge have to be filed with e-form 10 as attachments.

The e-form is required to be digitally signed by the trustee(s) of debentureholder as well as by Managing Director or director or manager or secretary of a company, in case of an Indian company and by an authorised representative, in case of a foreign company. Further, the e-form is required to be pre-certified by Chartered Accountant or Cost Accountant or Company Secretary (in whole time practice).

5. EFFECT OF REGISTRATION

A registration of charge under Section 125 constitutes a notice to whosoever acquires a future interest in the charged assets. Section 126 provides that where any charge on any property of a company required to be registered under Section 125 has been so registered, any person acquiring such property or part thereof or any share or interest therein shall be deemed to have notice of the charge as from the date of such registration.

The registration of charge is intended to give notice to people who may not otherwise be aware of it, particularly to persons who may advance money to the company, and it may also serve the purpose of preventing a fraudulent and belated claim of a charge in the event of liquidation [*Sree Meenakshi Mills Ltd. v. Registrar of Companies*, AIR 1966, Madras 24 : (1966) 36 Comp Cas 961].

The object of public notice is achieved in two ways. First, by requiring the companies to maintain record of charges and make it available for inspection to the members of the public. Secondly, by requiring the Registrar of Companies under Section 130 of Companies Act, 1956 to maintain record of the charges filed by companies and make it available for public inspection.

The inspection of public documents was earlier carried out by inspection of physical files containing company documents available in the concerned ROC offices. In e-governance era, the documents, in so far as these are available in digital form, shall be available for public inspection through electronic means using internet.

In accordance with the Rule 5 of Companies (Electronic Filing and Authentication of Documents) Rules, 2006, the Central Government shall set up and maintain a secure electronic registry in which all the documents filed electronically shall be stored. The electronic registry so set up shall enable public access and inspection of such documents as are required to be in public domain under the Act on payment of the fees as prescribed under the Act or the rules made thereunder.

The particulars similar to these required for a charge created by the company are to be filed, when any property is acquired by the company which is subject to a charge, within 30 days of the acquisition of the property.

Non-registration of mortgage or charges, does not however, render the transaction *void* or the debt not recoverable. The only consequence is that the security created by the charge or mortgage is *void* against the liquidator and other creditors. As against the company, the mortgage or charge is good and may be enforced so long as the company does not go into liquidation. The failure to register does not prejudice any contract or obligation for repayment of money secured by the charge. The company itself cannot have a cause of action arising out of non-registration of a charge.

Conclusive Nature of the Certificate of Registration

Dealing with the conclusive nature of the certificate of registration issued by the Registrar, Scrutton L.J. observed in *National Provincial and Union Bank of England v. Charnley* [(1924) 1 K.B. 431, 447 (CA)]* as follows:

“The object of the certificate in that case is to prevent the debenture holders’ security from being upset if it turns out that the company or the Registrar has made a mistake as to what has been put, on the register, I am bound to say that the language of the statute is rather puzzling: ‘Every mortgage or charge created by company shall be void unless the prescribed particulars of the mortgage or charge are delivered to the registrar within twenty-one days*.’ That makes the avoidance depend on the neglect to send in the particulars. The neglect to register the charge will not make it *void*. Then when the registrar has got the particulars and the instrument creating the charge, he is to enter in the register, not the particulars delivered by the company, but the date of the instrument and its description, the amount secured, short particulars of the property mortgaged or charged, and the names of the mortgagees or persons entitled to the charge, So that there is a possibility, first, of the company making an error in delivering the particulars, and, secondly, of the Registrar making an error either in omitting to enter something specified in the particulars, or in misunderstanding the instrument of charge delivered to him with the particulars; and for that reason one can well understand a clause being put in favour of the guaranties of the charge, who are not the persons whose duty it is to deliver the particulars, that if the Registrar gives a certificate that all is in order that certificate shall be conclusive evidence that the requirements as to registration have been complied with. The result of the legislation as it appears to me is that if the document sent in for registration does contain a charge on particular property, even if the company sending it in has misstated that charge, or the Registrar considering it judicially has misunderstood it, when once the certificate has been given the guaranties are safe. Though one can see that this may cause great hardship to a person who gives credit to the company in reliance on a defective register, one can also see that equal hardship would be caused to secured creditors if their security was to be upset for reasons connected with the action of persons over whom they had no control. For these reasons I take the view which was taken in *Cunard Steamship Co. v. Hopwood* (1908) 2 Ch. 564 (Ch. D) that the giving of the certificate by the Registrar is conclusive that the document creating the charge was properly registered, even if in fact it was not property registered.” [See also *Bank of Maharashtra Ltd. v. Official Liquidator*, (1973) 43 Comp. Cas. 505, wherein the aforesaid observation is quoted).

Consequences of non-registration

If a charge which requires registration under Section 125 is not registered as per Sub-section (1) of Section 125, the consequences are as follows:

- (a) The charge will be void as against the liquidator (if the company goes into liquidation) and against creditors, but against them only.
- (b) The charge is good against the company and the amount becomes payable immediately.

* The judgement was rendered under the English Act.

- (c) Until liquidation, the person seeking to enforce such a charge, has available to him all remedies of a mortgage against the company, though not against other creditors.
- (d) The company may give a subsequent valid mortgage to secure the same debt. But if a subsequent creditor, even with notice of the first charge, takes a registered charge before the first said charge is registered, he obtains priority.
- (e) During liquidation the charge-holder (creditor) assumes the status of an unsecured creditor, as the charge is void against liquidator and creditors.
- (f) The holder of an equitable charge whose charge is void on the ground of non-registration, has no lien on the title deeds or documents deposited with him as the deposit is only ancillary to the void charge.
- (g) Although a security becomes void by non-registration, it does not affect the contract or obligation of the company to repay the money thereby secured. In fact, Section 125 provides that where a charge becomes void by non-registration, the money becomes immediately payable and the company cannot repudiate it on the ground of non-registration.
- (h) Omission to register particulars of charges as required is punishable with fine. The company and every officer of the company or other person who is in default shall be punishable with fine which may extend to five thousand rupees for everyday during which the default continues. A further fine of Rs. 10,000 may be imposed on the company and every officer of the company for other defaults relating to the registration of charges (Section 142).

6. REGISTER OF CHARGES

Company's Register of Charges

As per section 143 of the companies act, every company is required to keep a register of all floating and fixed charge containing a short description of the property charged, the amount of the charge, and the names of the persons entitled to it

Further as per section 136 every company must keep at its registered office, a copy of every instrument creating any charge

Inspection of Register of Charges

As per section 144 of the Companies Act, Inspection of the Register of Charges and of the instrument creating charges can be allowed only during the business hours to any creditor or member of the company without fee and to any other person on payment of a fee of rupees ten

Registrar's Register of Charges

As per Section 130 of the Act, the Registrar shall, with respect to each company, cause to be kept a register containing all the charges requiring registration and shall on payment of the prescribed fee, cause to enter in the Register with respect to every such charge the following particulars:

1. The date of its creation.
2. The amount secured by the charge;
3. Short particulars of the property charged; and
4. The persons entitled to the charge

In the case of a charge to the benefit of which the holders of a series of debentures are entitled, the particulars to be entered in the Register are:

1. The total amount secured by the whole series.
2. The dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined;
3. A general description of the property charged;
4. The names of the trustees, if any, for the debenture holders; and
5. The amount or rate per cent of the commission or discount if any, paid to any person subscribing or procuring subscriptions for any debentures of the company [Sections 128 and 129].

All these Documents including the forms of charges can be accessed electronically upon payment of statutory fees of Rs. 50/- per company for a limited direction of three hours from the time of accessing the first document of the given company.

One can find charge ID by entering the CIN or foreign company registration number of the company in the "View index of charges" service available after logging in MyMCA portal. System displays all active charges with date of charge creation and amount secured. (Students may note that the Form 13 required to be filed earlier is done away with and the details of Form 13 are captured through other charge related forms).

The Registrar must also keep a Chronological Index of Charges so registered for ready reference, in Form No. 12 of the Companies (Central Governments) General Rules and Forms.

Index to register of charges [Section 131] — The Registrar shall keep a chronological index, in the prescribed form and with the prescribed particulars, of the charges registered with him in pursuance of the requirement of Section 125 of the Act.

Extension of time for registering or modification of a charge by Registrar

As per section 125 of the Act, every charge which requires registration must be registered within 30 days of its creation. However if the registrar is satisfied that the company had sufficient cause for not filling the charge within 30 days, the registrar may allow further thirty days immediately following the expiry of the 30 days on payment of such additional fee not exceeding ten times the amount of fee specified in Schedule X as the Registrar may determine, for filing the charge.

Extension of Time and Rectification of Register of Charges

As mentioned earlier, Section 125 of the Act requires filing of charges which require registration within 30 days after the date of its creation. However, the Registrar may allow further thirty days immediately following the expiry of the 30 days on payment of such additional fee not exceeding ten times the amount of fee specified in Schedule X as the Registrar may determine, for filing the charge, if the company satisfies the Registrar that it had sufficient cause for not filing the particulars and instrument or copy within the allowed period of 30 days.

When a company omits to file with the Registrar the particulars of any charge created by it or of any charge subject to which any property has been acquired by it

or of any modification of any such charge or of any issue of debentures of a series, or of the payment or satisfaction of a charge, within the time required, it has to make an application before the Central Government for extension of time as provided under Section 141 of the Act. Central Government has further delegated this work to the respective Registrar of Companies under whose jurisdiction the registered office of the company is situated.

The application for rectification of charges should be submitted to ROC where the registered office of the company is situated either by the applicant in person or through his authorized representative or may be sent by registered post with acknowledgement due to the Registrar concerned.

The Application should set forth the name of the company with its status, date of incorporation, address of its registered office, authorised capital, main objects in brief for which the company was formed, present business activities of the company etc. The application shall also state clearly, under distinct heads, the grounds for such application and the nature of reliefs prayed for.

The application should be accompanied by:

- (a) Copy of the agreement creating or modifying the charge as the case may be.
- (b) Copy of the resolution envisaged by Section 292(1)(b) or (c) and Section 293(1)(a), as may be applicable.
- (c) Affidavit verifying the petition.
- (d) Bank draft evidencing payment of prescribed application fee.
- (e) Memorandum of Appearance with a copy of Board Resolution or the executed Vakalatnama, as the case may be.

If the Registrar of Companies is satisfied that the omission to file with the Registrar the particulars of any charge or any modification thereof or the intimation of satisfaction of charge was accidental or due to inadvertence or due to some other sufficient cause or is not in a nature to prejudice the position of creditors or shareholders of the company, or if the Registrar is satisfied that on other grounds it is just and equitable to grant relief, it may direct that time for filing of charge or intimation for satisfaction of charge shall be extended.

The effect of extension of time for registration and actual registration within the extended time is that the charge becomes a valid charge from the date of its execution.

TEST YOUR KNOWLEDGE

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

Anybody can inspect the Register of Charges of any company

- True
- False.

Correct answer: True

Condonation of delay by the Central Government under Section 637B

When relief of extension of time is not granted by the Company Law Board a

further application under Section 637B, may be made to the Central Government who for reasons to be recorded in writing may condone the delay. On condonation of the delay the charge or other document which would otherwise be *void* gets revived.

TEST YOUR KNOWLEDGE**Choose the correct answer**

Where should a company make an application for the extension of time for filing the particulars of a charge if it fails to file it within the specified period?

- (a) Registrar
- (b) District Court
- (c) High Court
- (d) Company Law Board

Correct answer: (d)

7. SATISFACTION OF CHARGES

Section 138 of the Act requires that the company shall give intimation to the Registrar of the payment or satisfaction in full, of any charge relating to the company within 30 days from the date of such payment or satisfaction. The company shall intimate satisfaction of the charge in e-form 17 prescribed under the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 accompanied by appropriate fees, prescribed in Schedule X of the Act (which depends on the nominal capital of the company). In this case no extension of time can be allowed by the Registrar of Companies. The power to extend the time for filing the satisfaction of charges was lied with the Company Law Board, under Section 141 for which a petition has to be filed before it as indicated earlier in this Study in case of filing of charges. Now such power lies with Central Government (date of its coming into effect is yet to be notified), vide the Companies (Second Amendment) Act, 2002.

Under the system of e-filing, for satisfaction of charge only one e-form 17 is required to be filed instead of form 17 and form 13 which were required to be filed in physical mode.

E-form 17 is required to be filed within 30 days from the date of satisfaction or payment of full and final amount to the chargeholder.

While filling the e-form 17, the charge creation identification number obtained after filing e-form 8 or 10 or the charge satisfied should be entered and the relevant particulars of charge holders will get automatically displayed.

Letter of chargeholder stating that the amount has been satisfied is required to be attached with this e-form. E-form is required to be digitally signed by chargeholder or trustee of the debentureholder and in case of an Indian company, by the managing director or director or manager or secretary of the company authorised by the board of directors, while in case of foreign company, by an authorised representative.

Further, the e-form is required to be pre-certified by the Chartered Accountant or Cost Accountant or Company Secretary (whole-time practice).

If e-Form No. 17 is signed by both the parties and is filed with Registrar, the satisfaction of charge can be registered on the spot without issuing any notice to the creditor.

Under Section 139 of the Companies Act, 1956, Registrars have been empowered to record memorandum of satisfaction of a charge in the Register of Charges, on evidence being given to him to his satisfaction with respect to a registered charge that the debt for which charge was created has been paid or satisfied.

When the Registrar makes an entry of satisfaction of a charge, he will furnish the company with a copy of the memorandum of satisfaction (Section 140).

8. MODIFICATION OF CHARGES

As per Section 135 of the Act whenever the terms or conditions, or the extent or operation, of any charge registered are or is modified, it shall be the duty of the company to send to the Registrar the particulars of such modification within 30 days. For registration of modification of charges also e-form 8 (details of which were given earlier) has to be filed with the Registrar. Under Section 134 of the Companies Act, 1956, a charge can be filed by the company or by any person interested in the charge. However, under Section 135 modification of a charge can only be filed by the company.

While filing e-form 8 for modification of charge, charge identification number allotted at the time of registration of the charge is to be entered.

In this case, fields 4, 5, 6, 10, 11, 13 and fields 15 to 17 of e-form 8 are applicable and required to be filled.

In case the consortium finance is involved, then all the information like charge creation or modification, asset category, name and address of charge holders, nature of instrument creating charge, are to be provided as an attachment.

In case of acquisition of property, already subjected to charge, instrument evidencing creation or modification of charge is a mandatory attachment.

In case of modification of charge, if there is any modification in the charge amount, then the total amount secured by charge after such modification is required to be entered.

9. PURCHASE OR ACQUISITION OF A PROPERTY SUBJECT TO CHARGE

It has already been stated that when any person buys or acquires any property which is already under charge and the charge was duly registered with the Registrar, it will be deemed that the buyer or acquirer had notice of the charge. Therefore, when a company acquires a property which is subject to a charge requiring registration with the Registrar the acquiring company shall cause the prescribed particulars of the charge with a duly certified copy of the instrument creating or evidencing the charge to be delivered to the Registrar for registration, within thirty days of completion of the process of acquisition.

But, where a registrable charge is not registered, it was held in the *State Bank of India v. Vishwaniryat (P) Ltd.* (1987) 3 Comp. LJ 171 (Ker. DB) that the purchaser shall be deemed to have purchased the property subject to charge. It is because, a charge under Section 125 becomes void only against the liquidator and the creditor of a company and not against any other person including the purchaser thereof.

TEST YOUR KNOWLEDGE

Choose the correct answer

Which of the following is a necessary document in case of acquisition of property?

- (a) Asset category
- (b) Instrument evidencing creation of charge
- (c) Name of charge holder
- (d) Address of charge holder

Correct answer: b)

10. CHARGE ON PROPERTIES SITUATED OUTSIDE INDIA

There may be situations in respect of creation of charge on properties located abroad.

- (1) **Property situated out of India and charge created also out of India** — Registration of charge U/s 125 requires within 30 days from the day by which the instrument creating or evidencing the charge would have reasonably reached India through post
- (2) **Property situated abroad but charge is created in India** Registration of charge is to be done within the normal time of thirty days allowed under Section 125(1), notwithstanding compliance with further procedure being necessary to make the charge valid or effective according to the law of the country where the property is situated.
- (3) **Purchase of a property situated abroad but already subject to charge** — This case is similar to the one under (1) above. The period of thirty days for filing the copy of the instrument with the Registrar shall be counted from a day within which the copy in the normal course would have reached India through post.

11. DEFINITION AND NATURE OF MORTGAGE

According to Section 58 of the Transfer of Property Act, 1882, a mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an agreement which may give rise to pecuniary liability.

The transferor is called a mortgagor, the transferee a mortgagee; the principal money and interest the payment of which is secured for the time being are called the mortgage money and the instrument by which the transfer is effected is called the mortgage deed.

Essentials of a Mortgage

1. **Transfer of Interest:** The first thing to note is that a mortgage is a transfer of interest in the specific immovable property. The mortgagor as an owner of the property possesses all the interests in it, and when he mortgages the property to secure a loan, he only parts with a part of the interest in that property in favour of the mortgagee. After mortgage, the interest of the mortgagor is reduced by the interest which has been transferred to the mortgagee. His ownership has become less for the time being by the interest which he has parted with in favour of the mortgagee. If the mortgagor transfers this property, the transferee gets it subject to the right of the mortgagee to recover from it what is due to him i.e., the principal plus interest.
2. **Specific Immovable Property:** The second point is that the property must be specifically mentioned in the mortgage deed. Where, for instance, the mortgagor stated "all of my property" in the mortgage deed, it was held by the Court that this was not a mortgage. The reason why the immovable property must be distinctly and specifically mentioned in the mortgage deed is that, in case the mortgagor fails to repay the loan the Court is in a position to grant a decree for the sale of any particular property on a suit by the mortgagee.
3. **To Secure the Payment of a Loan:** Another characteristic of a mortgage is that the transaction is for the purpose of securing the payment of a loan or the performance of an obligation which may give rise to pecuniary liability. It may be for the purpose of obtaining a loan, or if a loan has already been granted to secure the repayment of such loan. There is thus a debt and the relationship between the mortgagor and the mortgagee is that of debtor and creditor. When A borrows 100 bags of paddy from B on a mortgage and agrees to return an equal quantity of paddy and a further quantity by way of interest, it is a mortgage transaction for the performance of an obligation.

Where, however, a person borrows money and agrees with the creditor that till the debt is repaid he will not alienate his property, the transaction does not amount to a mortgage. Here the person merely says that he will not transfer his property till he has repaid the debt; he does not transfer any interest in the property to the creditor. In a sale, as distinguished from a mortgage, all the interests or rights or ownership are transferred to the purchaser. In a mortgage, as stated earlier, only part of the interest is transferred to the mortgagee, some of them remains vested in the mortgagor.

To sum up, it may be stated that there are three outstanding characteristics of a mortgage:

- (a) The mortgagee's interest in the property mortgaged terminates upon the performance of the obligation secured by the mortgage.
- (b) The mortgagee has a right of foreclosure upon the mortgagor's failure to perform.
- (c) The mortgagor has a right to redeem or regain the property on repayment of the debt or performance of the obligation.

Kinds of Mortgages

There are in all six kinds of mortgages in immovable property, namely:

- (a) Simple mortgage.
- (b) Mortgage by conditional sale.
- (c) Usufructuary mortgage.
- (d) English mortgage.
- (e) Mortgage by deposit of title-deeds or equitable mortgage.
- (f) Anomalous mortgage.

Difference between Mortgage and Charge

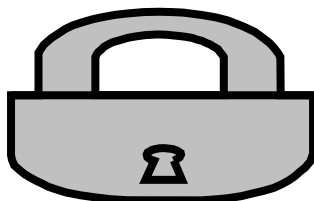
S.No	Mortgage	Charge
1	A mortgage is created by the act of the parties	a charge may be created either through the act of parties or by operation of law
2	A mortgage require registration under the Transfer of Property Act	A charge created by operation of law does not require the registration But a charge created by act of parties requires registration.
3	A mortgage is for a fixed term	the charge may be in perpetuity
4	A mortgage is a transfer of an interest in specific immovable property.	A charge only gives a right to receive payment out of a particular property
5	A mortgage is good against subsequent transferees	A charge is good against subsequent transferees with notice.
6	A simple mortgage carries personal liability unless excluded by express contract	In case of charge, no personal liability is created. But where a charge is the result of a contract, there may be a personal remedy
7	A mortgage is a transfer of an interest in a specific immovable property	There is no such transfer of interest in the case of a charge. Charge does not operate as transfer of an interest in the property and a transferee of the property gets the property free from the charge provided he purchases it for value without notice of the charge

LESSON ROUND-UP



- The power of the company to borrow includes the power to give security also. A charge is a security given for securing loans or debentures by way of a mortgage on assets of the company.
- There are two kinds of charges, fixed or specific charge and floating charge.
- A charge is fixed when it is made to cover assets which are ascertained and definite or capable of being ascertained and defined at the time of creating charge. Whereas floating charge is not attached to any definite property but covers property of a fluctuating type.
- When floating charge crystallizes, it becomes fixed.
- The floating charge allows wide powers to the company to deal with its property until such charge crystallizes.
- A company is required to file e-form 8 through MCA portal giving complete particulars together with the instrument creating charge within 30 days of creation of charges under Section 125 of the Companies Act, 1956.
- A charge identification number is allotted at the time of registration of the charge.
- A registration of charge constitutes a notice to whosoever acquires a future interest in the charged assets.
- In e-governance era, there is a facility for public inspection of charges by electronic means using internet.
- Non-registration does not render the transaction void or the debt non recoverable, but that the security created by the charge is void against the liquidator and other creditors.
- Every company is required to keep at its registered office a register of all charges as well as a copy of instrument creating any charge.
- Company may make petition to CLB (Central Government)* for extension of time for filing particulars of charges to ROC for registration.
- For intimating satisfaction of charge to ROC, e-form 17 is required to be filed.
- For intimating modification of charge, e-form 8 is required to be filed within 30 days of modification.
- Mortgage is created by the act of parties whereas a charge may be created either through the act of parties or by operation of law.

* amended vide Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

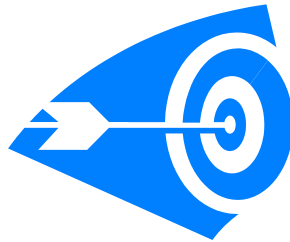
SELF-TEST QUESTIONS

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

1. Define mortgage. State the various types of mortgages.
 2. What are the essentials of a mortgage?
 3. What is a charge? Enumerate the statutory provisions for their registration. State the circumstances under which certain charges may be void against the liquidator or the creditors of company.
 4. What information must be entered in the register of charges maintained by the company? What is the effect of a failure to register a charge?
 5. Can a floating charge become a fixed charge? If so, under what circumstances?
 6. Distinguish between :
 - (a) Fixed and Floating Charge
 - (b) Mortgage and Charge
 7. Under what circumstances a Floating Charge is crystallised?
 8. Discuss various types of registerable charges.
 9. What are consequences of non-registration of charges?
 10. Write short notes on:
 - (a) Satisfaction of Charges
 - (b) Modification of Charges.
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STUDY XI
FINANCIAL STRUCTURE AND MEMBERSHIP-VI
ALLOTMENT AND CERTIFICATES OF SECURITIES

LEARNING OBJECTIVES



An allotment is the acceptance of an offer to take shares by an applicant in response to the shares or debentures offered to public for subscription. Allotment of shares is an important aspect of company. After going through the chapter, you will be able to understand what does allotment mean, what are the various statutory provisions regarding Allotment, what is minimum subscription, effects of irregular allotment, what is allotment procedure etc.

The topics covered under the chapter are:

- Allotment of shares
- General principles regarding allotment
- Statutory provisions regarding allotment
- Effect of irregular allotment
- Revocation by applicant
- Ultra vires allotment
- Allotment procedure
- Share certificate
- Share warrant
- Personation of shareholder
- Calls and forfeiture

1. ALLOTMENT OF SHARES

“Allotment” of shares means the act of appropriation by the Board of directors of the company out of the previously un-appropriated capital of a company of a certain number of shares to persons who have made applications for shares (*In Re Calcutta Stock Exchange Association*, AIR 1957 Cal. 438). It is on allotment that shares come into existence.

The re-issue of forfeited shares does not constitute appropriation out of unappropriated capital, and therefore is not an allotment within the meaning of Section 75(1) of the Companies Act, 1956 and a company need not file return in e-Form No. 2 in respect of the re-issue of forfeited shares.

Notice of Allotment

An allotment is the acceptance of an offer to take shares by an applicant, and like any other acceptance it must be communicated. Thus, a binding contract between the company and the applicant could emerge only when the allotment is made by a resolution of the Board of directors and notice of such allotment has been given to the allottee. If the notice (i.e. the Allotment Advice/Letter of Allotment) is posted to the proper address of the allottee, the contract will result even if the allotment letter does not reach him or is delayed in post. It should be noted that the allotment and its communication result in a contract between the company and the allottee. The allottee does not automatically become a member of the company, until his name is placed on the register of members.

2. GENERAL PRINCIPLES REGARDING ALLOTMENT

The following general principles should be observed with regard to allotment of shares:

- (1) **The allotment should be made by proper authority**, i.e. the Board Directors of the company, or a committee authorised to allot shares on behalf of the Board.
- (2) **Allotment of shares must be made within a reasonable time** (As per Section 6 of the Indian Contract Act, 1872, an offer must be accepted within a reasonable time). What is a reasonable time is a question of fact in each case. An applicant may refuse to take shares if the allotment is made after a long time
- (3) **The allotment should be absolute and unconditional**. Shares must be allotted on same terms on which they were applied for and as they are stated in the application for shares. Allotment of shares subject to certain conditions is also not valid. Similarly, if the number of shares allotted is less than those applied for, it cannot be termed as absolute allotment.
- (4) **The allotment must be communicated**. As mentioned earlier posting of letter of allotment or allotment advice will be taken as a valid communication even if the letter is lost in transit
- (5) **Allotment against application only** — No valid allotment can be made on an oral request. Section 41 requires that a person should agree in writing to become a member.
- (6) **Allotment should not be in contravention of any other law** — If shares are allotted on an application of a minor, the allotment will be void.

Judicial pronouncement relating to allotment of shares

- (A) Allotment made without proper authority will be invalid. Allotment of shares made by an irregularly constituted Board of directors shall be invalid [*Changa Mal v. Provisional Bank (1914) ILR 36 All 412*].
- (B) It is necessary that the Board should be duly constituted and should pass a valid resolution of allotment at a valid meeting [*Homes District Consolidated Gold Mines Re (1888) 39 Ch D 546 (CA)*].
- (C) An allotment may be valid even if some defect was there in the appointment

of directors but which was subsequently discovered. (Section 290 and the Rule in *Royal British Bank v. Turquand* (1856) 6 E & B 327 : (1843-60) All ER Rep 435)

- (D) An allotment by a Board irregularly constituted may be subsequently ratified by a regular Board [*Portugese Consolidated Copper Mines, (1889) 42 Ch. D 160 (CA)*].
- (E) A director who has joined in an allotment to himself will be estopped from alleging the invalidity of the allotment [*Yark Tramways Co. v. Willows, (1882) 8 QBD 685 (CA)*].
- (F) The interval of about 6 months between application and allotment was held unreasonable [*Ramsgate Victoria Hotel Company v. Montefione (1866) LR 1 EX 109*].
- (G) Where an applicant applied for shares on the condition that he will be appointed as branch manager of company but later on the condition was breached, it was held that he is not bound by the allotment of shares [*Ramanbhai v. Ghasi Ram (1918) BOM. LR 595*].
- (H) Grant applied for certain shares in a company, the company dispatched letter of allotment to him which never reached him. It was held that he was liable for the balance amount due on the shares. [*Household Fire And Carriage Accident Insurance Co. Ltd. Grant (1879) 4 E.D. 216*]
- (I) The mere entry of a shareholder's name in the company's register is insufficient to establish that an allotment was in fact made [*Official Liquidator, Bellary Electric Supply Co. v. Kanni Ram Ramwoothmal (1933) 3 Com Cases 45; AIR 1933 Med 320*].
- (J) There can be no proper allotment of shares unless the applicant has been informed of the allotment [*British and American Steam Navigation Co. Re. (1870) LR 10 Eq 659*].
- (K) A formal allotment is not necessary. It is enough if the applicant is made aware of the allotment. [*Universal Banking Corpn. Re. Gunn's Case (1867) 3 Ch App 40*].

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

An allotment of shares should be communicated.

- True
- False

Correct answer: True

3. STATUTORY PROVISIONS REGARDING ALLOTMENT

The Companies Act lays down the following conditions to be fulfilled before a Company can proceed to allot shares:

- (a) The Company intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchange(s) for permission for

the shares or debentures to be dealt with in the regional stock exchange or each of such stock exchanges [Section 73(1)]. If permission is not granted by any one of the stock exchanges named in the prospectus, the consequence by virtue of Section 73(1A) would render the entire allotment void. [*Rishyashringa Jewellery Ltd. v. Stock Exchange* 1995 6 SCL 227].

- (b) The company shall file with the Registrar, a prospectus or a statement in lieu of prospectus in e-form 19 or e-form 20, as the case may be, before making an allotment signed by every person who is named therein as a director.
- (c) The company shall receive in cash the amount payable on application which shall not be less than 5 percent of the nominal value of the shares and must keep in deposit the amount so received in a scheduled bank in a separate account till the allotment is made and until the certificate to commence business has been obtained under Section 149 of the Companies Act, 1956. [Section 69]
- (d) Where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription, as provided in the prospectus, has been received by the company.

Share application money collected should be kept deposited in a separate account with bankers to the issue only [*Rich Paints Ltd. v. Vadodara Stock Exchange Ltd.* (1998) 15 SCC 128/92-Comp Cas 8 (Guj.)].

If the above conditions are not fulfilled within 120 days of the first issue of prospectus, all moneys shall be refunded forthwith. If not refunded within 130 days, the directors are jointly and severally liable to repay the amount together with interest @ 6% p.a. from the expiry of the one hundred and thirtieth day.

- (e) No allotment shall be made where a prospectus is issued generally until the beginning of the fifth day after the date on which the prospectus is so issued or such later date as may be specified in the prospectus. This date is known as the "date of opening of the subscription list" (Section 72).
- (f) Closing of the Subscription List — SEBI Issue of Capital and Disclosure Requirements Regulations, 2009 (ICDR)] provide that the subscription list must be kept open for atleast 3 working days and not more than 10 working days and in the case of infrastructure company, the maximum period is 21 working days. In case of Rights issue, the SEBI ICDR Regulations provide that the issue shall remain open for atleast 15 days and not more than 30 days.
- (g) If the company having a share capital does not issue a prospectus, it cannot proceed with the allotment unless it files with the Registrar of Companies atleast 3 days before the first allotment, a Statement in lieu of prospectus in e-form 20 in Schedule III and must contain the particulars and reports set out therein.

3. ALLOTMENT OF SHARES/DEBENTURES TO BE LISTED ON STOCK EXCHANGE

Section 73(1) provides that every company intending to offer shares or debentures to the public for subscription by issue of prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for enlistment of its shares or debentures.

Sub-section 73(1) was inserted by the Companies (Amendment) Act, 1988 making the listing of all public issues compulsory with atleast one recognised stock exchange.

Section 73(1A) provides that where a prospectus states that application under Sub-section (1) has been made for permission for the shares or debentures offered thereby to be dealt in one or more recognised stock exchanges, then the allotment shall be void if the permission has not been granted by the stock exchange or each such stock exchange as the case may be, before the expiry of ten weeks from the date of the closing of the subscription lists.

However, where a stock exchange refuses to grant an application or fails to dispose it off within 10 weeks, the company may, under Section 22 of the Securities Contracts (Regulation) Act, 1956 appeal to the Securities Appellate Tribunal against the refusal:

- (1) within 15 days from the date of the refusal, or
- (2) within 15 days from the date of the expiry of 10 weeks. It can be seen that the obtaining of permission to deal is a condition precedent to allotment once the prospectus has stated that it has been or will be applied for.

Section 73(2) of the Companies Act, 1956 states that where the allotment is void under Section 73(1) because either the application has not been made for listing or the permission has not been granted, the company must repay the application money at once to the applicants, and if it is not repaid within 8 days after the company becomes liable to repay, the company and every director of company who is an officer in default shall on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest not less than @ 4% but not more than @ 15% p.a.

Section 73(2A) provides that where permission has been granted by the recognised stock exchange or exchanges, and the moneys received from applicants for shares or debentures are in excess of the aggregate of the application moneys relating to the shares or debentures allotted, the company must repay the excess amount forthwith without interest. If such money is not repaid within 8 days, then the company and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, (from the day the company becomes liable to pay) be, jointly and severally, liable to repay the money with interest at such rate, not less than four percent and not more than fifteen percent as may be prescribed, having regard to length of the period of delay in making the repayment of such money [vide Rule 4D of the Companies (Central Government's) General Rules & Forms, 1956, 15 percent interest has been prescribed]. If default is made in complying with this provision then the company and every officer in default shall be liable to be fined upto Rs. 50,000 and where the repayment is not made within 6 months from the expiry of the 8th day, also with imprisonment upto one year [Section 73(2A) and (2B)].

Section 73(3) states that all moneys received from applicants for shares must be kept in a separate account maintained with a scheduled bank and they shall not be utilised for any purpose other than adjustment against allotment of shares or for repayment to the applicants.

As per Section 73(5), it shall be deemed that the permission has not been

granted if the application for permission, for listing of companies shares, has not been disposed of within 10 weeks from the date of the closing of the subscription list.

In *CIT v. Henkel Spic India Ltd. Comp. Cases 189 (2004)* the Madras High Court held that any interest earned on application money deposited with the bankers, pending receipt of permission of listing on a stock exchange cannot be treated as money available to the company. The interest is an amount which accrues on a fund which is itself held in trust, until the allotment is completed and monies are returned to those to whom shares are not allotted. Therefore, only at a point, when the trust terminates, it can be stated that amount has accrued to the company as its income.

Basis of Allotment

Clause 45 of listing agreement requires that the allotment of securities offered to public shall be made within 30 days of closure of public issue. In case the allotment is not made or refund order not dispatched to investors within 30 days from the date of closure of issue, then the Company shall pay interest @ 15% p.a. as per the listing agreement.

Over Subscription

According to SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009, no allotment shall be made by the issuer in excess of the specified securities offered through the offer document. However, in case of oversubscription, an allotment of not more than ten per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

Minimum Subscription

Section 69(1) states that no shares shall be offered to the public until the minimum subscription stated in the prospectus has been subscribed and the amount payable on application has been received in cash by the company. In this context, SEBI has prescribed that any company making public or right issue must receive a minimum of 90 percent of the issue including devolvement on underwriters subscription against the entire issue before making allotment.

The amount of minimum subscription must be stated in the prospectus. Any amount other than in cash should not be included in the minimum subscription.

If the minimum subscription is not raised within 120 days after the issue of the prospectus the money paid by the subscribers must be returned forthwith. If it is not so returned, the directors become liable to repay the money with 6% interest from the end of the 130th day. All money received from the applicants should be kept deposited in a separate account with a scheduled bank until the company obtains the certificate to commence business. In case the company has already obtained the said certificate the amount so received should be kept in a scheduled bank until the entire amount payable on application for shares in respect of minimum subscription has been received by the company.

Letter of Allotment

The company is required to issue letter of allotment to persons who are allotted shares. Such letter is called Letter of Allotment. Such persons are required to surrender this letter of allotment to company for issue of share certificate.

Letter of Renunciation

Under Section 81, when the Public Company, at any time after 2 years from the formation of company or at any time after the expiry of the one year from the allotment of shares in that company made for the first time after its formation whichever is earlier, proposes to increase the subscribed capital of company by allotment of further shares, then the Board of directors are required to offer the shares first to existing shareholders.

Such shareholders are also given an option to renounce the shares in favour of any other person. The letter, through which such shareholders renounce shares in favour of other person is called "Letter of renunciation".

If the person to whom offer is made or the person in whose favour offer is renounced does not accept the shares, the Board may dispose of them in such manner as they think fit for the benefit of the company.

4. EFFECT OF IRREGULAR ALLOTMENT

An allotment is irregular if it is made without complying with the conditions precedent to a regular allotment as discussed above, viz, the provisions of Section 69 and 70 of the Act.

Consequences of irregular allotment depend upon the nature of irregularity involved. These may be noted as follows:

1. **Failure to deliver a copy of the prospectus to the Registrar before its issue** — In case an allotment has been made without delivering to the Registrar of Companies, a copy of the prospectus along with other specified documents either before or on the date of its issue, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to Rs. 50,000 [Section 60(5)]. The allotment, however, shall remain valid.
2. **Non-compliance with provisions of Section 69 and Section 70** — In the event of non-compliance with the provisions of Section 69 and Section 70 (viz allotment without raising minimum subscription or without either collecting application money or collecting less than 5 percent as application money or failure to deliver a copy of statement in lieu of prospectus at least three days before allotment), the following consequences shall follow (as mentioned in Section 71):
 - (a) The allotment is rendered voidable at the option of the applicant. The option must however be exercised —
 - (i) within 2 months after the holding of the statutory meeting of the company and not later; or
 - (ii) where the company is not required to hold a statutory meeting, or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment and not later.

The irregular allotment is voidable even if the company is in the course of being wound up.

- (b) Any director who has knowledge of the fact of the irregular allotment of shares shall be liable to compensate the company and the allottee respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred thereby. Proceedings to recover any such loss, damages or costs cannot be commenced after the expiration of 2 years from the date of allotment.

Rectification by company of irregular allotment

An irregular allotment of shares made by the directors in excess of their powers may be subsequently ratified by the shareholders at a general meeting [*Bamford v. Bamford*, (1969) 39 Com Cases 369].

Lapse of application on undue delay in allotment

An application to take shares lapses if allotment is delayed unreasonably [*Ramsgate Victoria Hotel v. Montefiore* (1866) LR 1 Ex 109 (C Ex)].

Cases where applicant cannot avoid allotment

We had noted earlier, that an allottee can avoid the allotment within the time frame mentioned in Section 71(1) of the Companies Act, 1956. However, the applicant cannot avoid the allotment if he unequivocally affirms the allotment by endeavouring to sell the shares, [Ex. P. Briggs 1866 LR 1 Eq 483]; (2) by executing a transfer of the shares [Crawley's case (1969) LR 4 Ch App 322]; (3) by paying calls or receiving dividends, [*Scholey v. Central Railway of Venezuela* (1868) LR 9 Eq 266]; (4) by attending and voting at a general meeting in person or by proxy, [*Sharpley v. Louth Co.* (1876) 2 Ch. 663 (CA)].

3. **Non-compliance of Section 72** — In case allotment is made in contravention of the provisions of Section 72 (viz, before the beginning of the fifth day from the date of issue of the prospectus), the company and every officer of the company shall be punishable with fine which may extend to Rs. 50,000 [Section 72(3)]. However, allotment in such a case shall be valid.
4. **Condition as to listing of shares on a stock exchange is not observed** — Where the prospectus of a company states that an application has been made for permission for the shares offered thereby to be dealt in one or more recognised stock exchanges, the allotment shall be void, if either the permission has not been applied for or refused or not granted before the expiry of 10 weeks from the date of the closing of the subscription list [Section 73(1) and (2)].

In a particular case, a company proposed public issue at a premium and it stated in the prospectus that it had applied for listing of the shares in four recognised stock exchanges. Three of the stock exchanges granted permission for listing after the Central Government had issued orders in this regard. The petitioner contended that the allotment made is void under Section 73 of the Companies Act. The court held that the question of public issue being declared void does not arise as three exchanges had granted listing permission [*Smt. Urmila Barutha v. Coventry Spring & Engineering Co. Ltd. and Other* (1997) 2 CLJ 48 (Cal)].

However, where an appeal against the decision of any recognised stock exchange refusing permission has been preferred with Securities Appellate Tribunal, under Section 22 of the Securities Contracts (Regulation) Act, 1956 such allotment shall not be void until the dismissal of the appeal [Section 73(1A)].

In case of allotment becoming void, the money becomes due to be refunded forthwith and must therefore be repaid.

5. REVOCATION BY APPLICANT/ALLOTTEE

Ordinarily the provisions of Law of Contract apply to applications and allotment of shares. An application is an offer by the applicant and allotment is an acceptance of the offer by the company. An offer can be revoked at any time before there is an acceptance to allot shares by the company subject to the provisions and restrictions of the Companies Act.

6. ULTRA VIRES ALLOTMENT

Where the directors have no authority under the company's Articles of Association to make an allotment, the allotment would be irregular and may be ratified by the company. But it would be void where the company itself has no power to make an allotment. At common law any subscription money was returnable to the allottee. [*Waverly Hydropathic Co. v. Barrowman*, 1895 23 R. 136].

Allotment of shares to a charitable Institution by way of donation

If there is no payment in monies worth for the shares; the allotment would be ultra vires. In case of allotment for consideration, other than cash, there is a requirement for companies to disclose in the return of allotment the number of shares allotted by it for consideration otherwise than in cash. Allotment of shares by the company as fully paid up shares to charitable trust by way of donation shall not be valid.

7. ALLOTMENT PROCEDURE

Where the company has received from bankers all the share applications, the directors shall proceed with the allotment of shares. If the issue is fully subscribed, then there is no difficulty in allotment of shares. If, however, the issue is over-subscribed, then shares are allotted on the basis of scheme of allotment worked out in consultation with the Stock Exchange(s) where shares are to be listed, by a Board/Committee resolution. The Board also authorises the Secretary, by a resolution, to issue letter of allotment or Allotment Advice-cum-Allotment Money Notice and letters of regret, as the case may be, to all the applicants. The resolution should also provide for the refund of the application money.

When the company's issue is over-subscribed, the directors allot less shares to all or some applicants than applied for, it is called partial allotment. Allotment of lesser than the number of shares applied for is not binding on the applicant. He may accept or refuse the shares allotted to him, as the allotment of fewer shares is a counter-offer by the company to the applicants. Hence, in order to guard against any such problem, the application forms provide for such clauses accepting the partial allotment by the applicants.

Return of Allotment

Section 75 of the Companies Act provides that after allotment of shares by any company, a return of allotment in the prescribed e-form 2 even if it is of a single share, must be filed with the Registrar of Companies within thirty days of the allotment of shares.

(a) Where shares are allotted for cash

The return of allotment must state:

- (i) The number and nominal amount of the shares allotted.
- (ii) The amount paid or payable on each share.
- (iii) The class of shares-equity or preference.
- (iv) The amount of premium paid/discount.

The company shall in no case show in such return any shares as having been allotted for cash if cash has not actually been received in respect of such allotment [Proviso to Section 75(1)(a)]. As per the Department of Company Affairs (Now, Ministry of Corporate Affairs) allotment of shares by a company to a person in lieu of a genuine debt due to him is in perfect compliance with the provisions of Section 75(1). In this connection, it has been clarified that the act of handing over cash to the allottee of shares by a company in payment of its debt and the allottee in turn returning the same cash as payment for the shares allotted to him is not necessary for treating the shares as having been allotted for cash. What is required is to ensure that the genuine debt presently payable by a company is liquidated to the extent of the value of shares [Circular 8/32 (75) 77-CL/V dated 13th March 1978].

(b) Where shares (other than bonus shares) are allotted fully or partly paid-up otherwise than in cash (e.g. where consideration for allotment of shares is paid by way of property, goods or services), the following are required:

- (i) A copy of contract, if any, for allotment of such shares is required to be attached with the e-form.
- (ii) The contract of sale or for services or other consideration for which the allotment was made; and
- (iii) A return stating the number and nominal amount of the shares so allotted, to the extent to which they are paid-up, and the consideration for which they are allotted.

Where shares are issued as fully or partly paid up in consideration of a property thereafter to be sold to the company or services to be rendered to the company or in consideration of the release of a claim or by way of compromise, the issue is for consideration other than cash.

(c) Where bonus shares have been issued, a return must be filed with the Registrar stating:

- (i) The number and nominal amount of such shares comprised in the allotment;
- (ii) The names, addresses and occupation of the allottees; and
- (iii) A copy of the resolution authorising the issue of such shares is required to be attached with the e-form 2.

- (d) **Where the shares have been issued at a discount, A copy of the resolution passed by the company authorizing such issue and a copy of the order of the Central Government sanctioning the issue must be filed with the Registrar. If rate of discount exceeds 10% the relevant order of the Central Government must also be filed with the Registrar as an attachment with e-form 2.**

It should be ensured that filing of e-form 23 precedes filing of e-form 2, in case e-form 23 is required to be filed in relation to the resolution passed for issue of shares under Section 81(1A) of the Act.

The following items are also required to be attached with e-form 2 along with the earlier stated attachments:

1. List of allottees.
2. Copy of board or members' resolution approving the allotment of shares.
3. In case of allotment of shares for consideration otherwise than in cash, attach copy of contract.
4. In case of issue of bonus shares, attach copy of said resolution.
5. In case of issue of shares at discount, attach copy of resolution with copy of order of Central Government (Company Law Board).

E-form 2 is required to be digitally signed by managing director or director or manager or company secretary of the company. Further the e-form is required to be precertified by certifying professionals (Chartered Accountant or Cost Accountant or Company Secretary in whole time practice).

Penalty: If default is made in complying with the provisions of Section 75, as stated above, every officer of the company who is in default shall be punishable with fine which may extend to Rs. 5000 for every day during which the default continues. However, where the default relates to contravention of proviso to clause (a) Sub-section (1), viz showing in the return that shares have been allotted for cash, when such is not the case, every promoter and every officer of the company who is guilty of the contravention shall be punishable with fine which may extend to Rs. 50,000 [Section 75(4)].

Judicial Pronouncement about return of Allotment

1. **In *Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd. 1963-(033)-Comp Cas-0862-SC***, the Supreme Court held that the exchange was not liable to file any return of the forfeited shares under Section 75(1) of the Companies Act, 1956, when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital and approved the observations of *Harries C.J. in S.M. Nandy's case* that: "On such forfeiture all that happened was that the right of the particular shareholder disappeared but the shares considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it".
2. ***Alote Estate v. R.B. Seth Hiralal Kalyanmal Kasliwal [1970] 40 Comp.***

1116 (SC), In case of inadequacy of consideration, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full, unless the contract is fraudulent.

3. **Harmony and Montage Tin and Copper Mining Company; Spargo's case (1873) 8 Ch. App. 407.** Any payment which is presently enforceable against the company such as consideration payable for property purchased, will constitute payment in cash [].
4. **Chokkalingam v. Official Liquidator AIR 1944 Mad. 87.** Allotment of shares against promissory notes shall not be valid.

Cases where return of allotment is not required to be filled

- (a) Issue of debentures
- (b) Re-issue of forfeited shares
- (c) Shares subscribed by subscribers to memorandum of association
- (d) On conversion of debentures or loan into equity by an order of Central Government u/s 81(4).

8. SHARE CERTIFICATE

8.1 What is a share certificate

A share certificate is a certificate issued to the members by the company under its common seal specifying the number of shares held by him and the amount paid on each share. According to Section 83 of the Companies Act, 1956 each share of the share capital of the company shall be distinguished with a distinct number for its individual identification. However, such distinction shall not be required, as per proviso to Section 83, if the shares in a company are held in depository form.

In terms of Section 84(1) of the Act, a certificate under the common seal of the company is prima facie evidence of the title of the member to the shares specified therein. The certificate is the only documentary evidence of title in the possession of the shareholder. But it is not a warranty of title by the company issuing it.

8.2 Time of issue of Share Certificate

Under Section 113(1) of the Act where shares have been allotted to an applicant or where a valid transfer of shares by a shareholder to another person has been lodged with the company, the company (unless prohibited by any provision of law or any order of any Court, Tribunal or other authority) must deliver within three months after the allotment and within two months after the receipt of the applications for registration of transfers, a certificate or certificates evidencing the title of the allottee or transferee to the shares allotted or transferred. In case of listed companies the period prescribed is two months allotment and one month for transfer. However, such period may be extended upto a further period of nine months by the Company Law Board for issuing debenture certificates [See proviso to Section 113(1)].

Where the Securities are dealt in a depository system, the company shall intimate the details of allotment of securities to a depository immediately on allotment of such securities under Section 113(4) inserted by the Depositories Act, 1996.

As per Rule 8 of the Companies (Issue of Share Certificate) Rules, 1960, all blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board of directors.

If default is made in complying with these provisions, the company and every officer of the company who is in default, shall be liable to fine upto Rs. 5000 for every day during which the default continues. A person entitled to the certificate may give notice to the company to make good the default and if the company fails to do so, he may apply to the Company Law Board (CLB). The CLB will then ask the company to make good the default within a specified period of time and pay costs of and incidental to, the application.

8.3 Significance of Share Certificate

A certificate of shares is an evidence to the effect that the allottee is holding a certain number of shares of the company showing their nominal and paid-up value and distinctive numbers. This certificate is a prime facie evidence of title to the shares in the possession of shareholders. [*Societe Generale De Paris v. Walker*, (1885) 11A AC 20, 29].

Moreover, when the company issues a certificate, it holds out to the world that the facts contained therein are true. Any person acting on the faith of the share certificate of the company, can compel the company to pay compensation for any damage caused by reason of any misstatement in the share certificate as the company is bound by any statements made in the certificate.

Share certificate is the only documentary evidence of title and that the share certificate is a declaration by the company that the person in whose name the certificate is issued is a shareholder in the company. [*Ghanshyam Chhaturbhuj v. Industrial Ceramics (Pvt.) Ltd.* (1995) 4 Com LJ 51].

Also the company cannot dispute the amount mentioned on the certificate as already paid. [*Bloomenthal v. Ford* (1897) AC 156 (HL)].

8.4 Damages against Company and Directors for wrong certificates

As already mentioned, a person acting on the share certificate issued by the company may recover compensation for the damages suffered by him. The measure of damage is the value of the shares at the time of the refusal by the company to recognise him as a shareholder together with interest from that date. [*Bahla and San Francisco Rly. Co.*, (1868) LR 3 QB 584].

Where directors issue a certificate of title of shares which the company has no power to issue, they may be held personally liable to damages on an implied warranty of authority to any person who acts on such certificate. As per Section 113(3) compensation is paid for actual losses/costs incurred by an applicant but not for any hypothetical losses suffered by the applicant.

8.5 Split Certificate

A split certificate means a separate certificate claimed by a shareholder for a portion of his holding. The advantages of a split certificate are that the shareholder

may benefit in case of a transfer by way of sale or mortgage in small lots and the right to multiply the certificates into as many shares held by the shareholder.

8.6 Purpose and Form of Share Certificate

With the help of a share certificate a member of a company may deal with his shares in the market whether it is one of sale, mortgage or pledge by showing a good *prima facie* marketable title to the shares. A share certificate is a documentary evidence of title to shares in the possession of the shareholder. It is a *prima facie* evidence of his title to the shares.

The Act does not provide for any specific form of a share certificate. Rule 5 of the Companies (Issue of Share Certificates) Rules, 1960 provides that every share certificate shall specify the name(s) of the person(s) in whose favour the certificate is issued, the shares to which it relates and the amount paid-up thereon. Every share certificate should also state the name of company, address of its registered office and date of issue. In case of listed companies, the size, form and contents of the share certificate are required to be approved by the concerned Stock Exchange before its issue to the public.

8.7 Specifying authorised capital on share certificate

It is not obligatory to publish the authorised capital of the Company on its share certificates. However, where the Company does so, it would be mandatory in terms of Section 148, to publish the subscribed and the paid-up capital also. Paid-up capital for the purpose would mean the capital paid-up at the time of the issue of the share certificate [DCA Circular No. 8/35 (147)/66-CL-V, dated 13th January, 1967].

8.8 Issue of Share Certificates

The Companies (Issue of Share Certificate) Rules, 1960 provides that when a company issues any capital, no share certificate shall be issued except-

- (i) In pursuance of a Board resolution and;
- (ii) On surrender to the company of its letter of allotment or its fractional coupons of requisite value, save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares.

Provided that if the letter of allotment is lost or destroyed the Board may impose such reasonable conditions as to evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating evidence as the Board thinks fit.

8.9 Issue of Duplicate Share Certificate

Section 84(4) confers the right to obtain the duplicate share certificate when the original certificate is lost or destroyed or has become mutilated and issue of such certificate is governed by rules of the Companies (Issue of Share Certificate) Rules, 1960.

Section 84(2) provides that a certificate may be renewed or duplicate of a certificate may be issued if such certificate is proved to have been lost or destroyed, or having been defaced or mutilated or torn is surrendered to the company.

No share certificate shall be issued either in exchange for those which are sub-divided or consolidated or in replacement of those which are defaced, torn, mutilated or worn out, or where the cages in the reverse of the certificate for recording transfers have been fully utilised, unless:

- (1) the consent of the Board is given (in case of loss or destruction of certificate);
- (2) the certificate in lieu of which it is being issued is surrendered to the company and is cancelled;
- (3) Payment of fees for issue of duplicate certificate is made by the shareholder (not exceeding Rs. 2 per share certificate);
- (4) Proper evidence and indemnity to the satisfaction of the company is furnished;
- (5) out-of-pocket expenses estimated to be incurred by the company in investigating the evidence, as the Board may think fit, are deposited with the company, in case of lost or stolen share certificates the cost of public notice shall also be borne by the member;
- (6) the words "Duplicate issued in lieu of Share Certificate No. .../Sub-divided/ Replaced/Lost/Consolidation of share (as the case may be)" are rubber stamped on its face and also on the counterfoil. The word 'Duplicate' may either be rubber stamped or punched;
- (7) Mutilated, defaced or torn certificates surrendered shall be defaced by a 'cancellation' mark and destroyed after three years with the authority of Board.

Once a duplicate certificate is issued, the original certificate becomes extinct. In order to safeguard the original shareholder from any jeopardy, it is necessary under Sub-section (2)(a) of Section 84 that there is proof of the fact that the original has been lost or destroyed. It has been held by the Company Law Board that the original cannot be said to have been lost or destroyed as long as the existence of the original is known. Hence, as a matter of precaution public notice of the loss must be given whenever duplicate certificate is sought. This will be particularly more necessary where a substantial number of share certificates are involved. No company should take this precaution lightly. An issue of duplicate certificates was held to be not in accordance with Section 84(2) where the precautions prescribed by the sub-section for ascertaining genuineness of loss were not observed. The purpose of the sub-section is to safeguard the share market from fraudulent dealings in duplicates.

If the company refuses to issue a duplicate share certificate, the remedy of the aggrieved person is to file an application in terms of Rule 9 and Rule 11(b) of the Companies (Court) Rules, 1959. The application has to be filed in the High Court and there must be a specific prayer for a direction to the concerned company to issue a duplicate share certificate.

If a certificate is renewed or a duplicate is issued with fraudulent notice, a fine upto Rs. 10,000/- shall be imposed on the company and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to Rs. 10,000/- or with both (Section 84). if any person impersonates or obtains a certificate fraudulently he may be liable for imprisonment up to three years and also with fine (Section 116).

In case of loss of share certificates a newspaper advertisement can be issued by a company only upon receipt of an application by the registered shareholder or in case of his death by the legal representatives of the deceased stating loss of original share certificates and asking for issue of duplicate share certificates.

Where company issuing duplicate certificates was aware of the whereabouts of original share certificates, same could not be deemed to have been lost and, therefore, issue of duplicate certificates was irregular being not in conformity with Section 84(2).

8.10 Sealing and Signing of Certificate

Accordance to Rule 6 of the Companies (Issue of Share Certificate) Rules, 1960, every share certificate shall be issued under the common seal of the company, which shall be affixed in the presence of (i) two directors or persons acting on behalf of the directors under a duly registered power of attorney; and (ii) the secretary or some other person appointed by the Board for the purpose. The two directors or their attorney/attorneys and the secretary or other person shall sign the share certificates.

Provided that, if the composition of the Board permits, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director.

Explanation: For the purpose of this Rule, a director may sign a share certificate by affixing his signatures thereon by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, but not by means of a rubber stamp, provided that the director shall be responsible for the safe custody of such machine, equipment or other material used for the purpose

8.11 Records of Certificates

- (1) Particulars of every share certificate issued in accordance with Rule 4, sub-rule (1) shall be entered in the Register of Members in a form as near thereto as circumstances admit against the name(s) of person(s) to whom it has been issued, including the date of issue.
- (2) Particulars of every share certificate issued in accordance with Rule 4, sub-rules (2) and (3) shall be entered in a Register of Renewed and Duplicate Certificates indicating against the name(s) of the person(s) to whom the certificate is issued the number and the date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-reference in the „Remarks’ column.
- (3) All entries made in the Register of Members or the Register of Renewed and Duplicate Certificates shall be authenticated by the secretary or such other person as may be appointed by the Board for the purpose of sealing and signing the share certificate under the provisions of Rule 6.

8.12 Whether Share Certificate an Official Publication

The question whether a share certificate is an official publication within the meaning of Section 147(1)(c) was considered by the Department of Company Affairs (Now, Ministry of Corporate Affairs) and the Department has clarified vide Circular

No. 3/73[8/10(47)]/72-CL-V dated 3.2.1973 as follows:

“It will be seen that in terms of Section 82, the shares in a company are movable property transferable in the manner provided in the articles of the company.

Section 84 provides that a certificate under the common seal of the company specifying any share held by any member shall be prima facie evidence of the title of the member to such share.

Thus, shares are movable property transferable in the manner provided in the articles of the company and that the share certificates are certificates of title and are movable property but are not publications in the nature of prospectus, balance sheet, profit and loss account, notice or advertisement.

The conclusion reached, therefore, is that the share certificate is not an official publication within the meaning of Section 147 (1)(c).

8.13 Legal Effect of Share Certificate

We have already stated that a share certificate is prima facie evidence to the title of the person whose name is entered on it. It means that the share certificate is a statement by the company that the moment when it was issued, the person named in it was the legal owner of the shares specified in it, and those shares were paid-up to the extent stated. It does not constitute title but it is merely evidence of title. It is, however a statement of considerable importance, for it is made with the knowledge that other persons may act upon it in the belief that it is true and this fact brings into operation the doctrine of estoppel. As a result, a share certificate once issued by the company binds it in two ways, namely:

- (a) by estoppel as to title, and
- (b) by estoppel as to payment.

Estoppel as to Title: A share certificate once issued binds the company in two ways. In the first place, it is a declaration by the company to the entire world that the person in whose name the certificate is made out and to whom it is given is a shareholder in the company. In other words the company is estopped from denying his title to the shares.

Estoppel as to Payment: If the certificate states that on each of the shares full amount has been paid, the company is estopped as against a bona fide purchaser of the shares, from alleging that they are not fully paid.

If a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company *Barrow case, (1880) 14 Ch D 432: 42LT 891CA*

Despite everything, a certificate must be issued by someone who has the authority. For example, where the secretary forged the signature of two directors in a company, the company had refused to register the holder of shares as a member. Further a certificate is not evidence as to the equitable interest in shares. Also, where an individual is aware of the false statements in a certificate, he will not be entitled to claim an estoppel.

Judicial pronouncement relating to share certificate

1. In **Re. Bahia and Skin Francisco Rail Co. (1868) L.R. 3 Q.B. 584**, „T’ a registered shareholder, left her shares with her broker. A forged deed of transfer of these shares to „S’ together with the certificate was lodged with the company for registration. In the usual way the Secretary wrote to „T’ informing her of the proposed transfer and in the absence of a reply registered „S’, issuing him a certificate and removing „T’s name from the register. „S’ sold the shares to „B’ who relied on the certificate and „B’s name was placed on the register. Later the forgery was discovered and the company was ordered to restore T’s name as holder of the shares. In an action for damage by „B’. it was held that „B’ was entitled to recover damages from the company for the loss of the shares as „B’ had relied on the company’s statement as to title made in the certificate. The measure of damages would be the value of the shares at the time the company refused to recognise “B” as holder plus interest from that time
2. In **Re. Ottos Kopje Diamond Mines (1993) 1 Ch. 618** „A’ bought from „B’ 4,000 shares in a company on the faith of certificate issued by the company. A tendered to the company a transfer deed from „B’ to himself duly executed together with the share certificate. The company discovered that the certificate in the name of B had been fraudulently obtained and refused to register the transfer. It was held that though the certificate was not a warranty of title upon which „A’ could maintain against the company, it estopped the company from disputing A’s right to be registered. „A’ could maintain against the company, it estopped the company from disputing A’s right to be registered. „A’ could claim damages from the company to the extent of the value of the shares at the time, it refused to register
3. In another case, an individual applied for shares in a company. An officer of the company fraudulently transferred 800 shares in favour of the individual inspite of the fact that he owned no shares, the company registered the transfer and issued a new certificate to the applicant of shares. The company was liable for damages to him.
4. It should be noted that in case of a controversy as to whether a person is a member on the basis of the certificate as issued to him though his name may not be placed in the Register of Members, it has been held that the Register of members could be subject to manipulation and membership evidenced through the share certificate would get precedence.
5. In **Bloomenthal v. Ford, (1897) A.C.: 156 B**, lent Rs. 1,000 to a company on the security of 1,000 shares which were issued to him as fully paid. In fact nothing had been paid on them. In the winding up of the company it was held that neither the company nor the liquidator could deny that the shares were fully paid and therefore „B’ could not be called upon to pay anything on those shares. When a company issues a share certificate, that certificate creates an estoppel so that the company cannot afterwards deny, as against a person who has acted on the faith of the truth of the matter stated in it.
6. **Tracstar Investments Ltd. v. Gordon Woodroffe Ltd., (1996) 87 Com. Cases. 941 (CLB-Mad)]**. A Division Bench of the Madras High Court affirmed this decision in *Shoe Specialities Ltd. v. Tracstar Investment Ltd., (1997) 88*

Com. Cases. 471 (Mad-DB) and added that where matters are so extremely complicated that the directors themselves are not able to find out the reality as to the loss of documents and the genuineness of the claims for duplicates, the company should refer the matter to a decision in a regular civil suit where truth of the matter can be ascertained to a greater certainty.

7. ***In Chambal Fertilizers & Chemicals Ltd. v. Bukka Ramulu***, the company issued duplicate share certificate on receipt of a complaint for loss of two share certificates for 200 shares and an affidavit and indemnity bond duly executed. Subsequently, the company received the lost share certificates which were lodged for transfer alongwith the relevant transfer documents. Held, the purchasers should be indemnified by the company towards the purchase consideration. Further, the company having already issued duplicate shares, the original share certificates were directed to be cancelled.
8. ***Dixon v. Kennaway & Co. (1900) 1 Ch. 833***. Where the share certificates are issued under the authority of the directors, it binds the company even if the directors' authority is obtained by fraud and by connivance on the part of the secretary.

9. SHARE WARRANT

A share warrant is a bearer document of title to the specified shares. As per Sections 114 and 115 of the Companies Act, a public company, if authorised by its articles, may, in respect of fully paid shares, issue under its common seal, and with the previous approval of the Central Government, a share warrant stating that the bearer thereof is entitled to the shares specified therein. The payment of future dividends is made by coupons or otherwise. Shares specified in the warrant are transferable like negotiable instruments by mere delivery of the warrant. A private company cannot issue share warrants.

Position of the Holder of a Share Warrant

When a share warrant is issued in respect of any shares, the company must strike out from the register of members the names of the members who held the shares, now comprised in the share warrant and should enter into the register:

- (a) the fact of the issue of share warrant;
- (b) a statement of the shares included in the warrant, distinguishing each share by its number; and
- (c) the date of the issue of the warrant.

Since the name of the shareholder has been removed from the register of members, the company is no more in a position to know who the shareholder is and who is entitled to the dividends. For this reason, dividend „coupons' are attached to each share warrant showing the dates on which dividends, if declared, will become payable during several years following the issue of the share warrant, and the dividend will be paid on such date to the person who produces the appropriate coupon.

The holder of a share warrant is not strictly a member of the company, but the articles usually provide that the holder of a share warrant could be treated as member

of the company and can attend the company meetings, have the powers of voting etc., as if he was on the register of members provided he surrenders or deposits the share warrants against a receipt within the stipulated time (at least two days before the meeting). But the holder of a share warrant cannot qualify himself as a director of the company (in cases where qualification shares are required for directorship).

Section 115(2) of the Act entitles the bearer of a share warrant to surrender it for cancellation and, on payment of a fee prescribed by the Board of directors and subject to the articles of the company, to have his name entered as a member in the register in respect of the shares which were included in the warrant and to have a share certificate issued in his name.

Section 115(6) provides that if default is made in complying with the provision of Section 115, the company and every officer in default shall be punishable with fine which may extend to Rs. five hundred for every day during which the default continues.

State whether the following statement is “True” or “False”	
A share warrant holder is not a member of the company.	
<ul style="list-style-type: none"> • True • False 	
Correct answer: True	

Share Certificate and Share Warrant Distinguished

S.No	Share Certificate	Share Warrant
1	The holder of a share certificate is a registered member of the company.	The bearer of a share warrant is not a registered member of the company.
2	Holder of a share certificate is essentially a member of the company.	The bearer of a share warrant can be a member only if the articles so provide and only for the purposes as defined in the articles.
3	The issue of a share certificate does not require the approval of the Central Government.	Share warrant can be issued only if the articles authorise its issue and the Central Government has accorded its previous approval.
4	Both public and private companies must issue share certificates.	Share warrants can be issued only by public companies
5	A share certificate is issued in respect of partly or fully paid shares.	A share warrant can be issued only in respect of fully paid shares

S.No	Share Certificate	Share Warrant
6	The shares specified in a share certificate can be transferred by the execution of a transfer deed and its delivery along with the share certificate to the transferee to enable him to get himself registered as a member.	In case of share warrants the shares are transferable by mere delivery of the warrant.
7	A share certificate is not a negotiable instrument.	A share warrant is a negotiable instrument.
8	The holder of share certificate is qualified as a director of the company (where qualification shares are prescribed).	The holder of a share warrant is not qualified as a director of the company (where qualification shares are prescribed).
9	The holder of a share certificate can present a petition for winding up.	The holder of a share warrant cannot present a petition for winding up.
10	Stamp duty is payable on transfer of shares specified in a share certificate.	No stamp duty is payable on transfer of a share warrant.
11	In the case of issue of share certificate a nominal stamp duty is payable.	Heavy stamp duty is payable at the time of issue of share warrant itself.
12	No permission of RBI is required for issue of Share Certificate.	Since a share warrant is a negotiable instrument, previous permission of the Reserve Bank of India is also required for issuing share warrants.

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

Share warrant is not a negotiable instrument.

- True
- False

Correct answer: False

10. PERSONATION OF SHAREHOLDER

Section 116 of the Companies Act provides that if any person deceitfully personates an owner of any share or interest in a company, or of any share warrant or coupon issued in pursuance of the Companies Act, and thereby obtains or

attempts to obtain any such share or interest or any share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term extending to three years and shall also be liable to fine.

THE COMPANIES (ISSUE OF SHARE CERTIFICATE) RULES, 1960

1. Short Title

These rules may be called the Companies (Issue of Share Certificate) Rules, 1960.

2. Effect of Rules

These rules shall have effect notwithstanding anything to the contrary contained in the Articles of Association of a company.

3. Definitions

In these rules, unless the context otherwise requires:

- (a) "Act" means the Companies Act, 1956 (1 to 1956);
- (b) "Board" means the board of directors of a company or a committee thereof consisting of not less than three directors where the total number of directors exceeds six, and not less than two directors where the total number does not exceed six;

Provided that, to the extent that the composition of the Board of directors permits of it, at least half of a number of members of the Committee shall consist of directors other than (i) a managing or whole time directors;

- (c) "Seal" means the common seal of a company.

4. Issue of Share Certificate

1. When a company issues any capital, no certificate of any share or shares in the company shall be issued except:
 - (i) In pursuance of a resolution passed by the Board; and
 - (ii) On surrender to the company of its letter of allotment or its fractional coupons of requisite value, save in cases of issues against letters of acceptance or of renunciation, or in cases of bonus shares;

Provided that if the letter of allotment is lost or destroyed the Board may impose such reasonable terms, if any, as to evidence and indemnity and the payment of out of pocket expenses incurred by the company in investigating evidence, as the Board thinks fit.

2. No certificate of any share or shares shall be issued either in exchange for those which are sub-divided or consolidated or in replacement of those which are defaced, torn or old, decrepit, worn out, or where the cases in the reverse for recording transfers have been duly utilised, unless the certificate in lieu of which it is issued is surrendered to the company;

Provided that the company may charge such fee, if any, not exceeding Rs. 2 per

certificate issued on splitting or consolidation of share certificate or in replacement of share certificate that are defaced or torn, as the Board thinks fit.

3. No duplicate share certificate shall be issued in lieu of those that are lost or destroyed without the prior consent of the Board or without payment of such fees, if any, not exceeding Rs. 2, and on such reasonable terms, if any as to evidence and indemnity and the payment of out of pocket expenses incurred by the company in investigating evidence, as the Board thinks fit.
4. The companies listed with OTC Exchange of India, a company registered under Section 25 of the Companies Act, 1956 may issue a jumbo share certificate in favour of the Custodian and issue counter receipts to every allottee with respect to their holding.

Provided that no counter receipts shall be issued after the 28th February, 1999.

Explanation: For purpose of Sub-rule (4), "Custodian" means an entity carrying on post trade activities such as, settlement of purchases and sales, information reporting, safe keeping of securities and/or participating in any clearing system for and on behalf of the client to effect deliveries of the securities.

5. Forms of Certificates

- (1) Every certificate shall specify the name(s) of the person(s) in whose favour the certificate is issued, the shares to which it relates and the amount paid-up thereon.
- (2) When any certificate is issued in any of the circumstances specified in rule 4, sub-rule (2) it shall state on the face of it and against the stub or counterfoil to the effect that it is "Issued in lieu of share certificate no./sub-divided/ replaced/on consolidation of shares".
- (3) When a certificate is issued in any of the circumstances specified in rule 4 sub-rule (3), it shall state on the face of it and against the stub or counterfoil to the effect that it is a "duplicate issued in lieu of share certificate No.....". Further, the word "duplicate" shall be stamped or punched in bold letters across the face of the share certificate.

6. Sealing and Signing of Certificate

Every share certificate shall be issued under the seal of the company, which shall be affixed in the presence of (i) two directors or persons acting on behalf of the directors under a duly registered power of attorney; and (ii) the secretary or some other person appointed by the Board for the purpose. The two directors or their attorneys and the secretary or other person shall sign the share certificate.

Provided that, if the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than a managing or whole-time director.

Explanation: For the purpose of this rule, a director may sign a share certificate by affixing his signature thereon by means of any machine, equipment or other material used for the purpose.

7. Record of Certificates Issued

- (1) Particulars of every share certificate issued in accordance with rule 4, sub-rule (1) shall be entered in the Register of Members maintained in the form set out in the appendix annexed hereto or in a form as near thereto as circumstances admit against the name(s) of person(s) to whom it has been issued, indicating the date of issue.
- (2) Particulars of every share certificate issued in accordance with rule 4, sub-rules (2) and (3) shall be entered in a Register of Renewed and Duplicate Certificates indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column.
- (3) All entries made in the Register of Members or the Register of Renewed and Duplicate Certificates shall be authenticated by the secretary or such other person as may be appointed by the Board for purposes of sealing and signing the share certificate under the provisions of rule 6.

8. Printing of Forms

All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board. The blank form shall be consecutively machine-numbered and the forms and the blocks, engravings, facsimiles and hues relating to the printing of such forms shall be kept in the custody of the secretary or such other person as the Board may appoint for the purpose; and the secretary or other person aforesaid shall be responsible for rendering an account of these forms to the Board.

9. Custody of Books and Documents

- (1) The following persons shall be responsible for the maintenance, preservation and safe-custody of all books and documents relating to the issue of share certificates except the blank forms of share certificates referred to in Rule 8, namely:
 - (a) [omitted]
 - (b) [omitted]
 - (c) [omitted]
 - (d) where the company has a managing director, the managing director; and
 - (e) where the company has no managing director, every director of the company.
- (2) All books referred to in sub-rule (1) shall be preserved in good order permanently, and all certificates surrendered to a company shall immediately be defaced by the word "cancelled" being stamped or punched in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

Provided that nothing in this sub-rule shall apply to cancellation of the certificate of security under Sub-section (2) of Section 6 of the Depositories Act, 1996 when such certificate are cancelled in accordance with Sub-regulation (5) or Regulation 54 of SEBI (Depositories and Participants) Regulations, 1996.

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

Duplicate share certificate can be issued in lieu of those that are lost or destroyed without the prior consent of the Board.

- True
- False

Correct answer: False

No duplicate share certificate shall be issued in lieu of those that are lost or destroyed without the prior consent of the Board.

11. CALLS AND FORFEITURE

Calls

A company issuing shares to its members may call the money due on shares at intervals depending upon the requirements for funds for implementing the project and the shareholders also prefer to pay the nominal value on their shares in installments as and when demanded by the company.

A call is a demand, by the company in pursuance of a Board resolution and in accordance with the articles of the company, upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted or held by them made at any time during the life of the company. A call may also be made by the liquidator in the course of winding up of the company. The amount payable in application on each share shall not be less than five per cent of the nominal amount of the share. The balance may be payable as and when called for in one or more calls. The prospectus and the articles of a company generally specify the amount payable at different times, as call(s).

Under Section 36(2) of the Act all moneys payable by any member to the company on the shares held by him under the memorandum or articles is a debt due from him to the company. In the event of default in payment of a valid call, the company can enforce payment of such moneys by legal process and forfeit the shares in case the call is not paid. The liability of members is enforceable only after a proper notice which is called ‘call letter’ or call notice as 1st, 2nd and final or so on, is given to him in accordance with the articles.

Requisites of a valid call

1. Board of Directors to make call(s) on shares

The power to make calls is exercised by the Board in its meeting by means of a resolution [Section 292(1)(a)]. The Board, in making a call, must observe the provisions of the articles, otherwise the call will be invalid, and the shareholder is not bound to pay. A proper notice must be given, and the notice must specify the amount called up and manner i.e. the date for payment and place and to whom it is to be

paid. It may be emphasised that the time and place at which the call is to be paid are essential ingredients of a valid call.

Apart from this rule, "in making call, care must be taken that the directors making it are duly appointed and qualified; the meeting of the directors has been duly convened; proper quorum was present, and that the resolution making the call was duly passed and specifies the amount of the call, the time and place of payment-for

2. Call(s) to be made bonafide in the interest of the company

The power to make call is in the nature of trust and must be exercised only for the benefit of the company, and not for the private ends of the directors. If the call is made for the personal benefit of directors, the call will be invalid. In *Alexander v. Automatic Telephone Co.*, (1900) 2 Ch. 56, the directors of the company paid nothing on their shares but did not disclose this fact to the shareholders and called on them to pay certain amount partly as allotment money and partly as call money. The directors were held guilty of breach of trust and the call was held invalid

3. Call(s) must be made on uniform basis

According to Section 91 of the Act, calls on same class of shares must be made on a uniform basis. Hence a call cannot be made only on some of the members unless they constitute a separate class. In other words, there cannot be any discrimination between shareholders of the same class as regards amount and time of payment of call.

4. Notice of call(s)

The notice of call must specify the exact amount and time of payment. In *Shackleyford & Co. Dangerfield* (1868) (R3 CP 407) the notice had specified the time and amount to be paid as a call, it will be a valid call inspite of the fact that the form of notice was an inaccurate one. A call must be made by serving upon member formal notice in accordance with the provisions of Section 53.

5. Time limitations for receiving the call money

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue

Usually Articles of association of companies provide for the manner in which calls should be made. They follow the pattern set out in Regulations 13 to 18 of Table-A of Schedule-I appended to the Companies Act, 1956.

- (a) For each call at least 14 days notice must be given to members.
- (b) An interval of thirty days is required between two successive calls and not more than fifty per cent of the nominal value of shares can be called at one time. However, companies may have their own articles and raise the limit.
- (c) The Board of directors has the power to revoke or postpone a call after it is made.
- (d) Joint shareholders are jointly and severally liable for payment of calls.

- (e) If a member fails to pay call money he is liable to pay interest not exceeding the rate specified in the articles or terms of issue. The directors are free to waive the payment of interest.
- (f) If any member desires to pay the call money in advance, the directors may at their discretion accept and pay interest not exceeding the rate specified in the articles.
- (g) A defaulting member will not have any voting right till call money is paid by him.

The liability of the joint shareholders shall be joint and several (Section 43 of the Indian Contract Act and Regulation 15 of Table A of the Companies Act, 1956).

Some judicial pronouncement about Call

1. In a certain case, the directors realising that the company was in financial difficulties made a call only to enable them to draw their own remuneration, the call was held to be an invalid one and the directors were bound to refund the remuneration drawn by them.
2. In *E & W Insurance Co. Ltd. v. Mrs. Kamala Mehta*, A.I.R. 1956 Bom. 537, the directors of the company decided to make call and passed two resolutions therefor. None of the resolutions specified the date and time of payment. The blanks were filled subsequently by the secretary who sent the notice. The call notice was held to be invalid.
3. As in the case of *Shiromani Sugar Mills Ltd. v. Debi Prasad* AIR 1950 All 508, where the articles provide that the acts of directors would be valid notwithstanding the fact that it was afterwards discovered that their appointment was defective it was held that a call made by such directors was a valid one.

Interest on calls due but not paid — A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table A, in this regard provides:

- "16 (1) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest thereon from the day appointed for payment thereof to the time of actual payment at 5% per annum or at such lower rate, if any, as the Board may determine.
- (2) The Board shall be at liberty to waive payment of any such interest wholly or in part."

Payment in advance of Calls

Section 92 of the Act provides that the directors may, if authorised by the articles, allow shareholders to pay up the amount in whole or in part if due on their shares before any call has been made and may pay interest not more than @ 6% unless the company directs otherwise in a general meeting on the amount so paid in advance of calls. Where the interest is agreed to be paid, it may be paid out of the capital, if profits are not available. The amount so paid is not refundable except in winding up and such shareholders rank after creditors in respect of the advance, but in priority to the other shareholders.

The effect of the payment in advance of calls is that the shareholder's liability in respect of the calls or call is extinguished. But they will not be entitled to any voting rights in respect of the moneys paid in advance of the calls. When, however, the calls are made and these moneys become presently payable, they will acquire the voting right.

Quantum and Interval between two calls

Proviso to Regulation 13(1) to the Table 'A' of the Companies Act provides that no call shall exceed 25% of the nominal value of the share or be payable at less than one month from the date fixed for the payment of the last preceding call.

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited. However, it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 16 of SEBI (ICDR) Regulations, 2009.

Regulation 16 of ICDR provides that if the issue size exceeds five hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by one of the Scheduled commercial banks named in the offer document as bankers of the issuer. However, nothing contained in this clause shall apply to an offer for sale or an issue of specified securities made by a bank or public financial institution.

Forfeiture of Shares

Forfeiture may be termed as penalty for violation of terms of contract. Forfeiture of shares means taking back of shares by the company from the shareholders. If the shareholder makes default in payment of calls on shares, then the company can use the option of forfeiting the shares. For a valid forfeiture, satisfaction of following conditions is necessary: -

- 1. Articles of Association must authorise the forfeiture of shares.** Where power is given in the articles, it must be exercised in accordance with the regulation regarding notice, procedure and manner stated therein; otherwise the forfeiture will be void. The power of forfeiture must be exercised bona fide and in the interest of the company. It should not be collusive or fraudulent. If Articles authorise, the forfeiture shall include forfeiture of all dividends declared in respect of the forfeited shares and such dividend is not actually paid before the forfeiture of the shares.
- 2. Resolution for Forfeiture** - Article 31 of the Table A provides that if the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors may pass a resolution forfeiting the shares.
- 3. Proper Notice** - Before the shares of a member are forfeited, a proper notice to that effect must have been served. Regulation 30 of Table A provides that a notice shall name a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. The notice must also mention that in the event of non payment, the shares will be liable to be forfeited.

4. **Power of forfeiture must be exercised bona fide and for the benefit of the company** - The power to forfeit be exercised bona fide and for the benefit of the company. The power must be used in order to coerce reluctant shareholders into paying their calls. The power of forfeiture cannot be exercised to relieve unwilling shareholders from the liability of making the payment. Such a shareholder continues to be responsible for the unpaid part of the shares

When forfeiture of shares takes place, shareholder ceases to be a member and the forfeited shares become the property of the company. Regulation 33(2) of table A further provides that the liability of a person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares forfeited. If liquidation takes place, the original holder shall remain liable as a past member to pay calls within one year of forfeiture. However, a company cannot recover from him more than the difference between the amount payable and the amount received on forfeited shares.

In case, the defaulting shareholder approaches the Board to cancel the forfeiture, the Board is empowered to cancel such forfeiture and claim the due amount with interest

Some Legal Pronouncement about forfeiture of shares

1. **Shah J. in Naresh Chandra Sanyal v. Calcutta Stock Exchange Assn. Ltd. AIR 1971 SC 422**, As per Regulation 29 of Table A, shares can be forfeited only against non-payment of any call, or instalments of a call. The Articles of a company may, however, lawfully incorporate any other grounds of forfeiture
2. **Linkmen Services (P.) Ltd. v. Tapas Sinha (2008) 83 SCL 143 (CAL)**, a company amended its articles of association for the purpose of (i) forfeiting the shares of any defaulting member and (ii) expelling member who desert the company by not doing business with it. The respondents challenged the above amendments on the grounds of oppression. The CLB held that the articles of company could not empower to forfeit the shares on account of dues other than unpaid calls. The appellant company appealed to the High Court. Allowing the appeal the Court held that forfeiture on grounds as mentioned in the articles of company is not alien to corporate jurisprudence as the CLB found in the impugned judgment. It is a power that the articles can confer.
3. **Hope v. International Finance Society (1876) 4 Ch. D 598**. Where the articles authorise the directors to forfeit the shares of a shareholder, who commences an action against the company or the directors, by making a payment of the full market value of his shares, it was held that such a clause was invalid as it was against the rights of a shareholder.
4. **Re Exparto Trading Co. [1879] 12 Ch. D 191** Where two directors were allotted qualification shares, without any payment, and these shares were forfeited by a Board resolution passed at the request of those two directors, the forfeiture was held to be invalid and the directors were held liable to pay the nominal value of the shares.
5. **Public Passenger Services Ltd. v. M.A. Khader 1966 1 Comp. LJ1: A**

proper notice is a condition precedent to the forfeiture, and even the slightest defect in the notice will invalidate the forfeiture.

6. ***Johnson v. Lyttle's Iron Agency* 1877 Ch D 687.** The notice should mention that the payment of interest should be made from the date of the call.
7. ***Sparks v. Liverpool Water Works Co.*, 1807 13 Ves 428.** Accidental non receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected.
8. ***Sha Mulchand & Co. v. Jawahar Mills Ltd.* 1953 23 Comp. Cas 1 (SC).** Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void. The aggrieved shareholder may bring an action for setting aside the forfeiture as well as for damages. Mere waiver or acquiescence would not deprive him of his rights against an invalid forfeiture of his shares.
9. ***Sha Mulchand & Co. v. Jawahar Mills (supra)*.** After shares have been forfeited, no further notice intimating forfeiture is required

Forfeiture of fully paid shares

The clauses of Table A on forfeiture do not make specific provision for forfeiture of fully paid up shares. On the other hand in *Shyam Chand v. Calcutta Stock Exchange Assn.* [1945] 2 I.L.R. Cal 313 fully paid up shares could be forfeited in cases like expulsion of members where the articles authorise.

In any case, right of recovery of call money expires three years after the date of allotment.

Re-issue of Forfeited Shares

Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board. Generally, such shares are re-issued at a discount which cannot exceed the amount already paid on such shares. This is done by a Board resolution.

After the money due is received from the new member(s), the company executes a transfer deed and issues a share certificate, and if the original holder has already surrendered the share certificate, it is duly transferred, otherwise after a public notice in a newspaper, a new share certificate is issued.

If the shares are re-issued at a price more than the face value, the excess of the proceeds of sale is not payable to the former owner, if the articles provide otherwise (*Calcutta Stock Exchange Assn. Ltd Re* AIR 1957 Cal 438). The excess of the proceeds so retained shall constitute a premium and must therefore be transferred to the securities premium account. However, in the case of *Naresh Chandra Sanyal v. Calcutta Stock Exchange Ass. Ltd.*, AIR 1971 SC 422, Supreme Court held that, where the articles are silent with regard to such surplus, the right of a company upon the forfeiture and sale of forfeited shares is to use the proceeds for discharging the liability for which the forfeiture was effected and if there is any balance, it belongs to the defaulter and cannot be appropriated by the company.

Where shares are sold for non payment of calls, the purchaser is liable to a fresh

call in respect of the total amount of the prior calls. But, if any amount is recovered from the ex-holder in respect of the calls, the purchaser will be entitled to the benefit of any amount so recovered. Likewise, any payments by the purchaser will reduce the liability of the ex-holder.

Where the forfeited shares are re-issued, the new shareholders will not only be liable for the balance amount remaining on the shares but he will also not be entitled to voting rights so long as calls payable by the original shareholder remain unpaid, if the company's articles so provide, as stated in Section 181.

A listed company for reissuing forfeited shares should comply with the relevant clause of the listing agreement and due approval of the regional stock exchange and others as well.

No return of allotment in respect of re-issue of Forfeited Shares - No return of allotment of the shares re-issued need to be filed with the Registrar [Section 75(5)]. Such re-issue, in fact, cannot be called allotment.

Surrender of shares

A company cannot accept a surrender of its shares "as every surrender of shares, whether fully paid-up or not involves a reduction of capital which is unlawful...forfeiture is a statutory exception and is the only exception". [*Bellerby v. Rowland and Marwood's S.S. Co. Ltd.*, (1902) 2 Ch 14]. But a surrender may be dealt with in the manner indicated in *Re Castiglione's Willtrusts, Hunter v. Mackenzie*, (1958) 1 All ER 480 viz., directing that the shares be held in the name of a nominee as trustee for the company. However, a surrender can be accepted in circumstances absolutely parallel to the requirements of a forfeiture, the only difference being that instead of going to the length of the formalities of a forfeiture, the company accepts in good faith in its own interest the shares which the shareholder is voluntarily surrendering. The other advantage to the company is that the shareholder becomes estopped from questioning the validity. [*Collector of Moradabad v. Equity Insurance Co. Ltd.*, AIR 1948 Oudh 197].

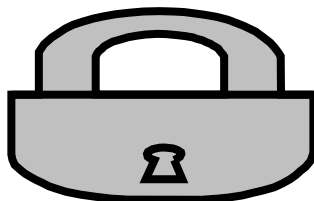
LESSON ROUND-UP



- Allotment means the act of appropriation by the Board of directors of the company of a certain number of shares to persons who have made applications for shares.
- The allotment should be made by proper authority, within a reasonable time, should be absolute and unconditional, must be communicated, should be against application only and should not be in contravention of any other law.

- The Companies Act lays down certain conditions under various sections to be fulfilled before a company can proceed to allot shares such as making an application for getting the securities listed u/s 73, filing prospectus or statement in lieu of prospectus before allotment, minimum subscription, no allotment until date of opening of subscription list.
- If the allotment is made without complying with the conditions as discussed above, allotment is said to be irregular and it will result to the consequences depending upon the nature of irregularity.
- After allotment of shares, a return of allotment in the prescribed e-form 2 is required to be filed with Registrar of Companies within 30 days of allotment of shares.
- A certificate under the common seal of the company is prime facie evidence of the title of the member to the shares specified therein. Companies (issue of shares certificate) Rules, 1960 deals with the rules relating to issue of share certificate by the company.
- Every share certificate shall be issued under the common seal of the company affixed in presence of two directors and the secretary. Two directors or their attorneys and the secretary shall sign the share certificates, if the composition of the board permits it and at least one of the aforesaid two directors shall be a person other than a managing or whole-time director.
- Share certificate is not an official publication within the meaning of Section 147(1)(c).
- A share warrant is a bearer document of title to the specified shares.
- With previous approval of Central Government and if authorized by the articles, a public company may issue share warrants.
- A call is a demand by the company upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted, made at any time during the life of the company.
- If a member fails to pay a valid call within the stipulated time, the company may exercise the power to forfeit the shares.
- Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board.

SELF-TEST QUESTIONS



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

1. What is the significance of a Share Certificate?
2. What do you mean by a Split Certificate?
3. A share certificate is lost. What are the provision under the Companies Act, 1956 and the Companies (Issue of Share Certificate) Rules, 1960 for the issue of a duplicate share certificate?

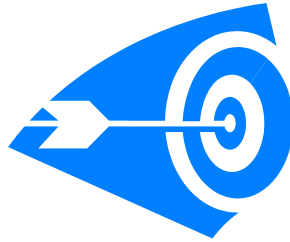
4. Explain the legal effects of a share certificate citing case laws.
 5. Is the share certificate an official publication? Give reasons for your answer.
 6. What is allotment? State the statutory provision regarding allotment? Can allotment be made on an oral application?
 7. Write short notes on:
 - (a) Return of Allotment
 - (b) Irregular Allotment
 - (c) Minimum Subscription
 - (d) Irregular allotment
 - (e) Share certificate
 - (f) Share warrant.
 8. Write the difference between the following:
 - (i) Notice of allotment
 - (a) under allotment of Physical shares,
 - (b) under allocation in Demat mode.
 - (ii) Process of holding of shares in Physical and Demat mode.
 - (iii) Maximum time limit of allotment of shares under Physical and Demat issue of shares.
 9. What is forfeiture of shares and the rules to be followed for the same? Can the forfeited shares be re-issued?
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STUDY XII

FINANCIAL STRUCTURE AND MEMBERSHIP - VII

MEMBERSHIP IN A COMPANY

LEARNING OBJECTIVES



Members of a Company play very important role in the corporate world. After going through this chapter, students will be able to understand who are members, how one can acquire membership, how can one cease to be a member. Also, what are the rights and liabilities of a member will be clear to the students.

This chapter covers the following topics:

- Who are members
- Modes of acquiring membership
- Cessation of membership
- Register of members
- Rights and liabilities of members

1. WHO ARE MEMBERS?

A company is composed of members, though it has its own separate entity. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity.

In the case of a company limited by shares, the shareholders are the members. The terms “members” and “shareholders” are usually used interchangeably, being synonymous, as there can be no membership except through the medium of shareholding. Thus, generally speaking every shareholder is a member and every member is a shareholder. However, there may be exceptions to this statement, e.g., a person may be a holder of share(s) by transfer but will not become its member until the transfer is registered in the books of the company in his favour and his name is entered in the register of members. Similarly, a member who has transferred his shares, though he does not hold any shares yet he continues to be member of the company until the transfer is registered and his name is removed from the register of members maintained by the company under Section 150 of the Companies Act, 1956.

In *Herdilia Unimers Ltd. v. Renu Jain* [1995] 4 Comp. LJ. 45 (Raj.), it was held that the moment the shares were allotted and share certificate signed and the name

entered in the register of members, the allottee became the shareholder, irrespective of whether the allottee received the shares or not.

In a company limited by guarantee, the persons who are liable under the guarantee clause in its Memorandum of Association are members of the company.

In an unlimited company, the members are the persons who are liable to the company, each in proportion to the extent of their interests in the company, to contribute the sums necessary to discharge in full, the debts and liabilities of the company, in the event of its being wound-up.

Definition of 'Member'

According to Section 41 of the Companies Act, 1956:

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

Accordingly, there are two important elements which must be present before a person can acquire membership of a company viz., (i) agreement to become a member; and (ii) entry of the name of the person so agreeing, in the register of members of the company. Both these conditions are cumulative. [*Balkrishan Gupta v. Swadeshi Polytex Ltd.* (1985) 58 Com Cases 563].

The person desirous of becoming a member of a company must have the legal capacity of entering into an agreement in accordance with the provisions of the Indian Contract Act, 1972. Section 11 of the Indian Contract Act lays down that

Every person is competent to contract who

- (i) is of the age of majority according to the law to which he is subject.
- (ii) is of sound mind.
- (iii) is not disqualified from contracting by any law to which he is subject.

2. MODES OF ACQUIRING MEMBERSHIP

As per Section 41 of the Companies Act, a person may acquire the membership of a company:

- (a) by subscribing to the Memorandum of Association (deemed agreement); or
- (b) by agreeing in writing to become a member:
 - (i) by making an application to the company for allotment of shares; or
 - (ii) by executing an instrument of transfer of shares as transferee; or
 - (iii) by consenting to the transfer of share of a deceased member in his name; or
 - (iv) by acquiescence or estoppel.

- (c) by holding equity share capital of a company and whose name is entered as beneficial owner in the records of a depository (Under the Depositories Act, 1996),

and on his name being entered in the register of members of company. Also every such person holding equity share capital of the company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be the member of the concerned company.

(a) *Subscribers to the Memorandum*

In the case of a subscriber, no application or allotment is necessary to become a member. By virtue of his subscribing to the memorandum, he is deemed to have agreed to become a member and he becomes *ipso facto* member on the incorporation of the company and is liable for the shares he has subscribed.

A subscriber to the memorandum cannot rescind the contract for the purchase of shares even on the ground of fraud by the promoters. In *Re. Metal Constituents Co.*, (1902) 1.Ch. 707.

In accordance with the provisions of Section 36(2) of the Companies Act, 1956, all money payable by any member to the company under the memorandum or articles shall be debt due from him to the company. Further, a subscriber to the memorandum must pay for his shares in cash even if the promoters have promised him the shares for services rendered in connection with the promotion of the company. Again, he must take the shares directly from the company, and not through transfer from other member(s). When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfills the obligation. His liability remains right up to the time when the company goes into liquidation and he is bound to bring the money for which he is liable to pay to the creditors of the company. By virtue of Section 266(2) of the Companies Act, a person who, being named in the articles as director, signs and files an undertaking to take and pay for his qualification shares, he shall, as regards those shares, be in the same position as if he has signed the memorandum for shares of the number and value.

(b) *Agreement in Writing*

(i) *By an application and allotment*

A person who applies for shares becomes a member when shares are allotted to him, a notice of allotment is issued to him and his name is entered on the register of members. The general law of contract applies to this transaction. There is an offer to take shares and acceptance of this offer when the shares are allotted. An application for shares may be absolute or conditional. If it is absolute, an allotment and its notice to the applicant will be sufficient acceptance. On the other hand, if the offer is conditional, the allotment must be made according to be condition as contained in the application. If there is conditional application and unconditional allotment, there is no contract.

(ii) *By transfer of shares*

Shares in a company are movable property as provided in Section 82 of the

Companies Act and are transferable in the manner as provided in the articles of the company and as provided in Section 108 of the Companies Act, 1956. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company, i.e. by getting his name entered in the register of members of the company.

(iii) By transmission of shares

A person may become a member of a company by operation of law i.e. if he succeeds to the estate of a deceased member. Membership by this method is a legal consequence. On the death of a member, his executor or the person who is entitled under the law to succeed to his estate, gets the right to have the shares transmitted and registered in his name in the company's register of members. No instrument of transfer is necessary in this case. If the legal representative of deceased member desires to be registered as a member in place of the deceased member, the company shall do so or in the alternative he may request the company to transfer the shares in the name of another person of his choice. The Official Assignee or Official Receiver is likewise entitled to be a member in place of the shareholder, who has been adjudged insolvent.

(iv) By acquiescence or estoppels

A person is deemed to be a member of a company if he allows his name, without sufficient cause, to be on the register of members of the company or otherwise holds himself out or allows himself to be held out as a member. In such a case, he is estopped from denying his membership. He can, however, escape his liability by taking prompt action for having his name removed from the register of members on permissible grounds.

(c) Holding Shares as Beneficial Owner in the Records of Depository.

A new Sub-section (3) has been inserted in Section 41 by Depositories Act to provide that a person holding equity share capital of a company whose name is entered in the records of the depository shall be deemed to be a member of the concerned company.

3. WHO MAY BECOME A MEMBER

Subject to the Memorandum and Articles, any *sui juris* (a person who is competent to contract) except the company itself, can become a member of a company. However, it is important to note the following points in relation to certain organizations and persons:

(a) **Company as a member of another company:** A company is a legal person and so is competent to contract. Therefore, it can become a member of any other company. However, it must be authorised by its Memorandum of Association to invest in the shares of that company or any other company. A subsidiary company cannot become a member of its holding company. Also a company cannot become a member of itself.

(b) **Partnership firm as a member:** A partnership firm is not a legal person and as such it cannot, in its own name, become a member of a company except in company registered u/s 25 of Companies Act.

(c) **Section 25 company:** A non-profit making company licensed under Section 25 of the Companies Act can become a member of another company if it is authorised by its Memorandum of Association to invest into shares of the other company.

(d) **Foreigners as members:** A foreigner may take shares in an Indian company and become a member subject to the provisions of the Foreign Exchange Management Act, 1999, but in the event of war with his country, he becomes an alien enemy and his power of voting and his rights to receive notices are suspended.

(e) **Minor as member:** A member who is not a *sui juris* e.g., a minor, is wholly incompetent to enter into a contract and as such cannot become a member of a company. Consequently, an agreement by a minor to take shares is void *ab-initio*.

It has been held by the Company Law Board that an agreement in writing for a minor to become a member may be signed on behalf of the minor by his lawful guardian and the registration of transfer of shares in the name of the minor, acting through his or her guardian, especially where the shares are fully paid cannot be refused on the ground of the transferee being a minor [*Miss Nandita Jain v. Benett Coleman and Co. Ltd.*, Appeal No. 27 of 1972 dated 17.2.78].

After attaining majority, the minor, if he does not want to be a member, must repudiate his liability on the shares on ground of minority, and if he does so, the company can not plead estoppel on the ground of his having received dividends during his minority or that he had fraudulently misrepresented his age in his application for shares [*Sadiq Ali v. Jai Kishori*, (1928) 30 Bom. L.R. 1346].

If shares are transferred to a minor, the transferor will remain liable for all future calls on such shares so long as they are held by the minor even if the transferor was ignorant of his minority. If the company knows of his minority it may refuse to register the transfer, unless the transfer was made through the guardian.

(f) **Insolvent as member:** An insolvent may be a member of a company as long as he is on the register of members. He is entitled to vote, but he loses all beneficial interest in the shares and company will pay dividend on his shares to the Official Assignee or Receiver [*Morgan v. Gray*, (1953) All E.R. 213].

(g) **Pawnee:** A pawnee has no right of foreclosure since he never had the absolute ownership at law and his equitable title cannot exceed what is specifically granted by law. In this sense, a pledge differs from a mortgage. In view of the above, a pawnee cannot be treated as the holder of the shares pledged in his favour, and the pawner continues to be a member and can exercise the rights of a member [*Balakrishna Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Comp. Cas. 563 (S.C.)].

(h) **Receiver:** A receiver whose name is not entered in the register of members cannot exercise any of the membership rights attached to a share unless in a proceeding to which company is a party and an order is made therein. Mere appointment of a receiver in respect of certain shares of a company without more rights cannot, deprive the holder of the shares whose name is entered in the register of members of the company, the right to vote at the meeting of the company [*Balakrishna Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Comp. Cas. 563 (S.C.)].

(i) **Persons taking shares in fictitious names:** A person who takes shares in the name of a fictitious person, becomes liable as a member besides incurring criminal liability under Section 68A of the Act, wherein punishment provided is imprisonment up to five years.

(j) **Trade Union as member:** A trade union registered under the Trade Union Act, can be registered as a member and can hold shares in a company in its own corporate name [*All India Bank Officers Confederation v. Dhanlakshmi Bank Ltd.*, (1997) 90 Com Cases 225].

Clarification regarding status of a holder of Global Depository Receipts (GDRs):

It is clarified by the Ministry of Corporate Affairs, vide Circular No.1/2009 No.17/67/2009 CL-V dated 16/6/2009 that :

(a) As per section 41(1) and (2) of the Companies Act, a person is a member of the company, (i) who is a subscriber to the Memorandum or (ii) whose name has been entered in the register of members. Since, holder of Global Depository Receipts is neither the subscriber to the Memorandum nor a holder of the shares, his name cannot be entered in the Register of Members. Therefore, a holder of Global Depository Receipts cannot be called a member of the company.

(b) As per Section 41(3) of the Companies Act, 1956, a person holding a share capital of the company and whose name is entered as beneficial owner in the records of the depository, is deemed to be a member of the company. Since the Overseas Depository Bank as referred in the 'Scheme' is neither the Depository as defined in the Companies Act, 1956 and the Depository Act, 1996 nor holding the share capital, therefore, it cannot be deemed to be a member of the company.

(c) A holder of Global Depository Receipts may become a member of the company only on transfer/redemption of the GDR into underlying equity shares after following the procedure provided in the "Scheme"/provisions of the Companies Act, 1956.

(d) Since the underlying shares are allotted in the name of Overseas Depository Bank, the name of such Overseas Depository Bank is to be entered in the Register of Members of the issuing company. However, until transfer/redemption of such GDR's into underlying shares, Overseas Depository Bank cannot be considered a nominee of the holder of GDR for the purpose of Section 42 read with Section 41 of the Companies Act, 1956.

Joint Members

If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member (*Narandas v. India Mfg. Co.*, A.I.R. 1953 Bom. 433]. Unless the Articles of the company otherwise provide, joint members can insist on having their names registered in any order they may require. They may also have their holding split into several joint holdings with their names in different orders so that all of them may have a right to vote as first named holding in one or the other joint holdings. *Burns v. Siemens Brothers Dynamo Works Ltd.* (1919) 1 Ch. 225.

Joint holders of shares in a public company are not a single member. Each of the joint holder of shares is a member of the company [*Narandas v. India Mfg. Co. Supra*], but joint holders are counted as one member for the purpose of determining the maximum number of members i.e. fifty in a private company and for determining the members required for making applications under Sections 397 and 398 of the Companies Act, 1956. Notices and other documents required to be served by the company will be deemed to be properly served if the service is effected on the first named joint-holder. Unless instructions in writing have been received to the contrary, the company, can pay dividend to the first named shareholder. Unless the Articles otherwise provide, any joint shareholder is entitled to be present in any general meeting and take part in the proceedings and vote on resolutions on show of hands. However, in the event of poll, voting right can be exercised only by one of the joint shareholders acting in consultation with and on behalf of all. Joint members are liable jointly and severally to pay calls on the shares held by them. Proxy form to be valid must be signed by all joint shareholders.

Registration of Shares in the name of Public Office

The Companies Act, 1956 contains no provisions with regard to the registration of shares in the name of a public office. Shares cannot, therefore, be registered in the names of public offices like the Collector of Central Excise or the Commissioner of Income-tax etc. Similar observations apply to the holder of any other public office which is not a corporation sole constituted by statute, e.g., the Administrators General Act, 1963) (Clarification issued by the Department of Company Affairs).

Section 41(2) provides that a 'person' (other than a subscriber of the memorandum) can become a member. The term 'person' has been held to include, among others, a corporation sole.

A "corporation sole" is a corporation constituted in a single person who in the right of some office or function and has corporate status. The object of corporation sole is to make it possible to distinguish the holder of an office or function in his official and in his private capacity. By this fiction of law, it is possible to attach rights and duties to the holder, for the time being, of the office or functions to convey real or personal property to him in his official name and style. In short, a corporation sole has the same characteristics of perpetual succession and separation of rights and duties of the corporate body from those of the corporate as all corporations possess.

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

A foreigner cannot take shares in an Indian company and become a member.

- True
- False

Correct answer: False

4. MINIMUM NUMBER OF MEMBERS

Section 12 of the Companies Act, 1956 provides that any seven or more persons,

or where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Act in respect of registration, form an incorporated company, with or without limited liability.

Maintenance of Minimum Number

Section 45 of the Act provides that the liability of the members of a company shall be unlimited, if the number of its members falls below the statutory minimum and the company carries on business beyond the period of six months after the number has so fallen and members are cognizant of the fact that it is carrying on business with less than seven or two members, as the case may be. In accordance with the provisions of Section 433(d) of the Act, a company, the number of whose members falls below the statutory minimum, may be wound-up by the Court. The purpose is to withdraw the benefits of incorporation in the event of default of the condition of incorporation with regard to the minimum number of members.

Restriction on Membership

By virtue of Section 3(1)(iii)(b) of the Companies Act, 1956, the maximum number of members of a private company is limited to fifty excluding the present and past employees of the company who continue to be members of the company. There is no restriction with regard to the maximum number of members of a public company.

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

A public company does not have any restriction regarding the maximum number of members.

- True
- False

Correct answer: True

5. CESSATION OF MEMBERSHIP

A person ceases to be a member of a company when his name is removed from its register of members, which may occur in any of the following situations:

- (a) He transfers his shares to another person, the transfer is registered by the company and his name is removed from the register of members;
- (b) His shares are forfeited;
- (c) His shares are sold by the company to enforce a lien;
- (d) He dies; (his estate, however, remains liable for calls);
- (e) He is adjudged insolvent and the Official Assignee disclaims his shares;
- (f) His redeemable preference shares are redeemed;
- (g) He rescinds the contract of membership on the ground of fraud or misrepresentation or a genuine mistake;

- (h) His shares are purchased either by another member or by the company itself under an order of the Court under Section 402 of the Companies Act;
- (i) The member is a company which is being wound-up in India, and the liquidator disclaims the shares;
- (j) The company is wound up; or
- (k) Share warrants have been issued in exchange of fully paid shares.

Though one ceases to be a member, he remains liable as a contributory and is also entitled to share in the surplus, if any.

Expulsion of a Member

A controversy had arisen as to whether a public limited company had powers to insert an article in its Articles of Association relating to expulsion of a member by the Board of Directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company.

The Department of Company Affairs (now, Ministry of Corporate Affairs) clarified that an article for expulsion of a member is opposed to the fundamental principles of the Company Jurisprudence and is *ultra vires* the company, the reason being that such a provision against the provisions of the Companies Act relating to the rights of a member in a company, the powers of the Central Government as an appellate authority under Section 111 of the Act and the powers of the Court under Sections 107, 395 and 397 of the Companies Act.

According to Section 9 of the Companies Act, the Act overrides the Memorandum and Articles of Association and any provision contained in these documents repugnant to the provisions of the Companies Act, is void.

The Department of Company Affairs (now MCA) has, therefore, clarified that any assumption of the powers by the Board of Directors to expel a member by alteration of Articles of Association shall be illegal and void.

The Supreme Court in the case of *Bajaj Auto Ltd. v. N.K. Firodia* [1974] 41 Comp. Cas. 1 has laid down the law as to the conditions on the basis of which directors could refuse a person to be admitted as a member of the company. The principles laid down by the Supreme Court in this case, even though pertain to the refusal by a company to the admission of a person as a member of the company, are applicable even with greater force to a case of expulsion of an existing member. As, under article 141 of the Constitution, the law declared by the Supreme Court is binding on all courts within the territory of India, any provision pertaining to the expulsion of a member by the management of a company which is against the law as laid down by the Supreme Court will be illegal and *ultra vires*. In the light of the aforesaid position, it is clarified that assumption by the Board of directors of a company of any power to expel a member by amending its articles of association is illegal and void [Circular: Letter No. 32/75, dated 1.11.1975].

6. PERSONATION AND PENALTY THEREFOR

Section 116 of the Companies Act, 1956 provides for penalty for personation of a

shareholder. The section reads:

“If any person deceitfully personates an owner of any share or interest in a company, or of any share warrant or coupon issued in pursuance of the Act, and thereby obtains or attempts to obtain any such share or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.”

The punishment provided by Section 116 is for obtaining or attempting to obtain or receiving or attempting to receive a share, share warrant, coupon due to the rightful owner. According to the criminal law, personation is one of the means of cheating..

Explanation: The offence is committed whether the individual personated is a real or imaginary person”.

7. REGISTER OF MEMBERS

Section 150 of the Companies Act, 1956 lays down:

- “(1) Every company shall keep in one or more books, a register of its members, and enter therein the following particulars:
- (a) The name and address, and the occupation, if any, of each member;
 - (b) in the case of a company having a share capital, the shares held by each member, distinguishing each share by its number except where such shares are held with a depository, and the amount paid or agreed to be considered as paid on those shares;
 - (c) the date at which each person was entered in the register as a member; and
 - (d) the date at which any person ceased to be a member.

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

- (2) If default is made in complying with Sub-section (1), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.”

The register of members is a *prima facie* evidence of its contents, including that of membership. It provides evidence whenever the question arises whether a person is or is not a member. The register of members should be in the Form given in the Appendix to the Companies (Issue of Share Certificates) Rules, 1960 or in a Form as near thereto as circumstances admit. The specimen of register of members is given hereunder:

Name		(See rule 7)										Folio No.....										
Address		REGISTER OF MEMBERS																				
Occupation																						
Date at which entered as a Member												Date at which ceased to be a Member										
Shares acquired					Cash Payable on shares	Cash paid on shares	Shares transferred															
1	2	3	Dist-inctive number of shares (inclusive)		6	7	8	9	10	11	12	13	14	15	16	Dist-inctive number of shares (inclusive)		19	20	21	22	23
			4	5												17	18					
No. of allotment of transfer	Date of allotment or entry of transfer or transmission	No. of shares allotted or transferred of transmitted	From	To	Number and date of issue of share certificate	Transfer's Folio	Nominal value of shares acquired	Amounts due and on what account (allotment or call)	Date when due	Date of payment	Cash book folio	Amount paid	No. of transfer	Date of entry of transfer or transmission	No. of shares transferred	From	To	No. and date of issue of the share certificate	Transferor's Folio	Total nominal value of shares transferred or transmitted	Balance of shares held	Remarks

NOTE: All entries in the Register should be authenticated by the Secretary or the person appointed by the Board to sign the share certificates.

Particulars of each jointholder have to be recorded. The names of minor members are entered along with the names of their guardians. If declaration under Section 187C had been received from any member, it has to be recorded.

Judicial Pronouncement relating to register of members

1. A person who claims to have purchased the shares of a member will be entitled to have his name entered in the register by satisfying the requirement of either Section 108 or 109. [*Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1988) 2 Comp LJ 41 (Ker)].
2. No company should enter in the register a statement that it has a lien on the shares of a member, [*W. Key & Son Ltd.*, (1902) 1 Ch 467].
3. A company cannot insist upon putting in the register anything except that which is required by the section to be inserted in it. [*T.H. Saunders & Co. Ltd. Re*, (1908) 1 Ch 415].
4. In a voluntary winding up, the liquidator may accept share transfers and alter the register accordingly. [*Taylor, Phillips and Richard's Case*, (1897) 1 Ch 298].
5. A firm in its own name cannot be registered as a member, as a firm is not a legal person like a company incorporated under the Act. Only the partners can be recognised and registered as joint holders. [See *Re Vagliano & Anthracite Calleries Ltd.*, (1910) 79 LJ Ch 769].

Index of Members

Section 151 of the Companies Act, 1956 requires:

- “(1) Every company having more than fifty members shall, unless the register of members is in such a form as in itself to constitute an index, keep an index, which may be in the form of a card index, of the names of the members of the company and shall, within fourteen days (14 days) after the date on which any alteration is made in the register of members, make the necessary alteration in the index.
- (2) The index shall, in respect of each member, contain a sufficient indication to enable the entries relating to that member in the register to be readily found.
- (3) The index shall, at all times, be kept at the same place as the register of members.
- (4) If default is made in complying with Sub-sections (1), (2) or (3), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees.”

Inspection must be allowed of the Index in the same manner as applicable to the register of members.

Place of keeping and inspection of the Registers

Section 163 of the Companies Act, 1956 fixes the place for maintaining a company's register including its register and index of Members, returns etc. and for allowing their inspection.

The Section lays down:

(1) The register of members commencing from the date of registration of the company, the index of members, the register and index of debenture holders, and copies of all annual returns prepared under Section 159 and 160, together with the copies of certificates and documents required to be annexed thereto, shall be kept at the registered office of the company :

Provided that such registers, indexes, returns and copies of certificates and documents or any or more of them may, instead of being kept at the registered office of the company, be kept at any other place within the city, town or village in which registered office is situate, if—

- (i) Such other place has been approved for this purpose by a special resolution passed by the company in general meeting; and
- (iii) The Registrar has been given in advance a copy of the proposed special resolution. (A copy of the special resolution when passed has also to be filed with the Registrar within 30 days of passing the resolution as per requirement of Section 192 of the Companies Act, 1956).

(2) The registers, indexes, returns and copies of certificates and other documents referred to in 163(1) shall, except when the register of members or debenture holders is closed under the provisions of this Act, be open during business hours, subject to reasonable restrictions, as the company may impose, so that not less than two hours in each day are allowed for inspection:

- (a) of any member or debentureholders, without fee; and
- (b) of any other person, on payment of a fee of Rs. 10 for each inspection.

(3) Any such member, debenture holder or other person may :

- (a) make extract from any register, index or copy referred to in Sub-section (1) without fee or additional fee, as the case may be;
- (b) require a copy of such register, index or copy of any part thereof, on payment of a fee of Re. 1 for every one hundred words or fractional part thereof required to be copied.

Remedy if inspection is refused

According to Section 163(5) : "If any inspection, or the making of any extract required under this section, is refused, or if any copy required under this section is not sent within the period specified in Sub-section (4), the company, and every officer of the company who is in default shall be punishable, in respect of each offence, with fine which may extend to five hundred rupees for every day during which the refusal or default continues".

Register *prima facie* evidence

A register of members is *prima facie* evidence of the truth of its contents. Accordingly, if a person's name, to his knowledge, is there in the register of members

of a company, he shall be deemed to be a member and onus lies on him to prove that he is not a member. He must promptly apply to the Court for rectification of the register under Section 111 of the Act to take his name off the register, failing which the doctrine of holding out will apply.

In *Re. M.F.R.D. Cruz*, A.I.R. 1939 Madras 803, the plaintiff applied for 4,000 shares in a company but no allotment was made to him. Subsequently 4,000 shares were transferred to him without his request and his name was entered in the register of members. The plaintiff knew it but took no steps for rectification of the register of members. The company went into liquidation and he was held liable as a contributory. The Court held "when a person knows that his name is included in the register of shareholders and he stands by and allows his name to remain, he is holding out to the public that he is a shareholder and thereby he loses his right to have his name removed".

Rectification of a Register of Members

The register of members of a company contains names, addresses, occupations, if any etc. only of members of the company. Any person, whose name is entered in the register of members of a company, considered to be its member, although he may not own the shares which are shown in his name in the register of members. On the contrary, a person, whose name is not entered in the register of members is not considered as member of the company even though he may have done everything to entitle him to be put on the register of members. Injustice may, therefore, result from such omission or commission.

Section 111(4) of the Companies Act, 1956 confers powers on the Company Law board to order rectification of register of members of a company if an application is made by or on behalf of the aggrieved person on any of the following grounds:

- (a) where the name of a person is without sufficient cause, entered in the register of members of a company;
- (b) where his name, having been entered, is removed without sufficient cause; or
- (c) where default is made or unnecessary delay takes place in entering in the register of members the fact of any person having become, or ceased to be, a member of company.

This may happen where a person has transferred his shares according to law and the company either refuses or delays registration of transfer in the transferee's name.

The application to the should be made in Form No. 1 specified in Annexure II of the Company Law Board Regulations, 1991. The application should be accompanied by (i) a copy of the memorandum and articles of association of the company; (ii) latest audited balance sheet and profit and loss account; (iii) auditors report and directors report; (iv) authenticated copy of the extract or register of members; and (v) an affidavit verifying the petition.

The application should be accompanied by a bank draft evidencing payment of application fee of Rs. 500.

The Company Law Board, while dealing with the application for rectification of register may after hearing the parties either reject the application or direct for rectification of the register including a direction to the company to pay damages if any, sustained by the person aggrieved.

It is pertinent to note that though the time limit for filing an application for rectification of register of members has not been specified in the Act, the provisions of Article 137 of the Limitation Act would apply and in consequence, the application for rectification must be made within three years from the date on which the right occurs [Ref. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.*, (1983) 54 Comp. Cases 301 (Delhi)].

The provisions stated above regarding rectification of register of members shall apply in relation to rectification of register of debentureholders as well.

In *Subash Ghosh v. Happy Valley Tea Co. Pvt Ltd.* (CLB) C.P. NO. 164 (111)/ERB/2004 [Decided on 12.6.2006] the petitioner was a selling agent of the respondent company and he had applied for certain shares in the company at the behest of the directors and made payment therefore. Article 4 of the Articles of association of the company read: "The shares shall be at the disposal of the directors and they may allot or otherwise dispose of them to such persons at such times and generally on such terms and conditions as they think proper....." From this Article, it is evident that the Board has the power to decide to allot shares on such terms and conditions as they think proper. From this article, it is evident that the Board has the power to decide to allot shares on such terms and conditions as they think proper. Board of directors allotted 16,000 equity shares to him. The company also filed Form 2 indicating that 16,000 equity shares had been allotted, subject to the approval of the shareholders, to the petitioner. The petitioner found that his name was not appearing in the members' register of the company. He petitioned the CLB for rectification of members' register by including his name.

CLB viewed that need to approach the CLB for rectification under Section 111(4) would arise only if a member's name is either omitted from or entered in the register of members without sufficient cause. In the present case, since the name of the petitioner has been omitted from the register of members without sufficient cause (even assuming his name was earlier entered in the register after allotment), i.e. members have not approved allotment of shares to the petitioner, which was a prerequisite, there is no scope to allow the petition. However, since no share has been allotted to the petitioner, the amount of money invested by him for the shares should be refunded to him within a period of one month of the date of this order. It was directed that the company would do so within the said time.

It is pertinent to note that though the time limit for filing an application for rectification of register of members has not been specified in the Act, the provisions of Article 137 of the Limitation Act would apply and in consequence, the application for rectification must be made within three years from the date on which the right occurs [Ref. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.*, (1983) 54 Comp. Cases 301 (Delhi)].

The Company Law Board may on any application under Section 111(4) decide

not only the title of any person but also any question which is necessary or expedient to be decided in connection with the application. The provisions stated above regarding rectification of register of members shall apply in relation to rectification of register of debentureholders as well.

In *Ramesh B. Desai and Ors. v. Bipin Vadilal Mehta and Ors.*, 2006 (7) SCALE 62, [2006] 132 Comp Cas 479 (SC), decided on July 11, 2006, the appellants, *Ramesh B. Desai and Ors.* had filed the Company Petition for rectification of the register of the company as provided by Section 155 of the Companies Act in the manner that the names of *Bipinbhai Vadilal Mehta, Smt. Nirmaiben Bipinbhai Mehta and Priyambhai Bipinbhai Mehta* may be deleted from the register of the Company. The allegation made in the petition was that the funds of the company were utilized for acquiring shares. The manner of acquiring the shares was violative of Section 77(2) of the Companies Act. Further, the company had no knowledge of the devise adopted by Bipinbhai nor the company had authorized these transactions by passing any resolution of the Board and the Company never rectified the action of Bipinbhai. It was also averred in the petition that Article 20 of the Articles of Association of the Company stipulates that "none of the funds of the company shall be employed in the purchase of shares of the company". The transaction devised by Bipinbhai in order to purchase the shares and get control of the company is also contrary to Article 20 of the Articles of Association of the Company and, therefore, it is void.

The respondents, Bipin Vadilal Mehta and Priyam Bipinbhai Mehta moved Company Application before the learned Company Judge to dismiss the said Company Petition, without going into the merits of the petition, on the ground that the same is barred by limitation.

This application was allowed by the learned Company Judge by the judgment and order dated 12.3.1996 and the said order was affirmed in appeal by a Division Bench of the High Court by the judgment and order dated 10.3.2000. This judgment was challenged in the Supreme Court.

According to learned Supreme Court Judge, in view of the facts pleaded in the Company Petition, the case is covered by Section 17(1)(a) of the Limitation Act and not by Section 17(1)(b) as the petitioners are not claiming any right or title over the shares of the Company, which according to them were purchased out of the funds of the Company. Section 17(1)(b) will apply when the plaintiff or applicant is claiming any kind of right or title to any moveable or immovable property etc. In view of the pleadings as aforesaid, it is Section 17(1)(a) of the Limitation Act which would govern the situation and not Section 17(1)(b) of the Limitation Act.

Further, the continuance of the name of Bipinbhai in the register of the Company was a continuing wrong and, therefore, the period of limitation would begin to run at every moment of time during which the wrong name of Bipinbhai continues to remain in the register. Learned counsel has submitted that in such a situation the principles enshrined in Section 22 of the Limitation Act will apply and the Company Petition cannot be held to be barred by limitation and the view to the contrary taken by the High Court is erroneous in law.

The appeal accordingly succeeded and allowed. The judgment and order passed by the learned Company Judge and that of the Division Bench were set aside. The High Court would decide the Company Petition afresh in accordance with law.

If the default is made in giving effect to the orders of Company Law Board, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 10,000 and with a further fine which may extend to Rs. 1000 for every day after the first day after which the default continues.

The provisions of Section 111 are applicable to a private company and shall include a private company which had become a public company by virtue of Section 43A of the Act. [Sub-section (14)].

Closing of Register of Members

Section 154 of the Companies Act, 1956 contains guidelines for closing the register of members. It lays down:

- “(1) A company may, after giving not less than seven days previous notice by advertisement in some newspaper circulating in the district in which the registered office of the company is situated, close the register of members or the register of debenture holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time.
- (2) If the register of members or of debenture holders is closed without giving the notice provided in Sub-section (1), or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees for every day during which the register is so closed.”

The provisions contained in Section 154 are permissive and not mandatory. The section has application only when a company desires to close its register of members and in such a situation, the requirements of the section are to be complied with. *Talyar Tea Co. v. Union of India*, (1991) 71 Com Cases 95

The power in this section is intended for the convenience of the company in order to enable the register of members to be brought up to date for the purpose of calculating dividend and bonus, etc. However, even if the register of members is closed, the company is obliged to make certain entries during the period of closure, such as entries relating to registration and probates and letters of administration, notices of change of name and address and court orders, such as changing orders, etc. [*Killick Nixon Ltd. v. Dhanraj Mill Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

The closure of the register is cloaked with the right to refuse the transfer of shares/debentures. Record date is an alternate for closing the registers. The purpose of closing the registers is to get the registers updated and to fix a cut-off date for the purpose of payment of dividend or issue of rights and bonus shares. This purpose can also be achieved by fixing a record date for a day.

The companies, whose shares are listed on one or more stock exchange(s) are required under the Listing Agreement to fix dates for closure of the register in consultation with the concerned stock exchange(s). Companies are required to give to the concerned stock exchange(s) advance notice as required by the Listing Agreement.

Foreign Register

Section 157 of the Companies Act, empower companies to keep foreign registers of members or debentureholders, states:

- “(1) A company which has a share capital or which has issued debentures may if so authorised by its articles, keep in any State or country outside India, a branch register of members or debentureholders resident in that State or Country, (In this Act called a “foreign register”).
- (2) The company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice with the Registrar of such change or discontinuance.
- (3) If default is made in complying with the requirements of Sub-section (2), the company and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.”

A foreign register is deemed to be a part of the company's principal register and it should be kept in the same manner as the principal register and be likewise open to inspection.

A duplicate of such register should be maintained at the registered office in India and all entries made in the foreign register should be made in the duplicate register at the registered office as soon as possible.

A company may discontinue a foreign register at any time but all the entries made in it must be transferred to the principal register.

The decision of a competent Court in the State or Country in which a foreign register is kept, with regard to its rectification, shall be as effective as if it were a decision of a competent Court in India, if the Central Government, by notification in the *Official Gazette*, so directs.

Preservation of Registers, etc.

The Companies (Preservation and Disposal of Records) Rules, 1966 regulate the preservation and disposal of registers which the companies registered under the Companies Act, 1956 are required to maintain.

Rule 2 of the said Rules lays down the preservation period of different registers which is given as under

S.No	Register Details	Retention Period
1	Register of members commencing from the date of the registration of the company	Permanent
2	Index of members	Permanent

3	Register and Index of debentureholders	Fifteen years after the redemption of the debentures.
4	Copies of all annual returns prepared under Section 159 and Section 160 and copies of all documents required to be annexed thereto under Sections 160 and 161	Eight years from the date of filing with the Registrar of Companies.

According to Rule 3 of the Rules, the Registrar of Companies may, by order in writing, direct any company to preserve any of the above registers and documents beyond the period specified above for retention.

Rule 4 makes it obligatory on the part of companies to maintain a register in the form prescribed in the Rules where they shall enter brief particulars of the documents destroyed and all entries made therein shall be authenticated by the secretary or such other persons as may be authorised by the Board for the purpose.

No Notice of Trust

Sometimes shares are held in trust. For example, shares of which A is the real owner may be registered by him in the name of B. A, in this case is the beneficial owner and B is the trustee. B holds the shares in trust for A. B's name will be entered in the company's register of members and he alone is the member entitled to the rights of membership and is also liable as member and as contributory in the event of the company going into liquidation, for the amount unpaid on the shares. According to Section 153 of the Companies Act; "No notice of any trust, express, implied or constructive, shall be entered on the register of members or of debenture holders".

In *Murshidabad Loan Office Ltd. v. Satish Chandra Chakravarti*, A.I.R. 1943 Cal. 440, S, a lady was registered as holder of certain shares in a company. The company, on learning that the shares actually belonged to her husband, sued her husband for the unpaid calls on the shares. *Held*, he was not liable as he was not the member of the company. It is only the registered member, who is liable on the shares, though he or she may not be the real owner of the shares. The Court observed: "Assuming that the registered shareholder is not the real owner but if he is the member in the books of the company, it is he alone who would be entitled to the rights of a shareholder and he alone is liable for call on shares and to be put on the list of contributories".

In a decision of the Madras High Court it has been held that the section does not prevent the managing director of a company from contending that the shares held by his wife were only held by her as benamidar for him. [*Parameshwari S.V. Kamadhenu Metal Rolling Mills*, (1970) 2 Comp LJ 120 : AIR 1971 Mad 293].

Though as per terms of this section no notice of any trust is to be entered in the register of members, the section does not prevent the company taking notice of a trust which is brought to its notice from other evidence [See *Parameshwari S.V. Kamadhenu Metal Rolling Mills Ltd. (Supra)*].

Power of the Central Government to Investigate into the Ownership of Shares

Sometimes, the registered holder of shares in a company may be a nominee for some other person, who really owns the shares. This enables persons, who in fact control a company, to conceal their real status from the shareholders and from the public and practice fraud with regard to the management of the company. To check such a practice, Sections 247 empower the Central Government to appoint an inspector to investigate into and report on the ownership of a company.

Declaration by Persons not holding Beneficial Interest in any Share

The main purpose of Sections 247 and 248 which empower the Central Government to investigate the ownership of the shares of the companies is to know the *benami* shareholding. However, these sections proved ineffective in this regard. Therefore, Section 187C was inserted by the Companies (Amendment) Act, 1974 in the Companies Act, 1956, which made it obligatory on the part of a person, whose name was entered at the commencement of the Amendment Act, i.e. 1st February, 1975, in the register of members of a company as the holder of a share in that company but who did not hold beneficial interest in such share to make a declaration to the company specifying the name and other particulars of the person who held the beneficial interest in such share [Sub-section (1)].

Sub-section (2) of the Section made it obligatory for any person who, after 1st February, 1975, held beneficial interest in a share or class of shares in a company or where there was a change in the beneficial interest in a share in a company, the beneficial interest holder shall make a declaration within thirty days, to the company in the prescribed Form and Sub-section (4) makes it obligatory on the part of the company to make a note of such a declaration in its register of members and to file within thirty days with the Registrar of Companies a return in the prescribed form with regard to such a declaration.

Sub-section (5) prescribes penalty for non-compliance of the foregoing provisions of Section 187C which may extend to one thousand rupees for every day during which the failure continues.

The Companies (Declaration of Beneficial Interest in Shares) Rule, 1975 has prescribed three forms in order to comply with the provisions of Section 187C. Form I is required to be filed by the holder of shares to the company. Form II is to be filed by the beneficial owner of the shares to the company and Form III is the return to be filed by the company with the Registrar of Companies.

It would, thus, be seen that Sections 153B and 187C which require the companies to take notice of the trusts and indicate the names of the *benami* shareholders in the register of members when a declaration is made to the company virtually negates the provision of Section 153 which requires the companies not to take the notice of any trust. Further Section 187C(8) of the Act directs that the provisions of Section 187C shall not apply to the trustee referred to in Section 187B on or after 13.12.2000.

8. RIGHTS OF MEMBERS

When once a person becomes a member he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the

Act. The appointment of a receiver, the attachment of the shares, the pledge of the shares or taking over of the management of a company which is holding shares in another company under Section 18A of the Industries (Development & Regulation) Act, 1951 will not alter the position. So long a person's name stands registered in the books as a member, even if he has sold the share and has given the share certificates and the blank transfer deed duly signed, he alone is entitled to exercise the rights of membership [*Balakrishna Gupta & Others v. Swadeshi Polytex Ltd. and Others* (1985) 58 Comp. Cas. 563 (S.C.); and *Life Insurance Corporation of India v. Escorts Ltd. & Others* (1986) 59 Comp. Cas. 548 (S.C.)]. These rights are derived by virtue of the membership contract between the company and the member and the general law. Some of these rights can be exercised by him individually and others alongwith other members unless member himself holds shares equivalent to the minimum holding prescribed under the various provisions of the Companies Act, 1956.

Individual Rights

Members of a company enjoy certain rights in their individual capacity, which they can enforce individually. These rights are contractual rights and cannot be taken away except with the written consent of the member concerned. These rights can be categorised as under:

- (1) Right to receive copies of the following documents from the company:
 - (i) Abridged balance-sheet and profit and loss account in the case of a listed company and balance-sheet and profit and loss account otherwise (Section 219).
 - (ii) Report of the Cost Auditor, if so directed by the Government.
 - (iii) Contract for the appointment of the managing director/manager (Section 302).
 - (iv) Notices of the general meetings of the company (Sections 171-173).
- (2) Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fee.

The members have been given right to inspect the following registers etc.:

 - (i) Debenture trust deed (Section 118);
 - (ii) Register of Charges (Section 141);
 - (iii) Register of Members, Register of Debenture holders, Index of Members, Index of Debenture holders and Annual Returns (Section 163);
 - (iv) Shareholders' Minutes Book (Section 196);
 - (v) Register of Contracts, Companies and Firms in which directors are interested (Section 301);
 - (vi) Register of directors (Section 303);
 - (vii) Register of Directors' Shareholdings (Section 307); and
 - (viii) Copy of agreement of appointment of the managing director/manager (Section 302).

The members can also get the copies of the aforesaid registers/returns on payment of prescribed fee except those of Register of Directors and Register of Directors' Shareholdings. Members can also get copies of memorandum and articles of association on payment of a fee of Re. One (Section 39).

- (3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 165, 166, 169, 176 and 177).

- (4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

- (i) To receive share certificates as title of their holdings [Section 84 read with the Companies (Issue of Share Certificates) Rules, 1960].
- (ii) To transfer shares (Sections 82 and 108 and Articles of Association of the company).
- (iii) To resist and safeguard against increase in his liability without his written consent.
- (iv) To receive dividend when declared.
- (v) To have rights shares (Section 81).
- (vi) To appoint directors (Section 255).
- (vii) To share the surplus assets on winding up (Section 511).
- (viii) Right of dissentient shareholders to apply to court (Section 107).
- (ix) Right to be exercised collectively in respect of making application to the Central Government for investigation of the affairs of the company (Section 235), and for appointment of Government directors (Section 408).
- (x) Right to make application collectively to the Company Law Board for oppression and mismanagement (Sections 397 and 398).
- (xi) Right of Nomination.

Corporate Membership Rights

Members of a company have certain rights which can be exercised by members collectively by means of democratic process, i.e. by majority of members usually unless otherwise prescribed. Corporate rights are the rights, which, each member has agreed, to be exercised by majority at general body meetings. This involves the principle of submission by all members to the will of the majority, provided that the will is exercised in accordance with the law and the Memorandum and Articles of Association of the company. Thus, the shareholders in majority determine the policy of the company and exercise control over the management of the company.

However, if and when the majority becomes oppressive or is accused of mismanagement of the affairs of the company, Section 399 confers right, to not less than one hundred members of a company or not less than one-tenth of the total number of its members whichever is less or any member or members holding not less than one-tenth of the issued share capital of the company (but they must have

paid all calls and others sums due on their shares) and in the case of a company not having a share capital, not less than one-fifth of the total number of its members, to apply to Board under Section 397 or Section 398 for relief in cases of oppression or for relief in cases of mismanagement respectively.

Section 169 of the Companies Act confers on members, holding not less than one-tenth of the paid-up share capital of a company, right to requisition an extraordinary general meeting of the company. The section also confers on members having not less than one-tenth of the total voting power in a company not having a share capital, to requisition an extraordinary general meeting of the company. If the Board of directors of the company does not, within twenty-one days from the date of the deposit of a valid requisition in regard to any matters, proceed to call a meeting for the consideration of those matters on a day not later than forty-five days from the date of deposit of the requisition, the meeting may be called by the requisitionists themselves.

It may be noted that mere appointment of a receiver in respect of certain shares of a company without anything further cannot deprive the holder of the shares, whose name is entered in the register of members of a company, the right to vote at the meetings of the company or right to issue notice under Section 169 of the Companies Act. Such rights are not affected by the attachment of the shares also. In the event of a pledge of shares, the pawnee cannot be treated as the holder of the shares, pledged in his favour and, therefore, the pledger continues to be a member and can exercise his voting right and the rights under Section 169 [*Balkrishan Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Comp. Cas. 563 (S.C.)].

Voting Rights of Members

The right of attending shareholders' meetings and voting thereat is the most important right of a member of a company, as shareholders' meetings play a very important role in the company's life. Directors are appointed by the shareholders, who direct the affairs of the company, formulate short-term plans and long-term policies of the company, appoint management personnel to constitute organisation to implement their plans and policies in order to achieve the objects of the company.

In view of the importance of the general meetings of a company, the Companies Act has not left the members to the will of the directors to call general meetings. If the members feel that the affairs of the company are not being properly managed by the directors and the directors are avoiding to call a general meeting of the company, Section 169 of the Companies Act confers right on members specified therein to deposit a requisition setting out the matters for the consideration of which the meeting is to be called and if the Board of directors does not proceed within twenty-one days of the requisition to call a meeting within forty-five days of the requisition, the requisitionists may themselves call the meeting.

Section 87 of the Act provides that every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company.

The Companies (Amendment) Act, 2000 has amended Section 86 of the Companies Act, 1956 which provides that a company limited by shares shall be entitled to issue (i) equity share capital with voting rights or with differential rights as

to dividend, voting or otherwise in accordance with such rules and subject to such conditions prescribed by the Government. The Central Government framed the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 which have come into force with effect from 9th March, 2001. As such, equity share capital with differential rights as to dividend, voting or otherwise can be issued.

Preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital. A resolution for winding up of the company or for the reduction of the share capital, will be deemed to affect directly the rights attached to preference share and so they can vote on such resolutions.

In case of a public company where preference shares are cumulative as to dividend and the dividend thereon has remained unpaid for an aggregate period of two years before the date of any meeting of the company, the preference shareholders shall have right to vote on every resolution before the meeting. In the case of non-cumulative preference shares, preference shareholders have the right to vote on every resolution if the dividend due on their capital remains unpaid either in respect of a period of not less than two years ending with the expiry of the financial year immediately preceding the commencement of the meeting or in respect of the aggregate period of not less than three years comprised in the six years ending with the expiry of the financial year aforesaid (Section 87).

Section 92 of the Act lays down that a company may, if authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him although no part of the amount has been called up. Such advance payment, however, shall not confer on the member concerned any voting rights.

Shareholders' Pre-emptive Rights with regard to further issue of share capital (Right Shares)

To preserve the shareholders' proportionate dividend, liquidation and voting rights, pre-emptive rights are often recognised, but their existence and scope can be effected by provisions in the articles. However, Section 81 of the Companies Act, 1956 secures shareholders' pre-emptive rights with regard to the further issue of share capital by the company. The Section lays down:

“(1) Where at any time after the expiry of two years from the formation of a company or at any time after the expiry of one year from the allotment of shares in that company made for the first time after its formation, whichever is earlier, it is proposed to increase the subscribed capital of the company by allotment of further shares, then such further shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company, in proportion, as nearly as circumstances admit, to the capital paid-up on those shares at that date [Sub clause (a)] and unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice of offer shall contain a statement to this right [Sub clause (c)].

Variation of Member's Rights

Member's rights are determined by the Companies Act, Memorandum of association, Articles of association of the company and the terms of issue of shares. Rights attached to a class of shares are known as “class rights”.

Member's rights relate to dividend, voting at members' meetings and return of capital. Preference shareholders may have rights to a fixed amount or a fixed rate of dividend or to cumulative dividend. Where the ordinary shareholders are conferred the right to participate in the surplus assets on winding up of a company, it is not deemed to be a class right as it is implied even in the absence of any express provision in the articles.

Section 106 of the Companies Act, 1956 lays down that the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class. Further, the variation of rights of shareholders can be effected only:

- (i) if provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or
- (ii) in the absence of any such provision in a Memorandum or Articles of association of the company, if such a variation is not prohibited by the terms of issue of the shares of that class.

Rights of Dissident Members

Section 107 of the Companies Act confers certain rights upon the dissentient shareholders. According to this section, where the rights of any class of shares are varied, the holders of not less than ten per cent of the shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, can apply to the Court to have the variation cancelled. Where any such application is made to the court, the variation will not be effective unless and until it is confirmed by the court.

9. LIABILITY OF MEMBERS

The liability of a member depends on the nature of the company. If the company is registered with unlimited liability, every member is liable in full for all the debts of the company contracted during the period of his membership. Where the company is limited by guarantee, each member will be bound to contribute in the event of winding up a sum specified in the liability clause of the memorandum of association. In case of company limited by shares, each member is bound to contribute the full nominal value of shares and his liability ends there. If before the full nominal value of the shares is paid, the company goes into liquidation, the member becomes liable as contributory to pay the balance when called upon to pay, by the liquidator of the company

The liability of the members becomes unlimited if the number of members falls below the statutory limits i.e., seven in a public company and two in a private company (Section 45).

If a member ceased to be member of a company within one year prior to the commencement of the winding up of the company he is liable to pay on the shares which he held to the extent of the amount unpaid thereon, if:

- (i) on the winding up, debts exist which were incurred while he was a member, and

- (ii) the present members are not able to satisfy the contribution required from them in respect of their shares.

A person is liable as member in spite of a valid transfer of shares by him, if the name of the transferee is not placed on the register of members, in place of the transferors' name. If a person applies for shares in the name of a fictitious person or a person not in existence or uses another person's name for himself, or uses an alias, and shares are allotted in that name or alias, he will be liable as a member.

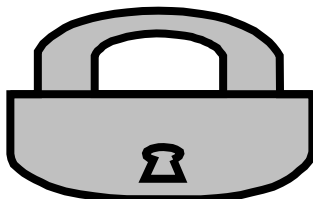
LESSON ROUND-UP



- A Company is composed of members, though it has its own entity distinct from members.
- Every shareholder is a member and every member is a shareholder, however, there may be exceptions to this statement.
- Section 41 of the Companies Act provides the modes by which a person may acquire membership of a Company.
 - by subscribing to the Memorandum,
 - by agreeing in writing to become a member,
 - by holding equity share capital of a Company as beneficial owner in the records of a depository.
- A non-profit making Company licensed under Section 25 of the Companies Act can become member of any other company.
- Foreigners, trade unions can hold shares in a company, and consequently become its members.
- Insolvent and bankrupt may be members of a company as long as they are on the register of members.
- Partnership firm, minor cannot become a member of a company.
- Pawnee and Receiver cannot be treated as members.
- Persons taking shares in fictitious names become liable as a member besides incurring criminal liability u/s 68A of the Act.
- Section 45 of the Act provides that the liability of the members of a company shall be unlimited if the number of members falls below the statutory minimum limit.
- Person ceases to be a member when his name is removed from register of members of a company.
- In accordance with Section 150, every Company shall keep register of its members. This register shall be kept at the registered office of the Company subject to the provisions of Section 163 of the Companies Act, 1956.

- Section 154 contains guidelines for closing the register of members.
- The Companies (Preservation and Disposal of Records) Rules, 1966 regulate the preservation and disposal of register and index thereof which the Companies registered under the Companies Act, 1956 are required to maintain.
- On becoming a member, the person enjoys certain rights and is bestowed with the liabilities as per the provisions of Companies Act.
- Every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company. On the other hand, preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital.
- Rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class.
- Where the rights of any class of shares are varied, the holders of not less than ten per cent of the shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, can apply to the Court to have the variation cancelled. Where any such application is made to the Court, the variation will not be effective unless and until it is confirmed by the Court.

SELF-TEST QUESTIONS



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

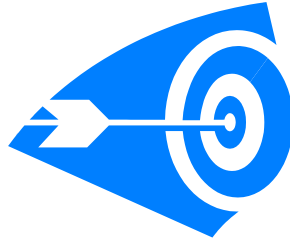
1. Every shareholder of a company is known as a member while every member may not be known as a shareholder. Comment.
2. Define a 'member'. Distinguish him from a shareholder. In what ways a person can become and cease to be a member of the company?
3. Who can become a member of the company? Can the following persons or institutions become member of a company:
(a) Minor; (b) Company; (c) Partnership firm; (d) Foreigner; (e) Insolvent.
4. Describe the circumstances under which a register of members may be rectified? Illustrate your answer in the light of the relevant provisions of the Companies Act, 1956.
5. What are the particulars to be recorded in a register of members of a company? Where is the register to be maintained and who has to maintain it? Can a member have access to the register?
6. The name of X is found entered in the register of a company. But X contends

that he is not a member of the company. The company maintains that X had orally agreed to become a member and hence his name was entered in the register and so he is a member. Is the contention of the company valid?

7. What are the individual and group rights of a member?
 8. When does the liability of a member of a limited company become unlimited?
 9. Write short notes on:
 - (a) Cessation of membership of a company;
 - (b) Index of members;
 - (c) Variation of members' rights;
 - (d) Registration of shares in the name of public office.
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STUDY XIII
FINANCIAL STRUCTURE AND MEMBERSHIP - VIII
TRANSFER AND TRANSMISSION OF SECURITIES

LEARNING OBJECTIVES



Transferability of shares is one of the important characteristics of a company. This chapter will make the students understand the concept of transfer of shares in a company, various provisions of company law regulating transfer of shares, powers of Board to refuse registration, transfer during winding up, transmission of shares, transfers under depository system, etc.

Topics covered under the chapter are:-

- Introduction
- Provision regulating transfer of Securities
- Stamp duty payable and Affixation/Cancellation of shares
- Transfer of Debentures
- Power of Board of Directors to refuse registration
- Extension of time limit for presentation to prescribed authority under Section 108(1D)
- Transfer of securities of a public Co. under Section 111A.
- Transfer of shares during winding up
- Rights of transferor
- Transmission of shares
- Legal framework for Depository Systems.

1. INTRODUCTION

One of the most important characteristics of a company is that its shares are transferable. Section 82 of the Companies Act, 1956 states that the shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. Shares of a public company are freely transferable. However, in terms of Section 3(1)(iii), a private company is required to restrict the right to transfer its shares by its articles.

In view of the importance of transfer of such securities, provisions for the regulation of their transfer have been enacted in Sections 108 to 111 of the Companies Act, 1956 and the Securities Contracts (Regulation) Act, 1956 and a

Share Transfer Form No. 7B is prescribed under the Companies (Central Government's) General Rules and Forms, 1956. For companies registered under Section 25 of the Companies Act, form 7BB has been prescribed by the Ministry of Corporate Affairs. The restrictions on acquisition and transfer of shares are also laid down by the Foreign Exchange Management Act, 1999 and the Securities Contracts (Regulation) Act, 1956.

2. PROVISIONS UNDER COMPANIES ACT REGULATING TRANSFER OF SECURITIES

As per Section 108(1) of the Companies Act, 1956, a company, whether public or private, shall not register a transfer of shares in, or debentures of, the company, unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name address and occupation, if any, of the transferee, has been delivered to the company along with the certificate relating to the shares or debentures, or if no such certificate is in existence, along with the related letter of allotment.

However, where on an application in writing made to the company by the transferee and bearing the stamp required for an instrument of transfer, it is proved to the satisfaction of the Board of directors that the instrument of transfer signed by or on behalf of the transferor and transferee has been lost, the company may register the transfer on such terms as to indemnity as the Board may think fit. This sub-section is mandatory and unless all the pre-requisites mentioned in the Sub-section are complied with, the transfer shall be void. (Appeal No. 29 decided by the Company Law Board on 25.4.1980).

Provided further that nothing in section 108(1) shall prejudice any power of the company to register as shareholder or debentureholders any person to whom the right to any shares in, or debentures of, the company has been transmitted by operation of law

The instrument of transfer of shares must be in the prescribed Form No. 7B The aforesaid Form No. 7B provides for writing the name, address and occupation of the transferee, and signature by the transferor and the transferee, name of the company to which the shares relate, the distinctive numbers of shares sought to be transferred, certificate number, amount of considerations and the name of the stock exchange on which dealt with, if any.

Section 108(1A) of the Companies Act, 1956 provides that every such form shall, before it is signed by or on behalf of the transferor, and before any entry is made therein, be presented to the prescribed authority, being a person in service of the Government, who shall stamp or otherwise endorse thereon the date on which it is so presented. Usually, Registrars of Companies are authorised to sign or stamp and put date on such transfer instruments. The transfer deeds duly executed and completed in all respects are required to be delivered to the company for registration within the time prescribed in Section 108(1A) of the Act, viz.,

- (i) in the case of shares dealt in or quoted on a recognised stock exchange, at any time before the date on which the Register of Members is closed, in accordance with the law, for the first time after the date of presentation of the form to the aforesaid prescribed authority or within twelve months from the date of such presentation, whichever is later;

- (ii) in any other case, within two months from the date of such presentation.

Exceptions of Section 108 (1A)

As per Section 108(1C) the aforesaid provisions contained in Sub-section (1A) shall not apply, to:

(A) Any share:

- (i) which is held by a company in any other body corporate in the name of a director or nominee in pursuance of Sub-section (2) or (3) of Section 49 of the Companies Act, 1956, or
- (ii) which is held by a corporation, owned or controlled by the Central Government or a State Government in any other body corporate in the name of a director or nominee,
- (iii) in respect of which a declaration has been made to the public trustee under Section 153B if:
 - (1) the company or corporation as the case may be, stamps or otherwise endorses, on the form of transfer in respect of such share, the date on which it decides that such share shall not be held in the name of the said director or nominee, or as the case may be in the case of any share in respect of which any such declaration has been made to the public trustees, the public trustee stamps or otherwise endorses, on the form of transfer in respect of such share under his seal, the date on which the form is presented to him, and
 - (2) the instrument of transfer in such form, duly completed in all respects, is delivered to the—
 - (a) body corporate, in whose share such company or corporation has made investment in the name of its director or nominee, or
 - (b) company in which such share is held in trust.

within two months of the date so stamped or otherwise endorsed, or

(B) any share deposited by any person with:

- (i) The State Bank of India, or
- (ii) Any Scheduled Bank, or
- (iii) Any other banking company, or financial institution approved by the Central Government by notification in the Official Gazette, or
- (iv) The Central/State Government or any corporation owned or controlled by any such Government,

by way of security for the repayment of any loan or advance to or for the performance of any obligation undertaken by such person, if:

- (1) the bank, institution, Government or corporation stamps or otherwise endorses on the transfer form of such share:
 - (a) the date on which such share is returned by it to the depositor, or
 - (b) in the case of the failure on the part of the depositor to repay the loan or advance or to perform the obligation, the date on which such share is released for sale by such bank, institution, Government or corporation, or

- (c) where the aforesaid bank, institution, Government or corporation intends to get such share registered in its own name, the date on which the instrument of transfer relating to such share, is executed by it; and
 - (2) the instrument of transfer in the prescribed Form No. 7B duly completed in all respects, is delivered to the company within two months of date of stamping or endorsement by the aforesaid prescribed authority, or
- (C) any share which is held in any company by the Central Government or a State Government in the name of its nominee except that every instrument of transfer executed on or after 1.10.1966 in respect of any such share shall be in the prescribed form.**

Central Government is vested with powers under Section 108(1D) of the Act to extend the aforesaid periods for delivery of the share transfer deed to the company on an application made, where, in the opinion of the Government, it is necessary to avoid hardship.

The Central Government has vide notification GSR No. 481(E) dated 22.4.1988, empowered the Registrar of Companies, of the State in which the registered office of the Company is situated or by the Registrar of Companies of the State in which the transferee ordinarily resides to exercise the powers and functions under Section 108(1D).

The number of extensions granted by the Central Government under this section and the period of each such extension shall be shown in the annual report laid before the House of Parliament under Section 638 of the Act.

The requirements of company's articles must also be satisfied. Where the article requires the payment of transfer fee in the office of the company, depositing the same in the Court was held to be not a sufficient compliance.

Restrictions on the acquisition and transfer of shares of, or by, certain bodies corporate

Sections 108A to 108G were introduced in the Companies Act by the Companies (Amendment) Act, 1974, to regulate the acquisition and transfer of shares of certain bodies corporate. By the MRTP (Amendment) Act, 1984 w.e.f. 1.8.1984 these sections were transferred to MRTP Act, 1991 as Sections 30A to 30G in Chapter IIIA of the MRTP Act, 1969 but again have been transferred to the Companies Act, w.e.f. 28.12.1991. Further, Ministry of Corporate Affairs vide its Circular No. 30/2011 dated 23.05.2011 clarified that after repeal of MRTP Act, 1969, the Provisions of Section 108A to 108I of the Companies Act, 1956 have become redundant and will have no legal force.

Transfer of shares by legal representative

As per section 109 of the companies Act, A transfer of the shares or other interest in a company of a deceased member thereof made by his legal representative shall, although the legal representative is not himself a member, be as valid as if he had been a member at the time of execution of the instrument of transfer.

3. NOMINATION OF SHARES/DEBENTURES

The Companies (Amendment) Act, 1999 has provided the facility to shareholders/debentureholders to make nomination of shares. According to Section

109A of the Companies Act, 1956 every shareholder or debentureholders of a company has right to nominate at any time in the prescribed manner, a person to whom his shares/debenture shall vest in the event of his death. The nomination is to be made in Form No. 2B of Companies (Central Governments) General Rules and Forms, 1956. In case shares/debentures are held jointly, then the joint holders may together nominate a person to whom their shares/debentures shall vest in the event of death of all the joint holders.

The nominee will on the death of shareholder or debentureholders become entitled to all rights in the shares/debentures to the exclusion of all other persons irrespective of anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise in respect of such shares or debentures, unless the nomination is varied or cancelled.

Where the nominee is a minor, it shall be lawful for the holder of shares or debentures, to make the nomination to appoint, in the prescribed manner, any person to become entitled to shares in, or debentures of, the company, in the event of his death, during the minority.

The nomination can be made by individuals only applying/holding shares or debentures on their own behalf singly or jointly. Non-individuals including society, trust, body corporate, partnership firms, Karta of Hindu Undivided Family, holder of power of attorney cannot nominate.

Where a nomination has been made by a shareholder/debentureholder of his shares/debentures in a company, the nominee will be entitled to all the rights in respect of shares in the event of death of the shareholder as against the legal representative/legal heirs of the deceased member

Transmission of shares in favour of nominee(s)

According to Section 109B, any person who becomes a nominee by virtue of the provisions of Section 109A, upon the production of such evidence as may be required by the Board and subject as hereinafter provided, elect, either:

- (a) To be registered himself as holder of the share or debenture, as the case may be; or
- (b) to make such transfer of the share or debenture, as the case may be, as the deceased shareholder or debentureholder, as the case may be, could have made.

If the nominee elects to be registered as shareholder or debentureholder, he shall have to deliver or send a notice in writing signed by him stating his intention along with death certificate of the deceased shareholder or debentureholder, as the case may be. All the limitations, restrictions and provisions of the Companies Act, 1956 relating to the right to transfer and the registration of transfer of shares/debentures shall be applicable to any such notice or transfer in the same manner as if the member has not died.

Such a nominee, on the death of the shareholder, shall be entitled to same dividends and other advantages as a member except that he shall not, before being

registered as a member be entitled to exercise rights of members in relation to meetings of the company. In other words he will not be entitled to attend and vote at general meetings unless he has become a registered member of the company.

However, the Board of directors may give a notice requiring any such person to decide whether to register himself or to transfer the shares or debentures. On non-compliance of the notice of the Board of directors within ninety days, the Board may thereafter withhold the payment of all dividends, bonuses or other money payable in respect of shares or debenture, until the requirements of the notice have been complied with.

Application for Transfer

As per section 110 of the Act, an application for the registration of a transfer of the shares or other interest of a member in a company may be made either by the transferor or by the transferee.

However where the application is made by the transferor and it relates to partly paid shares, the company will give a notice of the application to the transferee and the transfer shall be registered only after getting the no objection from transferee within 2 week from the receipt of the notice. Notice to the transferee shall be deemed to have been duly given if it is dispatched by prepaid registered post to the transferee at the address given in the instrument of transfer and shall be deemed to have been duly delivered at the time at which it would have been delivered in the ordinary course of post.

POWER TO REFUSE REGISTRATION AND APPEAL AGAINST REFUSAL

According to section 111 of the companies Act, 1) If a company refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any shares or interest of a member in, or debentures of, the company, it shall, within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be, giving reasons for such refusal.

STATUTORY REMEDY AGAINST REFUSAL UNDER SECTION 111

One of the fundamental features of joint stock companies is that their shares are capable of being transferred. The right of the shareholder to transfer his shares in a company is absolute as it is inherent in the ownership of the shares subject only to provisions of the Act and restrictions, if any, laid down in the articles.

According to Section 111(2) of the Companies Act, 1956, the transferor or the transferee, or the person who gave intimation of the transmission by operation of law, as the case may be, may appeal to the company law board against any refusal of the company to register the transfer or transmission, or against any failure on its part, within the period referred to in Sub-section (1) either to register the transfer or transmission or to send notice of its refusal to register the same.

An appeal under Sub-section (2) shall be made within two months of the receipt of the notice of such refusal or, where no notice has been sent by the company,

within four months from the date on which the instrument of transfer, or the intimation of transmission, as the case may be, was delivered to the company. [Section 111(3)]

Applicability of Section 111 to Private Companies and not to Public Companies

Sub-section (14) inserted in Section 111 by the Depositories Act, 1996 makes Section 111 applicable only to private companies which includes the private companies which are public limited companies by virtue of Section 43A. As a consequence of this addition, Section 111 is not applicable to public companies.

4. TRANSFER OF SECURITIES OF A PUBLIC COMPANY (SECTION 111A)

The newly inserted Section 111A provides that the securities of a company other than a private company are freely transferable. The Board of directors of a Company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.

Where, however, the transfer of shares or debentures is effected in contravention of the provisions of Securities and Exchange Board of India Act, 1992 or regulations made thereunder or the Sick Industrial Companies (Special Provisions) Act, 1985, or any other law for the time being in force an application can be made to the Company Law board by depository, company, participant or investor or the Securities and Exchange Board of India within two months from the date of transfer of the shares or debentures held by the depository or from the date on which the instrument of transfer or the intimation of transmission was delivered to the company, as the case may be, to rectify the register or records of the company or depository. If the CLB, after making such inquiry as it thinks fit, is satisfied that the contravention has taken place, it may direct the company or the depository to rectify the register or the records of ownership. In terms of Section 111A the CLB's scope of power for rectification of register of members is restricted only in cases of refusal by the company to make transfer of shares. This section applies to public companies.

The CLB may pending completion of the inquiry; at its discretion suspend the voting rights in respect of the securities, which are subject matter of inquiry. During the pendency of the application before the CLB, the transferee can transfer the security and such further transfer would entitle the transferee to voting rights also, unless the voting rights in case of transferee have also been suspended by CLB.

5. STAMP DUTY PAYABLE AND AFFIXATION/CANCELLATION OF STAMPS

Before the transfer is lodged with the company, it should be duly stamped. The transfer of shares attracts stamp duty under the Indian Stamp Act, 1899 (Act 2 of 1899). Only the Central Government can levy stamp duty on share transfers. Stamps at the rate of twenty five paise for consideration of Rs. 100 or part thereof is payable. The duty chargeable shall, wherever necessary, be rounded off to the next five paise. [S.O. 130(E) dated 28.1.2004 issued by Department of Revenue].

The stamp duty payable on transfer of debentures is, however, governed by Article 62(b) of Schedule I to the Indian Stamp Act, 1899, and also varies from State to State. In this case, the duty would be:

- (i) The duty applicable where the deed is executed, or

- (ii) The duty applicable where the registered office of the company is situated, whichever is higher.

The amount of consideration is required to be mentioned in the share transfer deed as otherwise the companies cannot verify whether share transfer stamp duty has been correctly charged thereby attracting the penal provisions of the Stamp Act in case of a default. Thus, in case where question of consideration does not arise like in the case of a gift of shares, stamp duty will be paid on the basis of the market value of shares and in case of unquoted shares or where quotations are not available at the face value of the shares.

Under Section 108(1), a company cannot register the transfer of shares unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and the transferee has been delivered to the company along with the share certificate in question. The expression 'duly stamped' has not been defined in the Companies Act. Under Section 2(11) of the Indian Stamp Act, 1899 'duly stamped' as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in India. Under Section 12(1) of the Stamp Act, whoever affixes an adhesive stamp to an instrument which has been executed by any person shall, when affixing such stamp, cancel the same so that it cannot be used again. Sub-section (2) thereof makes it clear that any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall, so far as such stamp is concerned, be deemed to be unstamped. Sub-section (3) thereof provides the manner in which the adhesive stamp can be cancelled and provides that the stamp be cancelled by writing on or across the stamp his name or initials or the name or initials of his firm. Section 17 of the Indian Stamp Act, 1899 makes it clear that all instruments chargeable with duty and executed shall be stamped before, or at the time of execution. Therefore, the legal requirement is that the stamp must be cancelled either before or at the time of execution [*Babulal Choukhani v. Western Indian Theatres Ltd.* (1958) 28 Comp. Cas. 565; *Canara Bank v. Ballarpur Paper and Strawboard Mills Ltd.*, CLB decision, p.137].

6. LOST TRANSFER DEEDS

It is sometimes found that the transfer documents sent to companies are lost, say, in transit. In such a case, the company may receive a request from the transferee by way of an application carrying adequate stamp duty. In terms of the first proviso to Section 108(1) of the Act, the procedure is: (1) an application, in writing should be made to the company by the transferee, which should bear stamp duty required for an instrument of transfer. (2) The Board of directors of the company should be satisfied that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee has been lost. The proof may be in the form of an affidavit from the transferor or the transferee and supported by the purchase or sale note of the broker and the registration receipt issued by the postal authorities. (3) In addition, the company can take an indemnity to safeguard its position. After getting all the above stated condition complied with, the company may register the transfer.

7. DELEGATION OF POWERS FOR TRANSFER

The Companies Act, 1956 does not mention that the registration of share transfers should be approved by the Board of directors in a meeting or a committee thereof. It is the articles of the company which authorise the Board of directors to accept or refuse transfer of shares, at their discretion. The Board further have the power to delegate all or any of their powers to any of the directors of the company or any person even not in the employment of the company. Therefore, the articles of association should authorise the Board of directors to delegate the powers suitably. Only in the case of refusal to register a transfer, the directors are required to exercise their discretion.

8. TRANSFER OF DEBENTURES

In the case of debentures, the transfer instrument is not required to be dated by the prescribed authority nor is the transfer subject to any statutory period within which the registration has to be effected. However, stamp duty is payable for transfer of debentures and the duty varies from State to State, as explained above.

After registering the transfer, the particulars thereof have to be recorded in the Debenture Transfer Register and should be initialed by the appropriate authority. After making appropriate endorsements, the debenture certificate may be sent to the party concerned.

9. TRANSFER OF SHARES TO A MINOR

In India, a minor is not competent to enter into any contract, as under Section 11 of the Indian Contract Act, 1872, a person who has attained the age of majority is only competent to contract. Since a minor cannot enter into a contract or agreement except through a guardian, and since as per Section 153, no notice can be taken of the fact that the guardian holds a share in trust for a minor, it follows that his name cannot be entered in the Register of Members and therefore, he cannot become a member of a company. There is, however, no objection in law to the guardian of a minor entering into a contract on behalf of a minor, by virtue of the statutory right conferred on the guardian of a minor under Section 8 read with Section 4 to 6 of the Hindu Minority and Guardianship Act, 1956. Since Section 108 of the Companies Act enables execution of transfer deed by or on behalf of the transferor or the transferee, the transfer deed can be executed by a minor through his natural guardian as transferee, and the contract so entered into by a minor through his natural guardian is a binding and valid contract under Section 8 of the Hindu Minority and Guardianship Act, 1956.

The articles of association of a company cannot impose a blanket ban prohibiting transfer of shares in favour of a minor, as such a restriction is unreasonable and not sustainable. Section 82 of the Companies Act, 1956 provides that shares in a company are movable property and are transferable. The expression 'in the manner provided by the articles of association of the company' can only be interpreted to mean the procedure to be adopted for transfer and impose restrictions, which are

meaningful and reasonable. In case, the restriction imposed on transfer to a minor is accepted, it would mean that the shares of a deceased member can never be inherited by the legal heir who might be a minor. This would lead to a highly unjust situation and cannot be accepted as tenable. Accordingly, if the shares can be transmitted in favour of a minor, there is no reason why the shares which are fully paid-up and in respect of which no financial liability devolves on the minor are to be held as not transferable merely because of the ban imposed in the articles of association [*Saroj v. Britannia Industries Ltd.*, Appeal No. 5/80 decided on 14.12.81 by CLB].

Transfer of Shares to Partnership Firm

The Companies Act does not contemplate the registration of the name of a firm as the holder of shares of a company. A firm is not a person and as such is not entitled to apply for membership. The Department of Company Affairs (Now, Ministry of Corporate Affairs) has in its Circular No. 4/72 dated 9.2.1972 stated that a firm not being a person cannot be registered as a member of a company except where the company is licensed under Section 25.

Transfer of shares to a Body Corporate

An incorporated body being a legal person can acquire shares in its own name. Where a company is a transferee, the following documents are required to be submitted to the company:

- (a) A certified true copy of the Board resolution and/or power of attorney authorizing the signatory of the instrument of transfer to execute the instruments;
- (b) A certified true copy of a Board resolution passed under Section 292(1)(d) of the Companies Act; and
- (c) A certified true copy of Memorandum and Articles of Association of a company.

Transfer of Share Warrants

A share warrant is transferable by mere delivery of the warrants without execution of any written instrument of transfer being registered by the company. The bearer of a share warrant is not a member of the company unless otherwise so provided in the articles of the company in terms of Section 115(5) of the Act and, therefore, such a bearer of share warrants does not impliedly covenant to observe the provision of the company's memorandum and articles.

10. TRANSMISSION OF SHARES

Transmission of shares has not been defined by the companies act. 'Transmission by operation of law' is not a transfer. It refers to those cases where a

person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the shareholder or by purchase in a Court-sale

Thus, transmission of shares takes place when the registered shareholder dies or is adjudicated as an insolvent, or if the shareholder is a company, it goes into liquidation. Because a deceased person cannot own anything, the ownership of all his property passes, after his death, to those who legally represent him. Similarly, when a person is declared insolvent, all his property vests in the Official Assignee or Official Receiver. Upon the death of a sole registered shareholder, so far as the company is concerned, the legal representatives of the deceased shareholder are the only persons having title to the shares unless shareholder had appointed a nominee, in which case he would be entitled to the exclusion of all others.

Section 108(1) of the Companies Act, 1956 states that the transfer of shares must be effected by a proper instrument of transfer and that a provision in the articles of an automatic transfer of shares of a deceased shareholder is illegal and void. Such transfer does not amount to transmission which takes place by operation of law. The second proviso to Section 108(1) of the Act provides that nothing in the sub-section shall prejudice the powers of the company to register as shareholder any person to whom the right to any shares has been transmitted by operation of law. It follows that, for such transmission, instrument of transfer is not required, and, merely an application addressed to the company by the legal representative is sufficient.

Articles of companies generally provide for formalities to be observed for transmission of shares. In the absence of such provision in the articles of the company, Regulations 25 to 28 of Table A of Schedule I to the Act will govern the procedure for transmission. According to these regulations, the legal representatives are entitled to the shares held by deceased member and the company must accept the evidence of succession e.g., a succession certificate or letter of administrations or probate or any other evidence properly required by the Board of directors. He is, however, not a member of the company by reason only of being the legal owner of the shares. But he may apply to be registered as a member. On the contrary, instead of being registered himself as a member, he may make such transfer of the shares as the deceased could have made. The Board of directors also have the same right to decline registration as they would have had in the case of transfer of shares before death. But if the company unduly refuses to accept a transmission, the same remedies are available to the legal representative as in the case of a transfer namely, an appeal to the tribunal under Section 111.

11. DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

S.NO	<i>Transfer of Shares</i>	<i>Transmission of shares</i>
1	Transfer takes place by a voluntary act of the transferor	transmission is the result of the operation of law

2	An instrument of transfer is required in case of transfer	no instrument of transfer is required in case of transmission
3	Transfer is a normal course of transferring property	transmission takes place on death or insolvency of a shareholder
4	Transfer of shares generally made for some consideration	Transmission of shares is generally made without any consideration
5	Stamp duty is payable on transfer of shares by a member	No stamp duty is payable on transmission of shares

Where the articles give power to the Board of directors to refuse to register a transfer of shares, such power must be exercised actively by the directors, and unless they do so, the transfer must be registered. This means that there must be a refusal to register a transfer by a resolution of the Board of directors passed either unanimously or by majority. If one of the two directors refuses to attend a Board meeting so that quorum cannot be reached and consequently the consent of the Board for registration of share transfer cannot be obtained, the Court will order that the transferee should be entered on the register of members [*Gopal Varnish Co. Ltd.* (1917) 2 Ch. 349].

Where the articles give the directors absolute and uncontrolled power to refuse registration of a transfer, they can do so without giving any reason and such refusal can be attacked only if the directors have not exercised their discretion honestly in the interest of the company.

The provisions with regard to power of the Board to refuse registration and appeal against refusal are contained in Section 111 of the Companies Act, 1956. It may be noted that though the inherent power of the Board to refuse registration of transfer of shares, if so, authorised by the articles and intimation thereof to the transferor and the transferee has been retained, this right has been sheltered with sufficient safeguards by the Amendment Act of 1988 by requiring companies to categorically state the reasons therefor. According to Sub-section (1) of Section 111, if a company refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of or the transmission by operation of law of the right to any shares or interest of a member in, or debentures of the company, it shall within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be giving reasons for such refusal.

The power to refuse registration of shares which is conferred on the directors by the articles, is a discretionary power and must be exercised reasonably, and in good

faith for the benefit of the company. Unless the contrary is proved, the power is deemed to have been exercised properly (*Berry & Stewart v. Tottenham Hotspur Football and Athletic Co. Ltd.*, 1936, 3 A11 E.R. 554).

Refusal to register share transfer on suspicion that the employee if admitted as a member will attend general meetings of the company and may create nuisance by raising irrelevant issues and also obtain access to the records to the company as a shareholder is not a valid reason. (Appeal to the CLB No. 27, of 1975 dated 17th August, 1976, *Shri Nirmal Kumar v. Jaipur Metal and Electrical Limited*).

The mere attempts of a person to wind up a company more than once cannot be a ground for refusing to register transfer by the directors [*Rangpur Tea Association Ltd. v. Makkan Lal Samaddar* (1979), 43 Comp. Cas. 58].

Where the articles of association of a company confer a discretion on the directors with regard to acceptance of transfers, this discretion like all the directors' powers is a fiduciary one to be exercised *bona fide* in what the Board considers to be in the interest of the company. If on a true construction of the articles, the directors are only given the powers to reject on certain prescribed grounds and it is proved that on these grounds the request for transfer was rejected, the Court cannot substitute the opinion of the Board. If the articles of association give an unfettered discretion, the court would interfere with it only on proof of bad faith. [*M.J. Amrithalingam v. Gudiyatham Textiles Pvt. Ltd.*, (1972) 42 Comp. Cas. 350].

The Supreme Court, in *Bajaj Auto Limited v. N.K. Firodia*, AIR 1971, S.C. 321, has laid down the principles of law relating to refusal of transfer of shares. While discussing the nature of directors' discretion to refuse registration of shares, the Supreme Court observed : "discretion implies just and proper consideration of the proposal under the facts and circumstances of the case. In the exercise of that discretion, the directors will act in the paramount interest of the company and in the general interest of the shareholders because the directors are in a fiduciary position both towards the company and towards every shareholder. The directors are, therefore, required to act *bona fide* and not arbitrarily and not for any collateral motive". It was observed further that where the articles permitted the directors to decline to register transfer of shares without stating reasons, the Court would not draw unfavourable inferences against the directors because they did not give reasons. The Court would assume that the directors acted reasonably and *bona fide* and those who allege to the contrary would have to prove and establish the same by evidence. However, if the directors gave reasons, the Court would consider whether they were legitimate and whether the directors proceeded on right or wrong principle. The Court has also laid down three tests to determine the proper exercise of power by the Board of directors. The tests are:

1. Whether the directors acted in the interest of the company;
2. Whether they acted on a wrong principle; and
3. Whether they acted on oblique motive or for a collateral purpose.

If the directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the Court would consider whether the reasons were legitimate or the directors acted on a wrong principle, or from corrupt motive. If the reasons for refusal given by the directors were legitimate, the Court would not overrule that decision merely on the ground that the court would not have come to the same conclusion. The discretion of the directors was to be tested as the opinion of any fair and sensible man in the interest of the company.

Where the appellant transferee and respondent company were in the same line of business and were rivals, the refusal on the ground of rivalry will be justified in terms of the decision rendered by the Supreme Court in the Bajaj Auto Case (ibid). Under these circumstances, the investment cannot be considered to have been made bona fide with the intention of making profits. The respondent company is entitled to refuse the registration even in the absence of an enabling provision in articles in view of the provisions of Section 111(2) [*Modi Carpets Ltd. v. Trans-Asia Carpets Ltd.*, Appeal No. 2 of 1980 decided on 26.12.1981 (CLB)].

A company cannot register transfer of shares unless the instrument of transfer is duly stamped and is delivered to the company. The expression "duly stamped" has to be construed with reference to the provisions of Section 2(11) of the Indian Stamp Act, 1899 and the document in question would be an invalid one if the stamp affixed thereon has not been cancelled. Under Section 108(1) of the Companies Act, 1956, it is mandatory that the company shall not register the transfer of shares unless a properly executed instrument of transfer duly stamped has been delivered to the company [*Shri Parveen Sharda v. Chopsani Ice Aerated Water and Oils Mills Ltd.*, Appeal No. 1 of 1982 decided on 10.1.1983 (CLB)].

In *Vardhaman Publishers Ltd. v. Mathrubhumi Printing & Publishing Co. Ltd.* (1990), the Kerala High Court held that affixing stamps on a separate sheet of paper and attaching it to the transfer application or cancellation of stamps by drawing a line across the stamp was not improper and would not invalidate the said application. On the question of whether a newly added Article empowering the Board to reject transfer of shares would affect transactions of sale of shares entered into before the insertion of the Article, the Court held that the property in the shares passes on the date of transfer and the right to have the shares registered in the transferee's name becomes crystallised on that day itself. Any alteration of articles will not affect concluded transactions and in respect of such transactions, the then existing articles would prevail. So, if the original (unaltered) Articles as on the date of transfer permit free transfer of shares, the Board cannot refuse registration of the transfer.

In *Shri T.N. Kuriakos v. Premier Tyres Ltd.*, decided on 13.6.1983 (CLB), the appeal against the refusal by the respondent company to register transfer of shares was allowed by the Company Law Board on the ground that the refusal of the respondent to register transfer of shares in favour of the appellant was based on the decision of the Transfer Committee, a sub-committee of the Board of directors and not that of the Board of directors as such, and, therefore, the said decision was not a valid and legal decision.

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

The Board of Directors of a company or the concerned depository has discretion to refuse or withhold transfer of any security.

- True
- False

Correct answer: **False**

The Board of Directors of a company or the concerned depository has no discretion to refuse or withhold transfer of any security.

Rejected Documents

Documents which are not duly stamped or where stamps are not cancelled should be returned to the persons lodging them pointing out the errors so as to enable them to rectify the error. In *Federal Bank Ltd. v. Smt. Sarla Devi Rathi* (1997) CLA 183 (Raj.), the company had not registered 100 shares that Smt. Sarla Devi Rathi, the respondent, had purchased. They neither returned the share certificates to her. The company urged that since the respondent had not become a shareholder of the company, no cognizance of the complaint could be taken. The High Court held that there was a *prima-facie* case against the company.

The CLB has pointed out that the company on not registering the transfer should have returned the documents to the party who lodged them (the transferee in this case) and not the transferor as the transferor loses his right in the shares as soon as he executes the transfer in blank.

Time for pointing out insufficiency of stamps

Where a company by mistake or otherwise registers a transfer which should have been refused because of insufficient or uncanceled stamps, or because of the instrument being unstamped, it should point out the error to the transferee within such time (within one year from the date of execution) that the transferee can have the matters rectified through the orders of the Collector. Afterwards it would be too late. [*Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.*, (1994) 1 Comp LJ 178 (CLB – Mad)].

Impounding of Documents Relating to Share Transfer

The Board of directors are not persons to impound or regularise an instrument of transfer which is not duly stamped, *Mathrubhumi Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases. 80 93 (Ker) as they have no authority under Sections 33 and 42 of the Stamp Act.

12. JUDICIAL PRONOUNCEMENT ABOUT TRANSFER OF SHARES

- (A) *In Dove Investments P. Ltd. v. Gujarat Industrial Investment Corpn. Ltd.* [(2005) 60 SCL 604 (MAD)], the respondent company lodged with the appellant company shares pledged with it for effecting transfer of the same in its name. The appellant registered some of the shares and refused to register the balance on the ground that the respondent had failed to comply with the

provisions of Section 108(1A) and 108(1C). The respondent was successful before the CLB which held that provisions of Section 108(1C) are directory and directed the appellant to register the shares. The appellant challenged the order of the CLB before the High Court. The Appeal was dismissed. According to the High Court, insofar as Sub-section (1C) is concerned, if the transfer of shares falls within any one of the exempted cases mentioned in that Sub-section, the requirements as to presentation of the instrument of transfer in favour of the prescribed authority and delivery thereof to the company within the prescribed time limit, as contemplated in Sub-section (1A) are not applicable, provided the conditions stipulated in Sub-section (1C) are satisfied. In view of the same, if any bank or financial institution or the Central Government or a State Government or any corporation owned or controlled by the Central Government or a State Government, or a corporation granting a loan against the security of shares, intends to get such shares registered in its own name, in the event of failure on the part of the borrower to repay the amount of loan, it shall complete the instrument of transfer and lodge it with the company for registration of the transfer in its own name. In such a circumstance, they will have to stamp or otherwise endorse on the instrument of transfer the date on which the bank or financial institution decides to get such share registered in its own name and the instrument so stamped or endorsed will have to be delivered to be company, together with the share certificate, for registration of the transfer within two months from the date so stamped or endorsed. It was not in dispute that the instruments of transfer were neither stamped nor endorsed by the petitioner, as required under Sub-section (1C) however, stamped by the prescribed authority contemplated under Sub-section (1A).

(B) *Mukundlal Manchanda v. Prakash Raodlines Ltd. (1971) Comp Cas 575,* it was held that the requirement of Sub-section 1A(b)(ii) has to be read reasonably, so as to enable its smooth functioning; a delivery of instrument of transfer within a reasonable time should be held as a proper delivery. Further, where the company opines that the instrument of transfer has become stale and that it is improper to act upon it, the instrument of transfer has to be held as liable to be ignored. Further, even the belated delivery can be acted upon under certain circumstances while moving the Central Government under Sub-section (1) of Section 108(1A). In the light of the said provision, even though the discretion lies in the company either to recognize the transfer or not to recognize it depending upon the staleness of the instrument, the affected person can very well move the Central Government under Sub-section (1D) by explaining the circumstances under which the delay occurred and the hardship that resulted by the non-recognition of the transfer. It was rightly concluded that in the light of the scheme of Section 108, particularly after the insertion of Sub-section (1A), (1B), (1C) and (1D), the court have to bear in mind that the trivialities would not render an act futile and technical formalities required to be complied with for a valid transaction cannot outweigh the importance to be given to the substance of the transaction. Though the matter was taken up by way of appeal before the Divisional Bench of the Karnataka High Court, the Division Bench had not gone into the said aspect, namely, whether mandatory or directory, however, confirmed the judgment of the Single Judge in Mukundlal Manchanda's case

was to be upheld and accordingly it was held that except Section 108(1) other provisions namely Sub-sections (1A) and (1C) are directory and not mandatory in nature

- (C) ***Letheby & Christopher Ltd., Re (1904) 1 Ch 815.*** A transfer deed executed by the transferor alone does not pass the title in the shares to the transferee. Where the transferor's address and the distinctive numbers of the shares were not mentioned in the transfer form, the same was held to be not void because those particulars were verifiable from the accompanying share certificate
- (D) ***CIT v. Ramaswamy (1985) 57 Com Cases 7, 10 (Mad).*** A transfer is complete as between the transferor and transferee when all the formalities such as execution of the transfer deed and handing over the share certificates are completed
- (E) ***Life Insurance Corporation of India v. Escorts Ltd., (1986) 59 AIR 1986 SC 1370,*** the Supreme Court held that "a transfer effective between transferor and the transferee is not effective as against the company and any person without notice of the transfer being registered in the company's register.
- (F) ***Vickers System International Ltd. v. Mahesh P. Keshwani (1992) 73 Com Cases 317: (1991) 2 Comp LJ 444 (CLB).*** Transfer of shares by HUF Section 108 enables the execution of a transfer deed by or on behalf of the transferor or the transferee. In the case of a joint family, the transfer form would be executed by the holding member or, in his absence, by the manager (Karta) of the family who represents the family. The same would be true when the family is transferee. The CLB directed the company to register shares in the name of the Hindu undivided family showing Mahesh P. Keshwani as its Karta.
- (G) ***Mohideen Pichai Taraganar v. Tinnevely Mills Co. Ltd., AIR 1928 Mad 571.*** Section 108 not to apply to Auction Sales/Sale of Forfeited Shares. A transfer by a registered holder of shares cannot have any application to a Court auction sale or sale of forfeited shares for non payment of calls etc.
- (H) ***Castrol India Ltd. v. S.S. Transfer of Mehta (1993) 78 Com Cases 146 (1993) 2 Comp LJ 8 (CLB).*** Where special permission is necessary Where the transfer in question could be effected only with the permission of Special Court, (Trial of Offences Relating to Transactions in Securities Ordinance, 1992), it was held that the refusal by the company to accept the transfer without such permission was justified.
- (I) ***Choukhani v. Western India Theatres Ltd., A.I.R. 1957 Cal. 709.*** If the director refuse the request for transfer of shares with mala fide intent i.e. if they act oppressively, capriciously, or corruptly, the Company Law Board (Now NCLT) will interfere and order registration of the transfer of shares
- (J) ***Re. Wahib Bus and Mails Transport Co., (1947) 17 Comp. Cas. 182*** The onus of proving bad faith on the part of directors rests on the plaintiff. However, the directors cannot refuse to register transfer of shares effected

by a Court sale, in spite of powers given by the articles

- (K) ***Vallur Mohammad Saheb v. Golden Agro-Tech Industries Ltd. (2008) 83 SCL 391 (CLB-CHENNAI)***, the transferee purchased 2700 shares of the company and lodged the transfer deed along with the original share certificates to the Registrar and Share Transfer Agent (RSTA) of the company. The company did not register the shares in the name of the transferee in spite of the transferor taking up the matter with the company. The transferee, therefore, filed petition under section 111/111A to direct the company as well as its RSTA to pay damages with future interest from the date of filing the petition till the date of realization, or to issue duplicate share certificates to the petitioner. Allowing the petition, it was held that the bar embodied in section 22 of the SICA does not extend to any direction which may be issued by the CLB under section 111/111A for rectification of the register of members of the company. In view of this legal position, the resistance of the company for not registering the transfer of shares constituting miniscule 2700 shares only in favour of the transferee was not tenable.
- (L) ***Hindustan Mercantile Bank Ltd. v. D.N.Choudhury Cotton Mills Ltd. (2008) 83 SCL 399 (CLB-KOL.)***, the legal opinion on which the transferor company had relied upon was on the basis that the transferee company along with a few other companies was acting in concert to acquire shares in violation of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. To come to the conclusion that the transferee along with others was acting in concert, reliance had been placed on commonality of directors both in the transferee-company and other companies. Since the company was not a listed company, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, were not applicable. Further, it was found that neither the transferee company nor other companies had acquired shares of the transferor company. Accordingly, the company was to be directed to register the transfer of shares in favour of the transferee.
- (M) ***Sham Sunder Kukreja v. Hindustan Lever Ltd. (2001) 44 CLA 38 (CLB)***. If, by virtue of Section 111A(3) of the Companies Act, 1956, the petition should have been filed within 2 months of the registration of the securities submitted for transfer, and where on the basis of facts and circumstances of the case, the transfer was effected in a fraudulent manner, the period of limitation (2 months) shall not apply.
- (N) ***Dr. Rajiv Das v. The United Press Ltd. (2001) (CLB)***. In the case, where the shares of a company are held in joint names and one of these joint holders requests the company to split the shares equally between the joint holders by issuing fresh certificates, the company shall not be legally bound to do so unless the share transfer deeds executed by both the joint holders duly completed and stamped are lodged with the company together with the relevant share certificates, in terms of the provisions of Section 108 of the Companies Act, 1956.
- (O) ***T.S. Premkumar v. Tamil Nadu Mercantile Bank Ltd. 2001 (CLB)***. There shall be no justification, if a company/bank asks for information on Income Tax Returns (including that of the nominees of the transferee), the sources of

the consideration paid for the purchase of shares, the details of the group to which the transferee is attached, for the purposes of registration of transfer of shares, if the number of the shares which are subject matter of transfer, is insignificant, and after the registration of which the controlling of interest in the company/bank is not changing.

- (P) Transferor Holds Bonus Shares Only as a Trustee for the Transferee.** *Charanjiv Lal v. ITC Ltd. and Another (2005) 5 COMP LJ 138 (CLB)*, the petitioner-transferee purchased 100 equity shares of ITC limited of bearing and lodged the same through post, which were received by the company on 10th December, 1991. However, the company did not take any action to register the shares in the name of the petitioner and informed him that it had not received the share certificates and the transfer instrument. To prevent any unauthorized transfer of the shares, he obtained a *status quo* order from Senior Civil Judge, Delhi. In the meanwhile, the company declared 60 bonus shares on two occasions against the impugned 100 shares of which the certificate relating to first 60 bonus shares had been sent to the transferor. The suit filed by the transferee-petitioner was dismissed for want of jurisdiction and hence this the petitioner-transferee approached the Company Law Board. The Petition was allowed. The view expressed by the Judge was that the bonus shares always go with the original shares and the transferor holds bonus shares only as a trustee for the transferee. Considering that the original shares have been sold before the record date, in the absence of denial by the transferor nearly a month before the record date, it is the petitioner transferee who is entitled to the bonus shares and not the transferor.

13. TRANSFER OF SHARES REGISTERED WITH A DEPOSITORY

Provisions of Section 108 not to apply to transfer of shares registered with the Depository.

As stated earlier, in terms of Section 108 of the Act, the transfer of shares and debenture of, a company, cannot be registered unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of transferee along with the certificate relating to the share or debentures has been delivered to the company. These requirements are not applicable in respect of transfer of securities where both the transferor and transferee are entered as beneficial owners in the records of a depository. A new Sub-section (3) has been inserted in Section 108 of the Act by Depositories Act, 1996 to this effect. Besides, no stamp duty is payable for registration of transfer of shares in depository form. However, transaction charges are payable to depository participants.

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

A transfer is said to be completed only after all the formalities such as execution of the transfer deed and handing over the share certificates are completed.

- True
- False

Correct answer: **True**

Extension of Time Limit for Presentation to prescribed Authority under Section 108(1D)

Where an instrument is not complete or is erroneous, it will be a case of bad delivery and the company would be entitled to refuse registration. The transferor is bound to rectify the errors and lodge the transfer within the prescribed time-limit from the date of presentation to the prescribed authority, failing which the investor will have to make the application to the Central Government (Registrar of Companies) under the provisions of Section 108(1D) for extension of the prescribed period for delivery of the transfer deed.

14. COMPLIANCE WITH SECTION 108 – A MANDATORY PROVISION

The Allahabad High Court had held that the provisions of Sub-section (1) are not mandatory but only directory and, therefore, the registration of a transfer of shares without an instrument of transfer is not void. *Maheshwari Khetan Sugar Mills v. Ishwari Khetan Sugar Mills*, (1963) 2 Comp LJ 74 : (1963) 33 Com Cases 1142 (DB) (All). But Section 108 mentions the words 'shall not register' which have the effect of forbidding the act of transfer except on the fulfilment of certain conditions precedent.

The above decision of the Allahabad High Court has since been reversed by the Supreme Court in *Mannalal Khetan v. Kedar Nath Khetan* (1977) 47 Com Cases 185: AIR 1977 SC 536 where the mandatory nature of the provisions of Sub-section (1) of Section 108 has been elaborately discussed and emphasised. The result is that without production of the share certificate along with the application for transfer, the transfer cannot be registered and if registered, the registration will be void.

In *Vasant Investment Corporation Ltd. v. Company Law Board* (1999) 19 SLL 502 (Bom), it was held that it is for the party making an appeal to the CLB to prove that the decision of the Board of directors is initiated by an ulterior motive in case of a refusal by the Board to register a transfer.

The amended Section 111 assimilates in its fold the provisions for rectification of register of members empowering the CLB to order rectification of register of members, instead of the High Court. Sub-section (4) of Section 111 provides that if (a) the name of any person is without sufficient cause entered in the register of members, or after having been entered in the register is without sufficient cause omitted therefrom, (b) default is made or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member including a refusal under Sub-section (1), the person aggrieved or any member of the company, or the company may apply to the CLB for rectification of the register.

The CLB while dealing with the cases of appeal preferred to it under the circumstances stated in Sub-section (2) above or on an application for rectification of the register under Sub-section (4) may after hearing the parties either dismiss the appeal or reject the application or by order direct that the transfer or transmission be registered by the company and the company shall be required to comply with such orders within 10 days of its receipt or direct for rectification of the register, and also direct the company to pay damages, if any, sustained by the person aggrieved [Sub-section (5)].

In *Ratnesh H. Bagga v. Central Circuit Cine Association* [(2005) 128 Comp Cas 370 (CLB)], decided on 10.9.2004, respondent is a Section 25 company. The petitioner applied for membership of the respondent and his application was rejected. The petitioner filed a petition under Section 111 of the Companies Act, 1956 seeking rectification of the register of members by putting his name in the register of members of the respondent company.

The petition was dismissed.

The reason stated was that Sub-sections (1), (2) and (3) of Section 111 apply only to transfer or transmission of shares and has no application in the present case. Sub-section (4) would apply only in a case of rectification of something in the register which should not be there or something omitted from the register which should rightly be there. The complaint of the petitioner is that the association had rejected his application for membership and thereby refused to put his name in the register of members. The two conditions prescribed in Section 41 of the Act are cumulative in nature in the sense that there should not only be an agreement in writing but the name also should be entered in the register of members to become a member of a company. Merely agreeing to become a member of a company and on that basis to claim that the refusal of the company to enter his name in the register would entitle a petitioner to file a petition under Section 111 is not sustainable. Whether the refusal by the association was *malafide* or whether the articles giving power to the association to reject an application of membership are valid etc are beyond the scope of Section 111.

It is, however, pertinent to note that though time limits for filing of an appeal in circumstances stated in Sub-section (2) have been specified, however no limit has been laid down for preferring an application for rectification of the register of members in Sub-section (4). But in regard to rectification to register of members provisions of Article 137 of the Limitation Act would apply and in consequence the application for rectification of register of members must be preferred within three years from the date on which the right occurs. [*Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.* (1983) 54 Comp. Cas 301 (Delhi)]. Every appeal or application to the CLB whether under Sub-section (2) or (4) shall be made by a petition in writing and shall be accompanied by a fee of Rs. 500 as has been specified in the Company Law Board (Fees on Applications and Petitions) Rules 1991.

The section empowers the CLB at its discretion to make such interim orders including orders as to injunction or stay, as it may deem fit and just, such orders as to costs as it thinks fit and incidental or consequential orders regarding payment of dividend or the allotment of bonus or right shares [Sub-section (6)]. The CLB may on any application under this section decide not only the question of title of any person but also any question which is necessary or expedient to be decided in connection with the application for rectification. The provisions stated above regarding rectification of the register of members shall apply in relation to the rectification of the register of debentureholder as they apply in relation to the rectification of the register of members.

If default is made in giving effect to the orders of the CLB under this section, the company and every officer of the company who is in default shall be punishable with

fine which may extend to Rs. 10,000 and with a further fine which may extend to Rs. 1000 for every day after the first day if such default continues. In addition, where the default is made in complying with any provisions of Section 111, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues.

In the matter of a private company, it may be stated that though by its very definition under Section 3(1)(iii) a private company restricts transfer of its shares, under Section 111 the power of a private company to refuse transfer of shares has been reiterated under Sub-section (13). However, the right conferred is only to the extent to enforcing restrictions contained in the articles of association and not on any other grounds. Also, Sub-section (11) of Section 111 provides that petition will lie for non-transmission of shares in or debentures of a private company which is not a subsidiary of a public company, if such transmission is by way of sale thereof held by a court or other public authority.

Transfer of Share Warrants

A share warrant is transferable by mere delivery of the warrants without execution of any written instrument of transfer being registered by the company. The bearer of a share warrant is not a member of the company unless otherwise so provided in the articles of the company in terms of Section 115(5) of the Act and, therefore, such a bearer of share warrants does not impliedly covenant to observe the provision of the company's memorandum and articles.

15. CERTIFICATION OF TRANSFER

The procedure outlined above is slightly different when a shareholder sells only a part of the shares (and not all of them) mentioned in the share certificate. In such circumstances, the transfer instrument, after being signed by the transferor, is not sent to the transferee, nor is the transferor's share certificate handed over to the transferee. Both these documents are lodged by the transferor at the company's registered office. The company retains the share certificate but issues to the transferor a balance ticket in respect of the shares which he is retaining, and an officer of the company, usually the secretary, certifies the transfer by endorsing on the transfer instrument a signed statement "certificate lodged" or words to that effect and mentions the number of shares which it is lodged. This is called "Certification of transfer" and, taken by the buyer of the shares as tantamount for delivery to himself of the share certificate; and he can make a good title to the share in the "certified transfer". When this "certified transfer instrument" is handed over to the transferee of shares, he signs it and forwards it to the company's registered office with a request for registration. When the transfer has been registered, the company cancels the old share certificate and issues two new certificates; one to the transferee in respect of the shares transferred and the other to the transferor, in exchange for the balance ticket in respect of the shares retained by him. Certification is also necessary when a shareholder disposes of the whole of his holding to two or more transferees. In such a case, each transfer instrument is certified but no "balance ticket" is issued because the transferor has not retained any shares for himself.

The "Certification" used to be in effect a representation by the company to any person acting on the faith of certification that the company has received such documents so as to show a *prima facie* title of the transferor but not that transferor has any title to the shares.

Thus in *Bishop v. Balkis Consolidation Co.*, (1890) 25 Q.B.D. 512 (C.A.), B transferred his shares to two persons and lodged the certificate with the company. The company certified the transfers, but instead of destroying the original certificate, returned it to the transferor who borrowed money on it. The company was held not liable to the lender. Even if he had deceived a person to accept the transfer of those shares, the company would not have been liable to the transferee. The reason was that the share certificate is neither a negotiable instrument nor a warranty of title on the part of the company issuing it.

However, Section 112 of the Companies Act, 1956 has altered this position to a great extent. The said section provides *inter alia* that if the company issues a false "Certification" negligently or deliberately, it would be liable to any person who is deceived by having acted on the faith of the certification. A certification is deemed to have been made by the company when it has been signed by a person authorised to do so.

16. BLANK TRANSFER

When a shareholder signs the transfer form without filling in the name of the transferee and the date of execution and hands it over with the share certificate to the transferee thereby enabling the transferee to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'. Shares are usually transferred in blank when a shareholder borrows money on its security, e.g., by pledging the shares; should the pledgor make default in payment of the amount due at the time appointed for repayment, the pledgee or the holder of the share certificate and the blank transfer instrument has implied power to fill up the blanks in the instrument by inserting the date and his own name as transferee and to get himself registered as a member of the company. The pledgor is under an implied obligation not to prevent or delay such registration. This right to get himself registered as a member is available to the transferee even after the death of the transferor [In *Re. Bengal Silk Mills Co. Ltd.*, (1942) Comp. Cas 206].

A blank transfer accompanied by the delivery of the share certificates vests in the transferee both equitable as well as legal rights in the shares. But until the registration of his name in the register of members, the transferee does not acquire a title and thus he cannot exercise any right as shareholder in respect of those shares.

In all cases only a *bona fide* holder will have the right to fill in his name or the name of a person for whom he is acting under an authority and apply for registration of the transfer. [*Colonial Bank v. Hepworth*, (1887) 36 ChD 26]. Where share scrips accompanied by duly executed transfer forms came into the hands of a *bona fide* purchaser, it was held that the original owner who signed in blank was estopped from questioning the validity of the title of the *bona fide* purchaser. [*Sumitra Debi Jalan v. Satya Narayan Prahladka*, AIR 1965 Cal 355].

In *Howrah Trading Co. Ltd. v. C.I.T.* (1959) 29 Com Cases 282 : AIR 1959 SC 775, the Supreme Court recognised the validity of "blank transfers" viz., where the name of transferor is entered and the transferor signs the transfer with the share scrip annexed, and hands it over to the transferee who, if he chooses, may complete the transfer by entering his name and then apply to the company to register his name in the place of that of the transferor.

17. TRANSFER OF SHARES DURING WINDING UP

Any transfer made during winding up of a company is void, unless it is made with the sanction of the Court in compulsory winding up (i.e. winding up by the order of the Court or under the supervision of the Court) and with the sanction of the liquidator in voluntary winding up (Section 536). Where an agreement for the sale of the shares was made in ignorance that a petition for winding up has been presented, the Court¹ will not sanction the transfer. The Court will put the buyer on the register of members only when the transfer was incomplete by reason of want of registration at the commencement of the winding up. Like the Court in compulsory winding up, a liquidator has power to register a transfer after winding up and transfer so registered, has full effect.

In *W. Gunther GmbH & Others v. Switching Technologies Gunther Ltd & Others*, (2004) 4 Comp LJ 507 (CLB), the petitioner company was the major shareholder in the Respondent JV Company with 61.22% shares. It had filed an insolvency petition before the German insolvency court, which declared it to be insolvent company, and an administrator was appointed. The insolvency court prohibited the petitioner from transferring any of its assets including its shareholdings in the Indian company. The administrator transferred the shareholding of the petitioner to another company. Just before declared as insolvent, the petitioner company had entered into a share purchase agreement with an American company for the transfer of its shareholding in the respondent company. The respondent company had transferred the shares in the name of the American company during the period when insolvency proceedings were going on. The petitioner and the administrator appointed by the German insolvency court challenged the above said share transfer before the Company Law Board on the ground that the transfer was against law as the transfer was prohibited by the German court. On the other hand the respondent company and the American company contended that the shares were transferred on the basis of blank share transfer forms handed over to it by the petitioner which took place before the commencement of the insolvency proceedings.

The Petition was allowed.

According to learned Company Law Board Judge, a careful perusal of terms and conditions of the agreement between the petitioning German company and the purchaser shows that the agreement dated 28.01.2004 is a conditional contract. Where the transfer of the property in the goods is subject to some conditions to be fulfilled, the property in the goods stands transferred on fulfillment of such conditions. In the instant case, one of the stipulations in the agreement is that the sale and transfer of shares is subject to the approval of the creditors of the German company. There is no document on record to show that this condition has been fulfilled, in which case, the interest or title over the impugned shares remains vested with the petitioners, empowering them to file the instant company petition, despite the stipulation that transfer was to take immediate and real effect. Moreover, the transfer in favour of the purchaser is not yet registered according to Indian law. At this juncture, it shall be borne in mind that the parties have excluded the applicability of the Indian law for legal enforceability of the agreement, dated 28.01.2004. There is, therefore, no merit in the plea of the respondents that in the light of the provisions of the Sale of Goods Act, the sale of shares in favour of the purchaser was completed with the execution of the agreement entered into between the petitioners and the

purchaser Amazeum Shop and Merchandising GmbH (Amaseum). Accordingly, the petitioning German company has *locus standi* to maintain this petition seeking restoration of its name on the register of members of the Indian company. It is not under dispute that the share transfer form was signed by the third respondent both on behalf of the transferor company (German company) and the transferee company (American company). There is no document by way of any legal authority empowering the third respondent to sign the share transfer form on behalf of the German company. The manner in which the registration of transfer had been approved in favour of the American company by the Share Transfer Committee of the Indian company raises doubts about *bona fides* of the entire transaction. When the Insolvency Administrator had cautioned the Indian company not to effect the registration of transfer, the Committee should have, before effecting the transfer, ascertained full particulars, as a measure of abundant caution, which in the present case, it had failed to do giving rise to possible conclusion that the registration was sought to be made before the Insolvency Court seized of the matter. It is clear that there is no adequate material to show that the German company had transferred the impugned shares in favour of the American company prior to the commencement of the insolvency proceedings and further that the Indian company had acted in contravention of the provisions of Section 108(1). Therefore, the petitioners are entitled to seek rectification of the register of members of the Indian company.

18. FORGED TRANSFER

It may happen that a forged instrument of transfer is presented to the company for registration. In order to avoid the consequences which will follow a forged transfer, companies normally write to the transferor about the lodgement of the transfer instrument so that he can object if he wishes. The company informs him that if no objection is made by him before a day specified in the notice, it would register the transfer. The consequences of a forged transfer are detailed hereunder:

- (a) A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder and the company is bound to restore his name on the register of members [*People's Ins. Co. v. Wood and Co.*, 1961 (31) Comp. Cas. 61]. A forged document never has any legal effect. It can never move ownership from one person to another, however, genuine it may appear. Thus, a forged instrument of transfer leaves the ownership of the shares exactly where it always was in the so-called transferor. It follows that if a company registers a forged transfer, the true owner can apply so as to be replaced on the register and his name will be restored. But the company does not incur any liability in damages by putting the name on the register.
- (b) However, if the company issues a share certificate to the transferee and he sells the shares to an innocent purchaser, the company is liable to compensate such a purchaser, if it refuses to register him as a member, or if his name has to be removed on the application of the true owner.
- (c) If the company is put to loss by reason of the forged transfer, as it may have paid damages to an innocent purchaser, it may recover the same independently from the person who lodged the forged transfer.

Let us take an example to illustrate the consequences of forged transfer. Suppose, 'A' is a registered shareholder and his name is entered on the register of members in respect of certain number of shares. By fraud or theft, B obtains possession of 'A's share certificate and having forged a document purporting to be a transfer of shares to himself from A, succeeds in getting himself registered as a member and obtains from the company a new share certificate made out in his name. In spite of this, A does not cease to be the owner of the shares and a member of the company, as a forged document, being a nullity, does not move ownership from him to B or any other person. Producing the new certificate as evidence of his title, B purports to sell the shares to C, an innocent purchaser, who in reliance upon B's certificate, buys the shares in good faith and without notice of B's fraud. The company then registers C as a member and issues the share certificate to him in respect of the shares purchased by him. When A discovers the fraud, he being entitled for the rectification of register, has C's name struck off the register of members and has his own name restored as the registered holder of the shares. A never ceased to be the owner of the shares, although the company issued successive certificates to B and C. The company will be liable in damages to C and for other incidental loss. But it would be entitled to indemnity as against B, and if the forged transfer were lodged by a broker acting for B, against the broker also, even though the broker was innocent to the fraud for a person who brings a transfer to the registering authority and requests him to register it, impliedly warrants that it is a genuine document.

A forged transfer can pass no title and is a nullity. In *Simm v. Anglo-American Telegraph Co.*, (1879) 5 QBD 188, CA; *France v. Clark*, (1884) 26 ChD 257 CA; when shares transferred under a forged signature and the transferee received a share certificate, the title does not pass to him.

The fact that the transferee was a *bona fide* purchaser for value did not make any difference and the transferee was bound to return the scrips to the person to whom the same rightfully belong. [*Kaushalya Devi v. National Insulated Cable Company of India* 1977 Tax LR 1928 (Del)]

A person acting in good faith, sends in and procures registration of the transfer and the issue of a fresh certificate on the basis of a forged deed is bound to indemnify the company against the untoward consequences. [See *Welch v. Bank of England*, (1955) Ch 508 : (1955) 1 All ER 811]. This happens when a stock broker, trusting his clients innocently forwards forged document to the company. [*Yeung v. Hongkong and Shanghai Banking Corpn.*, (1980) 2 All ER 599].

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

A forged transfer can pass title.

- True
- False

Correct answer: **False**

A forged transfer cannot pass any title and is a nullity.

19. TRANSPOSITION OF NAME

In the case of joint-shareholders, one or more of them may require the company

to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint-holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. Since no transfer of any interest in the shares takes place on such transposition, the question of insisting on filling transfer deed with the company, may not arise. Transposition does not also require stamp duty.

The Stock Exchange Division of the Department of Economic Affairs has clarified that there is no need of execution of transfer deed for transposition of names if the request for change in the order of names was made in writing, by all the joint-holders. If transposition is required in respect of a part of the holding, execution of transfer deed will be required.

20. DEATH OF TRANSFEROR OR TRANSFEREE BEFORE REGISTRATION OF TRANSFER

Where the transferor dies and the company has no notice of his death the company would obviously register the transfer. But if the company has notice of his death, the proper course is not to register until the legal representative of the transferor has been referred to.

Where the transferee dies and company has notice of his death, a transfer of shares cannot be registered in the name of the deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the names of the latter. But if there is a dispute, an order of Court will have to be insisted upon.

In Killick Nixon Ltd. v. Dhanraj Mills Ltd., it was held that the company is not bound to enquire into the capability of the transferee to enter into a contract. The company has to act on the basis of what is presented in the transfer deed.

Proof in a transfer by representative

Where a transfer is executed by a person in a representative capacity such as an officer of a body corporate or by an attorney, proof of the authority, must be produced, before the transfer can be registered.

Relationship between Transferor and Transferee

Pending registration, the transferee has only an equitable right to the shares transferred to him. He does not become the legal owner until his name is entered on the Register of Members in respect of the shares. But as between the transferor and the transferee, immediately after the transfer is made, the contract of transfer will subsist and the transferee becomes the beneficial owner of the shares so transferred to him. A relation of trustee (transferor) and beneficiary (transferee) is thereby established between them. The transferor is under obligation to comply with all reasonable directions of the transferee. The transferee should, however, take prompt steps to get himself registered as a member.

Section 206A inserted by the Companies (Amendment) Act, 1988 w.e.f. 15.6.88

provides that where the transferor gives a mandate to pay the dividend to the transferee pending registration of transfer, the same should be paid to the transferee, otherwise the dividend in relation to such shares should be transferred to the special account mentioned in Section 205A. It is further provided that in the case of offer of right shares or fully paid bonus shares, the same should be kept in abeyance till the title to the shares is decided.

21. RIGHTS OF TRANSFEROR

In JRRT (Investments) Ltd. v. Haycraft, (1993) BCLC 401 (Ch.D) it was held that, the transferor is not deprived off his valuable rights, the right to dividend and the right to vote even where the purchaser has failed to make payment. An unpaid vendor has the right to exercise voting rights in respect of shares registered in his name. He is not obliged to comply with the directions of the purchaser in respect of the shares taken by him.

But on the other hand, the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his directions and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on a consideration which has failed. However, after the transfer form has been executed the transferor cannot be compelled to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members, the Supreme Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor. [*Mathalone (R) v. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385 : (1954) 24 Com Cases 1 See also *Life Insurance Corporation of India v. Escorts Ltd.* (1986) 59 Com Cases 548 : AIR 1986 SC 1370]. But where, due to the transferee's own default, the transfer of shares is not registered the transferor cannot be held to be a trustee for the defaulting transferee simply because the share continues to remain in the transferor's name in the books of the company.

The seller's duty is complete when he hands over to the transferee a duly executed transfer form. [*Skinner v. City of London Marine Insurance Corpn.*, (1885) 14 QBD 882].

Where a transferor transfers his share for consideration and delivers along with the share certificate the transfer form duly signed by him, but the transferee, instead of completing the transfer by signing his own name as transferee and presenting it for registration to the company, chooses to keep the transfer in blank and passes it on to others along with the share certificate, it cannot be said that the transferor, simply because the share continues to stand in his name, should be treated as a trustee for a series of unknown holders of the blank transfer.

When he sold his share to the original transferee he could not be deemed to have represented to the transferee anything more than that the share was transferable nor to have agreed to the transferee keeping or passing on the transfer in blank from hand to hand for an indefinite duration, without its being presented to the company for registration.

Where a shareholder executes a blank transfer to enable another to deal with the shares, he is bound not to do anything to obstruct registration of the transfer and if he improperly intervenes he is liable in damages, *Hooper v. Herts*, (1906) 1 Ch 549: (1904-7) ALL ER Rep 849 (CA).

Transferor's right to indemnity for calls - Where a transferor has paid for calls to the company after the shares are transferred, there arises an implied promise by the transferee to indemnify the transferor. Such a promise to indemnify can be implied even in the case of blank transfers [*Ashworth Partington & Co.*, (1925) 1 K].

Transferee's right to Dividends, Bonus and Rights Shares - Where the transferor, by reason of the shares standing in his name, has received after the transfer, any dividend on shares, bonus or other benefit accruing in respect thereof, the transferee being the person lawfully entitled thereto, can recover the same from the transferor, provided that he has not allowed his claim to become time barred under the provisions of the Limitation Act. [*Chunnihal Khushaldas Patel v. H.K. Adhyaru*, (1956) 26 Com Cases 168 : AIR 1956 SC 655].

Dividend to transferee after transfer - In one case the transfer was registered and dividends paid to the transferee. Later, the register was rectified by removing the transferee's name from the register on the ground of a technical nature, like inadequacy of stamps, it was held that the transferee was not bound to handover the dividend amount to the transferor. [*Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.*, (1994) 1 Comp LJ 178 (CLB-Mad)]. However the Madras High Court held in this case that the company should not be allowed to rectify the register on a technical ground after transferring the shares.

Position under the Securities Contracts (Regulation) Act, 1956 - As regards the position of a transferor after transfer, Section 27 of the Securities Contracts (Regulation) Act (XLII of 1956) may also be noted. It provides as follows:

Title to dividends - (1) It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee, who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation: The period specified in this section shall be extended -

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
 - (ii) in case of loss of transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
 - (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.
- (2) Nothing contained in Sub-section (1) shall affect -
- (a) the right of a company to pay any dividend which has become due to any

person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or

- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security to the name of the transferee.

22. EFFECTS OF TRANSFER

Once a transfer form has been executed, the transfer is complete as between the transferor and the transferee and the transferee acquires the right to have his name entered in the register of members. No further application is necessary for having the name of the transferee entered in the register of members and the transferee perfects his title to the share after the entry in the Register of Members. Once the transferee becomes a member of the company, a contractual relationship arises with the company, [*Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

A company cannot refuse to register a transfer on the ground that the transfer was without consideration or that there was a collusion and connivance between the transferor and transferee. Any objection about inadequate consideration can be raised only by the transferor himself and not by the company particularly where the shares are fully paid. Where the transfer is in a spot delivery contract, Section 108 is not applicable. [*Sanatan Investment Co. Pvt. Ltd. v. Prem Chand Jute Mills Ltd.* (1983) 54 Com Cases 186 (Cal)].

Priority among Transferees

It was held in *Society General De Paris v. Jonet Walker and other* (1886) 11 Ac 20 that where a shareholder has fraudulently sold his shares to two different transferees, the first purchaser will, on the ground of time alone, be entitled to the shares in priority to the second.

For example, a person assigned his property, including some shares, for the benefit of his creditor. The assignee failed to get the share certificates registered in his name, but gave notice of assignment to the company. The assignor sold the shares to another who applied for registration. It was held that the assignee's claim was prior in time and therefore, entitled to registration. [*Pe C v. Clayton*, (1906) 1 Ch. 659].

Pledging of Shares

Shares of a company can be a subject matter of a valid pledge. Section 2(7) of Indian Contract Act defines the term 'goods' as meaning every kind of moveable property other than actionable claim and money and includes stocks and shares. Shares are goods under the Indian Contract Act and can be a subject matter of pledge. In *Kanhaiyalal Jhanwar v. Pandit Shinah & Co.*, the Calcutta High Court held that the deposit of share certificates themselves is sufficient to create a pledge thereon.

On the death of a sole owner of shares, the rights and liabilities goes in favour of the legal heirs. They are entitled to be registered as the holder of the shares. But the

company can register them as members with only their consent and when they apply for it. *Re Cheshire Banking Co., Duff's Executor's case* (1886) 32 Ch D 301.

Transmission of shares to widow

If a widow applies for transmission of the shares standing in the name of her deceased husband without producing a succession certificate and if the articles of association of the company so authorises, the directors may dispense with the production of succession certificate, probate or letter of administration upon such terms as to indemnity as the directors may consider necessary, and transmit the shares to the widow of the deceased by obtaining an indemnity bond.

Transmission of joint holdings

In case some shares are registered in joint names and the articles of the company provide that the survivor shall be the only person to be recognised by the company as having any title to the shares, the company is justified in refusing to register the transmission of title by operation of law in favour of the son of the deceased holder even though he may obtain succession certificate from the Court.

23. COMPANY'S LIEN ON SHARES

Articles 9 to 12 of Table A carry the rules as to lien. These articles are not compulsory. A company may adopt its own articles regarding the subject matter of lien as also regarding any money due to it from the shareholder either originally or subsequently by a special resolution. The fact to be noted is that unless the articles provide for a lien, a company has no inherent or prima facie right of lien on the shares of members. [*Canara Bank Ltd. v. Tribhuvandas Jetha Bhai*, AIR 1957 Trav. C. 183 : (1957) 27 Com Cases 647]. But in the case of listed company, one of the requirements is that the articles of the company shall provide that the fully paid shares will be free from all lien, while in the case of partly paid shares the company's lien will be restricted to monies called or payable at a fixed time in respect of such shares [Rule 19(2)(ii) of the Securities Contracts (Regulation) Rules, 1957]. In a lien the company shall have first and paramount lien on the shares of each member for his debts and liabilities to the company. Such a provision is fully effective for private as well as public companies. [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656: (1900-3) All ER 746 (CA)]

Where lien is acquired by a subsequent amendment of the articles, it will not allow the company to upset any rights which might have been acquired. But otherwise the right of a lien subsequently brought in, shall be binding on all the members even if they became shareholders before the alteration [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656 : (1900-3) All ER 746 (CA)].

Extent and waiver of lien

The right of lien extends to any monies receivable by the shareholder in respect of the shares even in the winding up of the company. A lien on the proceeds of sale of shares is a lien on the shares.

Where the articles of association of a private limited company gave the company a first and paramount lien over the shares of any shareholder indebted to it, and the

shareholder created an equitable charge on the shares in favour of a third party, the company's lien was held to have priority over the equitable charge. [*Champagne Perrier-Janet S.A. v. H.H. Finch Ltd.*, (1982) 3 All ER 713].

The company can waive the lien either expressly or by doing anything which has the effect of waiving the right.

Where a company registers a transfer of shares over which it has a lien, the registration will operate as a waiver of the lien. [See *Turner Morrison & Co. Ltd. v. Hungerford Investment Trust Ltd.*, (1972) 42 Com Cases 512 : AIR 1972 SC 1311].

Enforcement and postponement of lien

The usual method of enforcing a lien is a refusal by the company to register a transfer of shares until the dues of the company in respect of those shares are first paid.

An article merely giving a right of lien is not enough to confer a right to bring the property to sale in exercise of such right. [See *Bank of India Ltd. v. Rustom Fakirji*, AIR 1955 Bom 419].

In the absence of a provision in the articles giving power to the company to enforce a lien by sale, the lien cannot be enforced except through Court. [*New London & Brazilian Bank v. Brockle Bank*, (1882) 21 Ch D 302].

A lien cannot be enforced by forfeiture, even if the articles provide that it may be so enforced. For, a lien is in the nature of an equitable mortgage and a clause for forfeiture in a mortgage is invalid as a clog on the equity of redemption.

In a case, certain shares which were subject to a first and paramount lien were given to bank as security for an overdraft and the bank gave notice to the company, the Court held that the bank's claim was prior to that of the company which arose subsequently. Notice to the company means notice to any director or officer who is authorised in the matter. [*United India Sugar Mills Ltd., Re* AIR 1933 ALL 607].

24. TRANSFER AND TRANSMISSION OF DEBENTURES

For transfer of debentures there is no necessity to present the instrument of transfer before the prescribed authority. There is no time limit prescribed for lodgement for transfer deed with the company.

The rate of stamp duty payable on transfer of debentures is not prescribed by the Union of India, unlike in the case of transfer of shares. Therefore, the question would arise whether the stamp duty would be the one payable in the State where the transfer deed is executed or the one applicable in the State in which the registered office of the company is situate. Many State Governments have introduced a new Section 19A to the Stamp Act where under it is provided that the differential duty (i.e. duty in the State in which the Registered Office of the Company is situate minus the duty in the State in which the transfer was effected) has to be paid for. Such duty has to be paid by the person executing the instrument. In effect, the duty payable on transfer of debentures would be higher of the following duty on the value of

debentures:

- (a) Stamp duty applicable in the State in which the transfer deed is executed;
- (b) Stamp duty applicable in the State where the Registered Office of the Company is situated;

Provided the Stamp Act of the concerned State contains a provision to this effect. Otherwise, the stamp duty prevailing in the State where the registered office of the company is situated would be applicable.

25. TRANSFER OF SHARES IN DEPOSITORY MODE

Depository system maintains the ownership records of securities in the book entry form while in physical mode every share transfer is required to be accomplished by physical movement of share certificates to, and registration with the company concerned. The process of physical movement of share certificates often involves long delays and a significant portion of transactions end up as bad deliveries due to the faulty completion of paperwork, or signature differences with the specimens on record with the companies, or for other procedural lapses. Investors also face problems on account of loss of share certificates, forgery and mutilation. The significant time involved in effecting ownership changes also impounds a substantial volume of shares at any given time leading to lower trading volumes.

As part of capital market reform, the Government promulgated on September 20, 1995, the Depositories Ordinance, 1995 to provide for legal framework for setting up of depositories to record the ownership details in book entry form. Later, on November 28, 1995, the Government introduced in Parliament the Depositories Bill, 1995 to replace the said Ordinance. The Bill was enacted as the Depositories Act, 1996.

Legal Framework for Depository Systems

The legal framework for depository system in the Depositories Act provides for the establishment of single or multiple depositories. Any body to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 1956 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfilment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

In the depository system, share certificates belonging to the investors are dematerialised and their names are entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies register are replaced by the name of depository as the registered owner of the securities. The depository however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and be subject to all the liabilities in

respect of the securities held by a depository. Shares in the depository mode are fungible and do not have distinctive numbers. The ownership changes in, the depository are done automatically on the basis of *delivery v. payment*.

The companies which enter into an agreement with the depository will give an option to the holders of eligible securities to avail the services of the depository through participants. The investors desiring to join the depository are required to surrender the certificates of securities to the issuer company in the specified manner and on receipt of information about dematerialisation of securities by the issuer company, the depository enters in its records the names of the investors as beneficial owners. Similarly, the beneficial owner has right to opt out of a depository in respect of any security and claim the share certificates and get his name substituted in the register of members as the registered owner in place of the depository.

There has to be regular, mandatory flow of information about the details of ownership in the depository record to the company concerned. In case of any reservation about the share acquisition on the ground that the transfer of shares debentures is in contravention of any of the provisions of SEBI Act or Rules made thereunder or the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 or any other law for the time being in force, the depository, company participants or investors or SEBI shall have a right to make an application to the CLB for rectification of register or records. Pending decision of CLB the transferee concerned shall be entitled to all the rights and benefits of the shares including the right to transfer the securities except that the Company Law Board may at its discretion make an interim order suspending the voting rights.

The Act provides for detailed regulations to be framed by SEBI and detailed bye-laws to be framed by depositories with the approval of SEBI. The bye-laws have to provide for rights and obligations of participants, beneficial owners and procedure for ensuring adequate safeguards to protect the interests of investors. The Act requires the depository to indemnify for loss caused to beneficial owner due to negligence of depository or its participants.

The Companies (Amendment) Act, 2000 has inserted the definition of Depository as under :

“Depository” has the same meaning as in the Depositories Act, 1996 (22 of 1996).

26. THE DEPOSITORIES ACT, 1996: AN ANALYSIS

Objectives

Depositories Act, 1996, aims at providing for:

- (a) a legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records throughout by book entry.
- (b) dematerialisation of securities in the depositories mode as well as give option to an investor to choose between holding securities as at present or hold securities in a dematerialised form in a depository.
- (c) making the securities fungible.

- (d) making the shares, debentures and any interest thereon of a public limited company freely transferable; and
- (e) exempting all transfers of shares within a depository from stamp duty.

Benefits of depository system

The benefits from the depository system are following:

- (a) It reduces the cost of issue and transfer of securities by eliminating stamp duty.
- (b) It reduces the scope for theft, forgery damage to security certificates.
- (c) It eliminates bad deliveries.
- (d) It entitles the transferee to all the rights associated with the securities immediately on settlement of purchase transaction.
- (e) It enhances the velocity of the securities in circulation and hence liquidity in the market. The investors can trade in securities immediately on allotment without waiting for receipt of security certificates.
- (f) It makes faster disbursement of non cash corporate benefits like rights, bonus, etc. possible.
- (g) It reduces brokerage by many brokers for trading in dematerialized securities.
- (h) It eliminates problems relating to change of address of investor, transmission etc.
- (i) It eliminates problems relating to selling securities on behalf of a minor.

Services to be rendered by a Depository

The Depository Service for securities usually refers to making a computerised book entry record of securities to effect transfer of ownership. In the context of the Depositories Act, (a) allotment of securities, (b) transfer of ownership of securities are reflected through book entry system only and do not require existence of security certificates etc.

Who can render Depository services?

Any body to be eligible to provide depository services must–

- (a) be formed and registered as a company under the Companies Act, 1956,
- (b) be registered with SEBI as a depository under the SEBI Act, 1992,
- (c) have framed bye-laws with the previous approval of SEBI,
- (d) have obtained a certificate of commencement of business from SEBI,
- (e) have one or more participants to render depository services on its behalf, and
- (f) have adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI.
- (g) have been established by one or more of the following (i) public financial institution (ii) a bank (iii) a foreign bank (iv) recognised stock exchange (v) a body corporate engaged in providing financial services (vi) a body corporate

constituted or recognised in foreign country for providing custodial, clearing or settlement services in securities market and approved by the Central Government (vii) an institution engaged in providing financial services established outside India and approved by the Central Government (viii) fit and proper person.

Securities eligible for depository services

The Depositories services are available in respect of securities as may be specified by SEBI. The eligibility criteria for admission of securities into depository has been determined by SEBI Regulations. This provides flexibility to SEBI, for example, to admit certain instruments like units of mutual funds in the depository mode. An instrument to be under the depository mode need not be a security as defined in the Securities Contracts (Regulation) Act, 1956.

Are all eligible securities required to be in the depository mode?

It is not necessary that all eligible securities must be in the depository mode. In the scheme of the Depositories legislation, the investor has been given supremacy. If he wishes to avail of the depository services in respect of any eligible security, whether existing or to be issued, the issuer who has entered into an agreement with one or more depositories has to give him the facility. The investor has the choice of holding physical securities or opting for a depository based ownership record. At the time of fresh issue, the issuer who has entered into an agreement with the depository is under obligation to give the option to the investors either to receive the security certificates under the paper based system (non-depository mode) or opt to hold securities with a depository (depository mode). The decision on whether or not to hold securities within the depository mode and if in depository mode with which depository or participant, would be entirely with the investor. Such freedom can be exercised either at the time of the initial offer of the security by indicating his choice in the application form or at any subsequent time. He will also have the freedom to switch from depository mode to non-depository mode and *vice versa*. Section 68B has been introduced by the Companies (Amendment) Act, 2000 according to which public companies making public offer of any security for a sum of rupees ten crore or more, shall issue the same only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and regulations made thereunder.

Who is a participant?

Participant is an agent of depository and is registered as such under the SEBI Act, 1992 to render depository services. The participants shall have such rights and obligations as may be specified by the regulations viz. SEBI (Depositories and Participants) Regulations, 1996. The eligibility criteria for admission of any person as a participant has been determined by SEBI by Regulations. Banks, custodians, public financial institutions, foreign bank, state financial Corporation, an institution engaged in providing financial services, clearing corporation, stock broker, non-banking finance companies and Registrar to an issue or share transfer agent are eligible for registration as participant.

Responsibilities of a depository *vis-a-vis* participant

The depository does not render services directly but only through an agent who is

registered as a participant with SEBI. The relationship between a depository and the participant is that of a principal and agent and is governed by the bye-laws of the depository and the agreement between them. The depository shall maintain ownership records in the name of each participant and each such participant shall act as the agent of the depository, further maintain ownership records in respect of individual investors. The depository shall, however, indemnify the investor for any loss caused to him due to negligence of depository and/or participant. The depository in turn shall raise consequential claims on the concerned participant.

Status of the depository in the records of the issuer

By fiction of law, the depository is deemed to be a registered owner of the securities. In respect of the securities held in a depository, the name of the depository shall appear in the records of the issuer as registered owner of the securities and such registered owner shall have the right to effect the transfer of securities on behalf of the beneficial owner but shall not have voting and other rights associated with the securities.

Status of an investor who avails of depository services

If an investor avails of depository services, his name is replaced by the name of the depository in the records of the issuer, as the depository becomes the registered owner of the securities held by the investor. The status of the investor changes from that of a registered owner, again by fiction of law, to beneficial owner. The name of the investor appears on the records of the depository as beneficial owner in respect of the securities held by him. The beneficial owner shall continue to have all the rights and benefits and be subject to all the liabilities associated with the securities held by the depository on his behalf.

Dematerialisation of securities

The Depositories Act envisages dematerialisation in the depository mode. In such a case the securities held in a depository shall be dematerialised and the ownership of the securities shall be reflected through book entry only. The securities outside the depository shall be represented by physical scrips.

Fungibility

The Depositories Act, 1996 specifies that all securities held in a depository are fungible. That is all certificates of the same security are inter-changeable in the sense that investors lose the right to obtain the exact certificate they surrender at the time of entry into depository. It is like withdrawing money from the bank without bothering about the distinctive number of the currencies (Section 9). Nothing contained in Section 153, 153A, 153B, 187B, 187C, 372 (Now Section 372A) of the Companies Act, 1956 shall apply to depository in respect of securities held by it on behalf of the beneficial owners.*

How does an investor avail services of a depository?

(a) In the case of existing securities:

An investor before availing the services of a depository, shall enter into an

* Substituted by Depositories Related Laws (Amendment) Act, 1997.

agreement with the depository through a participant and then shall surrender security certificates to the issuer. The issuer on receipt of security certificate shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall thereafter enter the name of the investor in its records as beneficial owner.

(b) In the case of fresh issue:

At the time of initial offer the investor would indicate his choice in the application form. If the investor opts to hold a security in the depository mode, the issuer shall intimate the concerned depository about the details of allotment of a security made in the favour of investors and records the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the names of allottees as the beneficial owners. In such case a prior agreement by the investor with the depository as well as an agreement between the issuer company and depository may be necessary.

(c) In the case of exit from the depository:

If a beneficial owner or a transferee of a security desires to take away a security from depository, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and inform the issuer. The issuer shall make arrangements for the issue of certificate of securities to the investor within 30 days of the receipt of intimation from the depository.

(d) In the case of transfer within the depository:

The depository shall record all transfers of securities made among the beneficial owners on receipt of suitable intimation to the effect that a genuine purchase transaction has been settled.

(e) In the case of pledge:

Before creation of any pledge or hypothecation in respect of a security, the beneficial owner is required to obtain prior approval of the depository and on creation of pledge or hypothecation, the beneficial owner shall give intimation of such pledge or hypothecation to the depository. The depository shall make appropriate entries in its records which will be admissible as evidence.

What is free transferability of securities?

It refers to a situation where on receipt of intimation regarding settlement of purchase transaction, the transfer of a security is effected immediately and the transferee enjoys all the rights and obligations associated with the securities. Once a genuine purchase transaction is settled, nobody including the issuer, depository, participant, any intermediary or regulatory authority can withhold the transfer of security.

Types of securities freely transferable

Only the shares, debentures and any interest therein of a public limited company (listed as well as unlisted companies) have been made freely transferable. The Board of directors of such a company or the concerned depository shall not have any discretion to refuse or withhold a transfer of such security. Any other security, for example, shares or debentures of a private company or any unit of a mutual fund, or any security issued by any issuer other than a public limited company are not freely transferable and would be subject to

the restrictions contained in the articles of association or the bye-laws of the concerned issuer and terms of issue.

Refusal of a transfer which contravenes the provisions of the SEBI Act or SICA or any other law

In case of a public limited company, the transfer of shares or debentures or any interest therein cannot be refused without sufficient cause. It has to be given effect immediately by the company or depository. However, if the transfer has contravened any of the provisions of the SEBI Act, 1992 or the regulations made thereunder or Sick Industrial Companies (Special Provisions) Act, 1985 or any other law for the time being in force, the concerned company, depository, participant, investor or SEBI can move an application to the Company Law Board to determine if the alleged contravention has really taken place. After inquiry if the Company Law Board is satisfied of the contravention, it can direct the company or the depository to rectify the ownership records of securities. However, before completion of inquiry, the Company Law Board can suspend voting rights in respect of securities so transferred. The economic rights (bonus, dividend, rights etc.) cannot be suspended under any circumstances.

In case of any other security, the transfer can be refused under the bye-laws of the issuer and existing provisions of the relevant statutes.

The powers of the Company Law Board

As mentioned above the CLB has been empowered to—

- (a) determine if a transfer of a security of a public limited company is in contravention of any of the provisions of SEBI Act, 1992 or regulations made thereunder or the SICA, 1985 or any other law for the time being in force.
- (b) suspend voting rights in respect of securities before completion of enquiry.
- (c) direct the company/depository to rectify ownership records if the transfer has contravened SEBI Act, 1992 or SICA, 1985 or any other law for the time being in force.

Is it required to have a transfer deed for transfer of securities within the depository mode?

The provisions regarding transfer mentioned in Section 108 of the Companies Act, 1956 shall not apply to the transfers effected within the depository mode. However, this formality need to be complied with for transfer of securities outside the depository mode. In case of the securities in the depository mode, the depository would effect the transfer on the basis of intimation (contract note or some other suitable evidence to the effect that a purchase transaction has been settled) received through participants.

Areas on which Rules may be framed by the Central Government

The Central Government may frame Rules to provide, *inter alia*, for:

- (a) The manner of inquiry and the time within which an appeal may be preferred from the orders of SEBI. Section 23(1) provides that any person aggrieved by an order of SEBI made under the Act or the regulations made thereunder may prefer an appeal to the Central Government within the prescribed time.
- (b) the form in which an appeal may be preferred and the fees payable in

respect of such appeal.

- (c) the procedure for disposing of an appeal.
- (d) the form in which an appeal may be filed before the Securities Appellate Tribunal and Fees payable for it.

Powers of SEBI under the Depositories Act, 1996

- (a) to register the depositories and the participants under the SEBI Act, 1992.
- (b) to issue certificate of commencement of business to the depositories on being satisfied that the depository has adequate systems and safeguards to ensure against manipulation of records and transactions.
- (c) to frame regulations under the SEBI Act as well as under the Depositories Act to carry out the purposes of the Depositories Act.
- (d) to suspend or cancel the certificate of registration after giving a reasonable opportunity of being heard.
- (e) to regulate depositories, participants, issuers and their relationship with the investors.
- (f) to monitor, inspect, call for information, summon and enforce attendance of witnesses and production of documents, conduct inquiries and audit of depositories, participants, investors and issuers of securities.
- (g) to specify the securities and the eligibility criteria of the securities for admission into a depository.
- (h) to give directions to any depository, participant or issuer in the interest of investors or the securities market.
- (i) to approve the bye-laws of a depository and amend or a revoke any bye-laws of the depository.

Stamps duty on security certificates

At the time of fresh issue of securities (shares or otherwise) either issued in the form of physical certificate directly to investors or through records of a depository, the issuer shall pay the stamp duty on the total amount of the security issued by it, even though there may be no physical securities (instrument) which can be stamped (executed).

Payment of stamp duty at the time of entry into the depository

Entry by an investor into a depository by surrendering the security certificates involve change of registered ownership as the investor becomes the beneficial owner and the depository becomes the registered owner in respect of the security. Such change of registered ownership of shares from an investor to a depository has been exempted from stamp duty.

Stamp duty in the case of transfer of securities within the depositories

All transfer of securities involve change in registered ownership and/or beneficial ownership. If such change is in respect of shares within the depository mode, no stamp duty shall be payable.

Stamp duty payable while opting out of depository

If an investor opts to exit from a depository, the registered ownership changes

from the depository to the investor. Such change of ownership in respect of shares shall not attract stamp duty. However, when the investor seeks the issue of physical certificate of securities from the issuer, the issue of such certificates shall attract stamp duty as is payable on the issue of duplicate certificates.

Stamp duty in respect of transactions outside the depository mode

All transactions outside the depository mode attract stamp duty as at present.

Distinctive numbers of shares

The mandatory requirement of distinguishing each security by an appropriate number is not required. However, it does not prohibit a company from having distinct number for its securities which are outside the depository mode.

Exercise of membership rights in respect of securities held by a Depository

The Depository as a registered owner have not any voting rights or any other rights in respect of securities held by it on behalf of the beneficial owners. The beneficial owner shall be entitled to all the rights and benefits (including the right to vote) and be subjected to all the liabilities in respect of securities held by a depository.

The evidential value of the records of the depository

The depository has been treated as a bank for the purposes of the Bankers' Book Evidence Act, 1891. The ownership records of securities maintained by depositories, whether maintained in the form of books or machine readable forms, shall be accepted as *prima facie* evidence in all legal proceedings.

Cognizance of offences by courts

No court shall take cognizance of any offence, save on a complaint made by the Central or State Government or SEBI or by any person. No court inferior to that of a court of session shall try any offence punishable under this Act.

Penalty for offences under the Depositories Act

A maximum penalty of imprisonment for a term which may extend to ten years or fine or both can be imposed.

ANNEXURES

ANNEXURE - I

CIRCULARS AND CLARIFICATIONS

(1) Fixing a "record date" without closing register of members

The action of the company in fixing "record date" without seeming to close the register of members has no legal validity. If by naming a "record date" the company intends that any proposals for transfer of shares received by the company between the "record date" and the date of the (annual general) meeting at which dividends are declared would not be considered or would be held in abeyance, then, this would amount to closing the register of members on and from the "record date". The effect of the provisions of Section 108(1A) in such a case will have to be considered in the above light (Circular No. 8/4(108)/67-CL-V, dated 4-8-1967).

(2) Share transfer - Registration of - Transfer deeds in name of minor must be signed by natural guardian

This has refer to letter No. UT/2000/OPR-127/95-96 dated June 4, 1996 on Transfer Deeds being signed by the guardian on behalf of a minor under listed Schemes.

In slight modification thereof, keeping in mind with the revised SEBI guidelines on good and bad delivery, we confirm that in case of transfer, the transferee can be a minor represented by the natural guardian. In other words, the Transfer Deeds in the name of a minor must be signed by the Natural Guardian. In case of a Court Guardian, a Court order will be required.

(Press Release: *UT/69/OPR-127/97-98, dated 29-7-1997, issued by the Unit Trust of India*).

(3) Registration not to be effected if instrument is received after period stipulated in Sub-section (1B)

It would not be in order for a company to effect registration of a transfer of shares if the instrument of transfer has been received by it after the specified period even though the delay may have been caused by postal irregularity. As such, if the documents are so despatched that in the ordinary course of transit these would be received by the company whatsoever or if the documents are received in time but are deficient and compliance is not made within the prescribed time, the transferee will have to get the time extended by the Central Government (Registrar of Companies) as required under Section 108(1D) of the Companies Act before transfer can be effected (Source: Clarification issued by Department of Company Affairs).

(4) Bulk lodgement of instrument of transfer of shares/debentures

As per the existing procedure, prescribed under Section 108 of the Companies Act, 1956, the shares/debentures can be transferred only by execution of a transfer deed. In case of bulk handling of transfer deeds, in respect of transactions entered into by the Foreign Institutional Investors (FIIs) registered with SEBI, Public Financial Institutions as defined under Section 4A of the Companies Act, 1956 and Mutual Funds (domestic and off-shore), there is a considerable amount of difficulty in complying with the existing procedure of signing each individual instrument. With a view to overcoming these difficulties and simplifying the procedure, the companies are advised to accept transfer deeds executed in such cases in the manner specified below:-

- (i) In respect of bulk transfers where there is a single transferee, the transferee, instead of signing each transfer deed, may fill up and sign a covering transfer deed in the existing prescribed format complete in all respects, enclosing therewith all the related transfer deeds in the prescribed format duly executed by transferors.
- (ii) The covering transfer deed shall contain, by way of an Annexure, details of distinctive numbers and corresponding certificate numbers of shares/debentures involved in transfer.
- (iii) The part relating to 'transferee's particulars' in the individual transfer deed (enclosed with the covering transfer deed) need not be signed by the transferee and may be merely stamped with the name and address of the transferee.

- (iv) Requisite amount of stamps may be affixed on the covering transfer deed or paid in a manner as otherwise prescribed by the Government (Circular No. 15 of 1993, dated 28-12-1993).

(5) Whether execution of transfer deeds is necessary for effecting change in order of names of joint shareholders

Where some of the companies were insisting on execution of transfer deeds in cases in which the shareholders apply for transposition of their names in respect of their joint shareholdings. The necessity for execution of transfer deeds in such cases has been examined and it is now clarified that there is no need for insisting on execution of transfer deeds for transposition of names, that is, change in the order of names of joint shareholders provided such request is made in writing, by all shareholders jointly to the company. However, where change in the order of names is required in respect of a part of the holding, execution of a transfer deed will be required. (Letter No. F. 1/24/SE/80, issued by Stock Exchange Division, Department of Economic Affairs, dated 5-9-1980).

(6) Transfer of Shares when transfer deed is lost

Section 108 being mandatory, can a company give effect to a transfer where both the certificate or allotment letter and the instrument of transfer were lost, if the loss is proved to the satisfaction of the Board and indemnity as the Board may require is furnished by the transferee along with an application signed with the stamps required for the instrument of transfer affixed thereon, and also issue a duplicate certificate to the transferee?

Answer: In the opinion of the Department, Section 108 only envisages the case where the instrument of transfer is lost. If, therefore, the share certificate or the allotment letter is also lost, then a duplicate thereof will have to be obtained first. Reference is also invited in this connection to the provisions of Rule 4(3) of the Companies (Issue of Share Certificates) Rules, 1960.

The company will seek the no-objection of the transferor for issue of duplicate share certificate and then register the transfer in the name of the transferee (Source: *Company News & Notes, July 1963 issue*).

(7) Refusal to transfer shares on frivolous grounds such as non-tally of attested signature

Department's Circular I. – It has been brought to the notice of this Department that certain companies are returning instruments of transfer without effecting transfer of shares in the names of transferees on frivolous grounds, *inter alia*, that the specimen signatures of transferors do not tally with that on record, in spite of the fact that the transfer forms bear attestation of the magistrates, etc. In this connection, it may be stated that as per instructions below the prescribed share transfer form (No. 7-B) "attestation, where required, of thumb impression, marks, signatures, etc., should be done by a magistrate, notary public or special executive magistrate or a similar authority holding a public office or a member of a recognised stock exchange through whom the shares are introduced or a member of the transferor's bank". Further, the guidelines for good or bad delivery issued by the Ministry of Finance, Department of Economic Affairs, vide their Circular No. 1/10/SE/83, dated 21-7-83 also provide a similar requirement. You are, therefore, requested to advise your constituent member companies to follow the aforesaid

instructions scrupulously and to effect transfer of shares within the period prescribed under Section 113 of the Companies Act, 1956, and the listing guidelines. (Circular No. 3 of 1993 dated 22-3-1993).

Department's Circular II. In reference to this Department's Circular No. 3/93, dated 22-3-1993, on the above subject, in which companies were advised not to return transfer deeds on the ground, *inter alia*, that the signatures of the transferor do not tally, where the same are attested by Notary Public, Stock Broker, Magistrate etc., and to say that it has represented to this Department that in some cases, although the signatures are attested by Notary Public, the same do not tally or the signatures have not been properly attested, which may give rise to disputes. In view of these representations, the companies concerned are advised to satisfy themselves where there is doubt/apprehension about the genuineness of signatures by making a reference to the transferor. Such cases will, however, be more by way of exception rather than as a general rule." (Circular No. 10/93; File No. 3/4/92-CL.V dated 13-8-1993).

ANNEXURE - II

Schedule XV

[See Section 108B(2)(b)]

1. Arms and ammunition and allied items of defence equipment, defence aircrafts and warships.
2. Atomic energy.
3. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.
4. Railway transport.

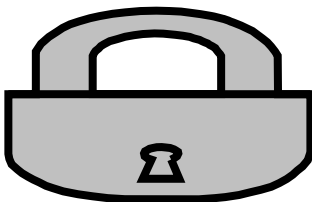
LESSON ROUND-UP



- As per Section 108(1) of the Companies Act, 1956, a company, whether public or private shall not register transfer of shares in or debentures of the company unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and transferee has been delivered to the company along with the certificate relating to the shares or debentures or if no such certificate is in existence, along with the related letter of allotment.
- The transfer deeds only executed and completed in all respects are required to be delivered to the company for registration within the time prescribed in Section 108(1A) of the Act.
- Section 108 (1A) does not apply to items specified under Section 108(1C).
- Provisions of Section 108 not to apply to transfer of shares registered with the Depository.

- The transfer of shares attracts stamp duty under the Indian Stamp Act, 1899.
- The power of refusal to register a transfer of shares must be exercised judicially and not arbitrarily.
- The right of the shareholder to transfer his shares in a company is absolute and he may appeal to the Company Law Board if there is any refusal to register transfer or transmission.
- Central Government has powers under Section 108D to direct companies not to give effect to transfer of shares.
- When a shareholder sells only a part of the shares and not all of them, the procedure is different.
- In compulsory winding up, the transfer made during winding up of a company is void unless it is made with the sanction of Court (Tribunal, on enforcement of Companies Second Amendment Act, 2002).
- Unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on shares of members.
- Every shareholder or debentureholder of a company has right to nominate at any time in the prescribed manner a person to whom his shares/debentures shall vest in the event of his death.
- Depository system reduces the cost of issue and transfer of securities by eliminating stamp duty, it entitles the transferee to all the rights associated with the securities immediately on settlement of purchase transaction.

SELF-TEST QUESTIONS



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

1. (a) Distinguish between transfer and transmission of shares.
(b) “The directors have uncontrolled and unfettered powers to refuse registration of transfer of shares” — Comment.
2. What are the remedies available against refusal to register transfer of shares?
3. Explain the procedure for transfer of shares and debentures.
4. What are the consequences of a forged transfer?
5. Under what circumstances shares can be transferred during the winding up of a company?
6. A buys 200 shares in a company from B on the faith of a share certificate issued by the company. A tenders to company a transfer to himself from B duly executed together with B’s share certificate. The company discovers that

the certificate in the name of B has been fraudulently obtained and refuses to register the transfer. Is A entitled to get the registration of the transfer?

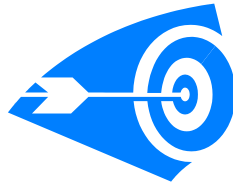
7. X and Y each held half the issued capital of the company. The Articles provided "the directors may, at any time, in their absolute and uncontrolled discretion refuse to register any transfer of shares".

X died and his executor applied to have his shares registered in his name. Y, who is director, refuse under the above mentioned provision of Articles. Can the Court come to the rescue of X's executor?

8. An agreement for transfer of certain shares was entered into and the transferee was registered as a member without transfer deed being executed. Is the registration of the transfer valid?
 9. State the powers of the Board of directors to refuse registration?
 10. What are the benefits of depository system?
 11. How does an investor avail services of a depository?
 12. Are all eligible securities required to be in the depository mode?
 13. How are the shares allotted/allocated and transferred under the Depository System?
 14. Who is a depository participant? How is he appointed by the Issuer company? Also narrate his liabilities, duties and rights.
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STUDY XIV
MANAGEMENT AND CONTROL OF COMPANIES-I
INSTITUTION OF DIRECTORS

LEARNING OBJECTIVES



After getting the detailed insight about transferability of shares, provisions of Company Law on transfer and transmission of shares in the previous chapter, let us understand about the management of company.

Company is a legal person but it is not a living person. To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors (collectively) and directors (individually). Directors of a Company are its eyes, ears, brain, hands and other essential limbs. This chapter deals with the concept of director, their qualifications, appointment, removal, remuneration, etc. After going through this study, one will be able to understand the following:

- Concept of Director
- Definition of Director
- Types of Directors
- Legal position of Directors
- Qualifications of Directors
- Companies (Disqualification of Directors under Section 274(1)(g) of Companies Act, 1956) Rules, 2003
- Qualification Shares
- Number of Directors
- Appointment of Directors
- Removal of Directors
- Penalty for Wrongful Withholding of Company's Property
- Remuneration of Directors
- Office or place of profit

1. CONCEPT OF DIRECTOR

When a company is registered under the Companies Act, 1956 (the Act), it becomes a legal entity. It lives like a human being and its death lies in its winding up or on its amalgamation with other company or on its being declared defunct by Registrar of Companies.

On incorporation, a company becomes a person in the eyes of law, it has a perpetual succession, its members may come and may go but the company lives till its death as aforementioned. It has a common seal, which is affixed on all the legal documents executed on behalf of the company in the presence of and signed by authorised

signatory or signatories. It is empowered to hold all properties in its own name and in its own right. It can sue others and can be sued by others in its own name.

With all the strapping of a legal person, a company is unlike a living human being. It has no physical existence. It has no eyes to see, no ears to hear, no hands to sign and execute documents, no brain to think and no nerves to communicate among its various limbs. In order to enable a company to live and to achieve its objects as enshrined in the objects clause of its Memorandum of Association, it has necessarily to depend upon some agency, known as Board of directors. The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company.

2. DEFINITION OF DIRECTOR

The supreme executive authority in the control of a company and its affairs resides in persons known as 'Board of directors'. Section 253 of the Act provides that only an individual, and not a body corporate, association or firm, shall be appointed as director.

Section 2(13) defines a 'director' as including "any person occupying the position of director by whatever name called".

This is a definition based purely on function; a person is a director if he does whatever a director does normally. The Act offers no further guidance on the functions and duties of directors. One may, therefore, attempt a functional definition of directors as the individuals who direct, control, manage or superintend the affairs of a company in the form of the Board of directors. As a body, they frame the general policy of the company, direct its affairs, appoint the company's officers, ensure that they carry out their duties and recommend to the shareholders regarding distribution of dividend as per its Articles of Association. The collective body in whom the authority is vested and through whom the company acts is called the "Board of directors" or the "Board". The Supreme Court has in *Ram Autar Jalan v. Coal Products (P) Ltd.* (1970) 40 Comp. Cas. 714 held that when a question arises as to whether a person is in law a director of a company, the minutes books and returns sent to Registrar of Companies are important evidence, rather than fact that the person was *de facto* functioning as director.

3. TYPES OF DIRECTORS

(a) Executive Director

Executive director or ED is a common post in many organizations, but the

Companies Act does not define the phrase. According to www.thefreedictionary.com, he is “a person responsible for the administration of a business”.

Executive directors perform operational and strategic business functions such as:

- managing peoples
- looking after assets
- hiring and firing
- entering into contracts

Executive directors are usually employed by the company and paid a salary, so are protected by employment law.

(i) Managing Director

Section 2(26) of the Companies Act, 1956 gives the definition of Managing Director as –“managing director” means a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or article of association, is entrusted with [substantial powers of management] which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called:

[Provided that the power to do administrative acts of a routine nature when so authorized by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to dire registration of transfer of any share, shall not be deemed to be included within substantial powers of management.

Provided further that a managing director of a company shall exercise his powers subject to the superintendence, control and direction of its Board of directors;]

(ii) Whole time Director

According to Explanation to Section 269(1), a “Whole-time Director” includes a director in the whole-time employment of the company”. Thus, a whole-time director” means a director who devotes all his time and attention to the management of the company. Where a director is appointed to act as Technical Director, Legal Director, Work Director and Sales Director on full time basis he is a whole-time director of the company. A whole-time director is also a managerial person [See Section 268(1)].

(b) Non-executive Director

Non-executive directors do not get involved in the day-to-day running of the business. Non-executive Director may or may not be an independent director.

(c) Nominee Directors

Nominee directors are appointed by financial institutions or banks, which extend term loans and/or working capital assistance or any other type of financial assistance

to companies. Nominee directors are a powerful tool of project supervision, monitoring and control, particularly following the issue of Government guidelines enjoining financial institutions to nominate directors on the boards of companies enjoying substantial assistance.

(d) Independent Directors

In Clause 49 of the listing agreement, the term “Independent Directors” has been defined as under:-

‘Independent director’ shall mean non-executive director of the company who

- (a) apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
- (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firms(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director.
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.
- (g) Is not less than 21 years of age.

For the purposes of above definition of independent directors:

- (a) **Associate** shall mean a company, which is an “associate” as defined in Accounting Standard (AS) 23, “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the institute of Chartered Accountants of India.
- (b) **“Senior management”** shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level the executive directors, including all functional heads.
- (c) **“Relative”** shall mean “relative” as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.

As per clause 49 of the Listing Agreement which deals with good Corporate Governance Practices, every company, to which this clause applicables shall have an optimum combination of executive and non-executive directors with not less than

fifty percent of the Board of directors comprise of non-executive directors. The number of independent directors would depend whether the Chairman is executive or non-executive. In case of a non-executive Chairman, at least one-third of Board should comprise of independent directors and in case of an executive Chairman, at least half of Board should comprise of independent directors. Further where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions and the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent director.

Further, all pecuniary relationship or transactions of the non-executive directors vis-à-vis the company should be disclosed in the Annual Report.

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

The number of independent directors would depend upon whether the Chairman is executive or non-executive.

- True
- False

Correct Answer: True

(e) Interested Directors

“Interested Director” means any director whose presence cannot, by reason of Section 300, count for the purpose of forming a quorum at a meeting of the Board, at the time of the discussion or vote on any matter.

(f) Government Directors

The Central Government has the power to appoint directors under Section 408 of the Act. The detailed provisions in this regard have been discussed later in this study lesson.

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

In case of a non-executive Chairman, at least half of the Board should comprise of independent directors.

- True
- False

Correct Answer: False

4. LEGAL POSITION OF DIRECTORS

It is very difficult to define the position of directors. Section 2(13) of the Companies Act, 1956 defines a director as ‘director includes any person occupying the position of director, by whatever name called’. Section 252 of the Act makes it obligatory on every public company to have at least three directors and on every other company to have at least two directors.

The true position of company directors **is that of agent** and apart from the

provisions of the various corporate laws, which bind them, confer certain rights upon, impose certain obligations on them and make them liable for defaults for violations thereof. Their real relationship with the company is governed by the arrangement of agency as governed by the Contract Act.

This position was established long back in *Ferguson v. Wilson (1966) L.R. 2 Ch.*, wherein it was held that wherever an agent is liable those directors would be liable; where the liability would attach to the principal and principal only, the liability is the liability of the company”.

In the aforesaid case, F applied for, and by resolution of the Board was allotted certain shares in a railway company. However, the company was unable to place F on the register of members as the holder of shares in the company. F sued W, a director of the company, claiming *inter alia* that W should transfer some of his own shares to F and pay damages. Held F’s claim failed on the ground that the directors of a company acting in the normal course of their duties are agents for their company and incur no personal liability.

In *Re. Desiraju Venkata Krishna Sharma*, AIR 1955 A.P. 26, it was held that directors being agents of the company, there could be no personal liability or obligation on them to pay the taxes payable by the company.

Section 179 of the Income Tax Act, 1961, imposes personal liability for tax arrears upon every director of a private company who cannot prove that the default was not due to his neglect, misfeasance or breach of duty. Personal liability of the directors might arise where they contract in their own name or fail to exclude personal liability, they will also be personally liable if they contract on behalf of the company without using the word “Limited” or the words “Private Limited” as part of the name. It is in the interest of the directors to make clear, while signing on behalf of the company that they are signing as agents.

It is important to remember that it is the Board of directors as a collective body that is the agent of the company and so if the Board acts as agent that binds the company, a single director will have no authority to bind the company, unless such powers are, specifically delegated to him by the Board of directors. If the directors exceed their powers, that is to say, if the contract made by them is *ultra vires* their powers, themselves, then such contract, if made with a member of the company is only voidable; and if made with an outsider who had no notice of the want of authority, binds the company but the company may claim damages for breach of implied warranty or authority [*Elkington and Co. v. Hunder (1892) 2 Ch. 452*]. The company may, however, ratify an act, *ultra vires* the directors, by a resolution at a general meeting.

To some extent, **directors are also trustees** for the properties of the company and of the rights which are conferred on them by law and conventions. “A trustee is a person who is the owner of the property, deals with it as principal, as owner and a master, subject only to an equitable obligation to account to some person to whom he stands in relation of trustee” [*Smith v. Anderson (1880) 15 Ch. D. 247*]. Directors stand in fiduciary position towards the company in regard to the powers conferred on them by the Companies Act and by the articles of the company and also with regard to the funds of the company, which are under their control.

In *Re. Land Allotment Co (1894) 1Ch. 616* Lord Lindley observed: "Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been held liable to make good, moneys which they have misapplied upon the same footing as if they were trustees."

Barring directors in the whole-time employment of the company, like the managing director, executive director, technical director, etc., directors are not in the employment of the company and they are not entitled to any remuneration beyond what is allowed to them by the Act, i.e. fee for attending meetings of the Board and its committees. They are also not required to hold any shares in the companies on whose Board they are appointed where the articles of the company do not provide for any share qualifications for their directors.

Section 314 of the Companies Act permits a director to hold an employment in the company, or what is called an office or place of profit in the company, in addition to his usual directorship. In such an event the director shall enjoy all the rights, privileges and benefits which are available to other employees of the company. But his rights as a director being separate from those of an employee, he will not be entitled to claim priority for his fees as a director under Section 530 of the Act in the event of winding up of the company.

As regards the position of directors as trustees, the directors are persons selected to manage the affairs of the company for the benefit of the shareholders. It is an office of trust which if they undertake, it is their duty to perform fully and entirely. A resolution by the shareholders that shares or any other property of the company shall be at the disposal of the director, binds them and they must deal with it within the scope of the functions delegated to them and in the manner that suited to benefit the shareholders.

The trusteeship of directors extends not merely to the property of the company, but also to the moneys of the company, trade secrets and other items of intellectual property, the existence or particulars of which may be within the personal knowledge of the directors [*Baket v. Citibbons*, (1972) WCR 693].

It, must, however, be noted that directors are not trustees for the company in the strict legal sense as they manage the property of the company which is not vested in them. Whereas the property of a trust is vested in its trustees and they manage the same.

To sum up, directors are trustees of the moneys of the company, but not of the debts due to the company. They are trustees also in respect of powers of the company that are conferred upon them, e.g. powers of: (a) issuing and allotting shares; (b) approving transfers of shares; (c) making calls on shares; and (d) forfeiting shares for non-payment of calls. They must exercise these powers solely for the benefit of the company. Since, however, they are not trustees for the company in the legal sense as aforesaid, the rules of law which apply in case of such trustees do not in all respects apply to them. They may, accordingly, avail themselves of the provisions of the Limitation Act or the Companies Act, as the case may be, for escaping any liability that may be sought to be enforced against them.

However, it must be remembered that directors are trustees for the company and not for the individual shareholders.

5. QUALIFICATIONS OF DIRECTORS

The Companies Act, 1956 does not lay down any qualifications for a person to be appointed as a director of a company. However, it mentions disqualifications of directors, which are contained in Section 274 of the Act.

Section 274 lays down: "(1) A person shall not be capable of being appointed director of a company, if—

- (a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- (b) he is an un-discharged insolvent;
- (c) he has applied to be adjudicated as an insolvent and his application is pending;
- (d) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence;
- (e) 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;
- (f) an order disqualifying him for appointment as director has been passed by Court in pursuance of Section 203 and is in force unless the leave of the Court has been obtained for his appointment in pursuance of that section; or
- (g) such person is already a director of a public company which, -
 - (a) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after first day of April 1999; or
 - (b) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause (a) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause.

(2) the Central Government may, by notification in the Official Gazette, remove—

- (a) the disqualification incurred by any person in virtue of clause (d) of Sub-section (1), either generally or in relation to any company or companies specified in the notification; or
- (b) the disqualification incurred by any person in virtue of clause (e) of Sub-section (1)

(3) A private company which is not a subsidiary of a public company may, by its articles, provide that a person shall be disqualified for appointment as a director on any grounds in addition to those specified in Sub-section (1)”

The expression 'moral turpitude' is not defined anywhere but it means anything done contrary to justice, honesty, modesty or good morals. [*Durga Singh v. State* AIR 1955 Punj. 97].

It would be seen from Sub-section (3) above, that the power to add to the disqualifications enumerated in Sub-section (1) of Section 274 is confined only to private companies which are not subsidiaries of public companies. Sub-section (3) by necessary implication, does not permit public companies from adopting by their articles any additional disqualifications for the appointment of directors [*Cricket Club of India v. Madhav. L. Apte* (1975) 45 Comp. 574].

In addition to the disqualifications specified above, Section 253 of the Act lays down that only an individual can be a director. The reason why only an individual should be a director, as pointed out by the Supreme Court in *Oriental Metal Pressing Works Pvt. Ltd. v. Bhaskar Kashinath Thakore* (A.I.R. 1961 S.C. 573) is that as the office of a director is to some extent an office of trust and there should be somebody available on whom responsibility could be fixed. Fixing such responsibility might be difficult if the director is a corporation or an association or firm.

In Essar Oil Ltd., In Re [(2005) 126 SCL (GUJ.) KA Puj, J. (Decided on 18.7.2005), the applicant company proposed scheme of compromise and arrangement with respect to 2000 debenture holders. As non redemption of debentures on due date is a disqualification for the directors, pending disposal of company petition and consideration of the scheme, the company moved an application praying for an order that directors of the applicant company not to be treated as disqualified under Section 274(1)(g). By order, the court granted the protection till one month after the scheme was sanctioned or otherwise disposed of by the Court. The scheme of compromise and arrangement had failed in the meeting convened on 25.6.2005. In order to overcome this difficulty and to extend the protection cover, the applicant company proposed another scheme whereby a new class of scheme lenders was created and debenture holders were put in the said class and there after permission was sought for convening the meeting of the scheme lenders. Pending consideration of the new scheme, the applicant company again sought declaration from the court that the directors of the applicant company would not be treated as disqualified under Section 274(1)(g) contending that if the scheme proposed by the company would be sanctioned, date of redemption would be deferred and in that case there would not be any violation of Section 274(1)(g).

The Application was dismissed.

It was viewed that Section 274(1)(g) is very clear and unambiguous. It is mandatory in nature. The provision of Section 274(2) carves out the exception only in case of Section 274(1)(d) and Section 274(1)(e). However, no exception is carved out so far as sub clause (g) is concerned. Thus, the said sub section must be given its natural meaning and once the default is committed the disqualification starts, which cannot be postponed or deferred in assumptions that if the scheme would be

sanctioned, the date of redemption would be deferred and in that case there may not be any violation of Section 274(1)(g). As on the date when the court was considering the application, admittedly the default had been committed. The debentures were not redeemed. The debenture holders were neither paid any principal amount nor interest accrued thereon. Even if it was accepted that the protection granted by the court was in operation up to 24.7.2005, the disqualification would start from 25.7.2005 and it could not be further delayed merely on account of scheme having been proposed by the applicant company and meeting for considering of the said proposal was scheduled to be held on 28.7.2005. Therefore, the substantive petition may be filed before the court which may or may not be sanctioned by the court. On the basis of all the ifs and buts, invocation of provision of Section 274(1)(g) could not be stopped, as it would amount to grant of stay against operation of law.

6. COMPANIES [DISQUALIFICATION OF DIRECTORS UNDER SECTION 274(1)(g) OF THE COMPANIES ACT, 1956] RULES, 2003

The Ministry of Finance, Department of Company Affairs has issued the following Notification with regard to Companies [Disqualification of Directors under Section 274(1)(g) of the Companies Act, 1956] Rules, 2003:

NOTIFICATION

New Delhi, the 21st October, 2003

G.S.R. 830(E). – In exercise of the powers conferred by clause (b) of Sub-section (1) of Section 642 of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules to carry out the purpose of Clause (g) of Sub-section (1) of Section 274 of the said Act, namely:

Short title, commencement and extent.

1. (1) These rules may be called the Companies (Disqualification of Directors under Section 274(1)(g) of the Companies Act, 1956) Rules, 2003.

(2) These rules shall come into force from the date of their notification in the Official Gazette.

(3) These rules shall apply to all public limited companies registered under the Companies Act, 1956.

Definitions.

2. In these rules, unless the context otherwise requires:

- (a) “disqualifying company” is the company in which the default has occurred on account of which a director stands disqualified;
- (b) “appointing company” is the company in which an individual is seeking appointment as a director, including re-appointment as director.

Disqualifications under clause (g) of Sub-section (1) of Section 274 of the Companies Act, 1956.

3. (a) Whenever a company fails to file the annual accounts and annual returns, as described in Sub-clause (A) of clause (g) of Sub-section (1) of Section 274, persons who are directors on the last due date for filing the annual accounts and the annual

returns for any continuous three financial years commencing on and after the first day of April, 1999, shall be disqualified.

(b) If a company has failed to repay any deposit, irrespective of the enactment, rules or regulations under which the deposits have been accepted by the companies, or interest thereon, or redeem its debentures, or pay any dividend declared on the respective due dates, and if such failure continues for one year, as described in sub-clause (B) of Clause (g) of Sub-section (1) of Section 274, then the directors of that company shall stand disqualified immediately on expiry of that one year from the respective due dates:

Provided that all the directors who have been directors in the relevant year, from the due date to the expiry of one year after the due date, will be disqualified:

Provided further that disqualification on account of the reasons cited under this Rule shall also apply to the reappointment as a director.

Explanation: For the purpose of this rule, it is clarified that non-payment of dividend referred to in sub-clause (B) of clause (g) of Sub-section (1) of Section 274 due to the reason of dividend not being claimed or kept in separate bank account as required under Section 205A of Companies Act, 1956 or paid into Investors Education and Protection Fund as required under Section 205C of that Act shall not be deemed to be a failure to make payment of dividend.

Duty of Statutory Auditor to report on disqualification.

4. (a) It shall be the duty of statutory auditor of the appointing company as well as disqualifying company, as required under Section 227(3)(f) to report to the members of the company whether any director is disqualified from being appointed as director under clause (g) of Sub-section (1) of Section 274 and to furnish a certificate each year as to whether on the basis of his examination of the books and records of the company, any director of the company is disqualified for appointment as a director not.

(b) It shall be the duty of the statutory auditors of the “disqualifying company” as required in Section 227(3)(f) to report to the members of the company whether any director in the company has been disqualified during the year from being re-appointed as director, or being appointed as director in another company under clause (g) of Sub-section (1) of Sub-section (1) of Section 274.

Duty of company to intimate disqualification.

5. Whenever a company fails to file the annual accounts and returns, or fails to repay any deposit, interest, dividend, or fails to redeem its debentures, as described in Sub-clauses (A) and (B) of clause (g) of Sub-section (1) of Section 274, the company shall immediately file a return in duplicate in Form ‘DD-B’, prescribed under these rules for this purpose, to the Registrar of Companies, furnishing therein the names and addresses of all the Directors of the company during the relevant financial years:

Provided that names of such directors who have been exempted from application of Section 274(1)(g) by the Central Government, from time to time, shall be excluded.

Provided further that no unusual abbreviations or short forms shall be used in filling up the Form 'DD-B', which shall give such details as may be necessary to distinguish and identify each director without any ambiguity.

5A. The Form 'DD-B' prescribed in these rules may be filed through electronic media or through any other computer readable media as referred under Section 610A of the Companies Act, 1956.

Failure to intimate disqualification shall render director as officer in default.

6. When a company fails to file the Form 'DD-B' as above within 30 days of the failure that would attract disqualification under Section 274(1)(g), officers of the company listed in Section 5 of the Companies Act, 1956 shall be officers in default.

7. (a) Upon receipt of the Form 'DD-B' in duplicate under Rule 5, the Registrar of Companies shall immediately register the document and place one copy of it in the document file for public inspection.

(b) The Registrar of Companies shall forward the other copy to the Central Government.

8. Names of the disqualified directors on the web-site etc.

(a) The Central Government shall place on the web-site of the Department of Company Affairs the names and addresses and such other details including names and details of the companies concerned, as may be necessary, in respect of all the disqualified directors.

(b) The Central Government may also publicize the names of disqualified directors in such manner as it may consider appropriate.

(c) The Central Government shall take such steps as may be required to update its web-site to ensure that name of the person, in whose respect disqualification period has expired after 5 years, is deleted from the web-site.

8A. The Form DD-C prescribed in these rules may be filed through electronic media or through any other computer readable media as referred under Section 610A of the Companies Act, 1956.

9. Duty of every director.

Every director in a public company registered under the Companies Act, 1956 shall file Form 'DD-A', prescribed under these Rules, before he is appointed or re-appointed.

10. If any question arises as to whether these rules are or are not applicable to a particular company, such question shall be decided by the Central Government.

11. Punishment for contravention of the rules.

If a company or any other person contravenes any provision of these rules for which no punishment is provided in the Companies Act, 1956, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first, during which the contravention continues.

12. On the commencement of these rules, all rules, orders or directions in force in relation to any matter for which provision is made in these Rules shall stand repealed, except as respects things done or omitted to be done before such repeal.

13. The electronic form shall be authenticated by the authorised signatories using digital signatures, as defined under the Information Technology Act, 2000.

14. The Forms prescribed in these rules, when filed in physical form, may be authenticated by authorised signatory by affirming his signature manually.

[F.No. 1/8/2002-CL.V]

Rajiv Mehrishi, Joint Secretary

In terms of Companies (Disqualification of Directors under Section 274(1)(g) of the Companies Act, 1956) Rules, 2003, a responsibility has been imposed on the disqualified directors and the companies of such directors to file returns in Form DD-A and DD-B respectively to the Registrar of Companies. The format of these forms has been prescribed as Annexure I.

Disqualification Provisions – Significance thereof

The purpose of these provisions is firstly to set some standards of corporate management, a degree of competence and responsibility and to save the owners, the shareholders and at large the community from the consequences of mismanagement.

Under Section 202 it is an offence for an undischarged insolvent to take part in or be concerned in the management of a company. An undischarged insolvent and one who has applied for adjudication as an insolvent are disqualified from being appointed as a director. The prohibition on insolvents from managing companies are not intended to punish them but is to protect the community.

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

The Companies Act, 1956 lays down disqualifications as well as qualifications for a person to become a director.

- True
- False

Correct Answer: False

7. QUALIFICATION SHARES

There is no statutory requirement that a director must hold qualification shares in the company in which he is a director. Thus, a person may be a director in a company without being its member unless the articles provide otherwise. However, the articles usually provide for a share qualification. The modern view is that holding a nominal share qualification does not make a director more responsible. If the articles of a company provide for share qualification, Section 270 lays down that—

- (a) each director must obtain his qualification shares within two months after his appointment as director.

- (b) any provision in the articles shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such.
- (c) the nominal value of the qualification shares shall not exceed Rs. 5,000 or the nominal value of the one share where it exceeds five thousand rupees;
- (d) for the purpose of any provision in the articles requiring a director to hold a specified share qualification, the bearer of a share warrant should not be deemed to be the holder of the shares specified in the warrant [*Spencer v. Kennedy* (1926) Ch. 125]

A director who accepts his qualification shares as a secret gift from promoters of a company is guilty of a gross breach of trust and he is liable to give up the shares. [*Boston Deep Sea Fishing Co. v. Ansell*, (1888) 39 Ch D 339].

A director can act for two months without possessing the qualification shares required under the Articles. If a director fails to acquire his qualification shares within two months after his appointment or at any time thereafter ceases to hold the share qualification his office shall become vacant on the expiry of that period [Section 283(1)(a)]. Thus, two months *locus poenitentiae* seems to have been given to a director to acquire the necessary qualification [*Zamir Ahmed Raz v. Dr. D.R. Banaji*, (1957) 27 Com Cases 634]. The date of appointment is the date when the result of a poll for the election was announced to the company by the scrutineers and not the date when the poll was taken. [*Holmes v. Keyes (Lord)*, (1958) 28 Com Cases 419].

Under Section 272 of the Companies Act if a person acts as a director after the expiry of the said period of two months without holding the qualification shares, such director shall be punishable with fine which may extend to five hundred rupees for every day of default.

The effect of this provision is that if the company goes into liquidation within two months of his appointment as director, his name cannot be included in the list of contributories, if he has not acquired the qualification shares, as his name could not be entered in the Register of Members of the company until he had applied for shares and those were allotted to him [*Zamir Ahmed v. D.R. Banaji (Supra)*]. His mere acting as a director does not imply agreement to take shares in the company but if in such circumstances he is put on the register of members by the officer of the company after the time fixed for qualifying has expired and he continues to act as a director, he is estopped by his conduct from repudiating shares, and will be liable to pay for them [Brown's Case (1873) L.R. Ch. at p. 102]. If a director resigns before the expiry of the period of two months, he is not liable to the company in respect of the qualification shares- although he might have been acting as a director in the meantime [*Re., Pandora Theatu Co.*, (1884) 24 Sol 30 238]. Also, where a director acts without acquiring his qualification shares after the expiry of two months from the date of his appointment, the company will be bound to third parties for acts of such a director until the defect in the appointment or disqualification is disclosed, and acts done after disclosure will not bind the company. [*Re., Hercynia Copper Co.*, (1894) 2 Ch. 403 (CA)].

Validity of acts not affected

The acts of a director are regarded as valid if done before he becomes bound by the articles to acquire his qualification shares or notwithstanding that,

having once becoming qualified, a defect may afterwards be discovered in his qualification [*International Cable Co. ex. p. Official Liquidator*, (1892) 66 LT 253 and Section 290].

Raising of share qualification

A director who has already purchased his qualification shares as originally required by the articles, will not have to vacate his office if the articles are altered later and a larger number of qualification shares is prescribed [*Molineaux v. London Birmingham and Manchester Insurance Co.*, (1902) 2 KB 589 (CA)].

Vacation of office and penalty

A failure to acquire or to keep the specified share qualification will result in the vacation of the office of the director under Section 283(1)(a) *Chander Bhan v. Emperor*, AIR 1914 Lah 222 and he can be restrained by an injunction from acting as director. [*Richard B.T.H. Chow v. James Chow* 75 (CWN 173)]. Section 283 also prescribes a penalty if a director, with knowledge that his office is vacated, continues to function as such with fine upto Rs. 5,000/- on each day on which he functions as a director.

Directors who need not hold qualification shares

A director appointed by the Central Government on the Board of any company under Section 408 of the Act need not hold qualification shares [Section 408(4)]. The nominee directors representing those financial institution that are established by a separate statute of Parliament are not required to acquire the qualifying shares by virtue of enabling provisions contained in the concerned statute e.g. Section 30A of the IDBI Act, Section 27 of the SFCS Act, Section 19A of the UTI Act.

Similarly, the directors who by the articles of association of the company are not required to hold qualification shares, need not hold such shares.

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

There is a statutory requirement that a director must hold qualification shares in the company in which he/she is a director.

- True
- False

Correct Answer: False

8. NUMBER OF DIRECTORS

According to Section 252 of the Companies Act, 1956 every public company shall have at least three directors. Every private company shall have at least two directors. Articles of Association of companies usually provide for the minimum and maximum number of directors for its Board.

Section 258 of the Act lays down that a company in general meeting may by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its articles. However, this is subject to the provisions of Sections 252, 255 and 259 of the Act. Only the Board of directors have the power of

increasing or reducing the number of directors and make proposal for the same to the general body. A shareholder can make a proposal of this kind through a requisition. [*Ravi Shankar Taneja v. Mother Son Triplex Tools P. Ltd.* (2001) 4 Comp LJ 102].

According to Section 259 of the Act, increase in the number of directors under certain circumstances requires Central Government's approval. In the case of a public company or a private company which is a subsidiary of a public company, any increase in the number of its directors, except:

- (a) in the case of a company which was in existence on the 21st July, 1951, an increase which was within the permissible maximum under its articles as in force on that date; and
- (b) in the case of a company which came or may come into existence after that date, an increase which is within the permissible maximum under its article as first registered,

shall not have any effect unless approved by the Central Government; and shall become void if, and in so far as it is disapproved by that Government:

Provided that where such permissible maximum is twelve or less than twelve, no approval of the Central Government shall be required if the increase in the number of its directors does not make the total number of its directors more than twelve.

Where an increase in the number of directors will involve an alteration of the articles, a special resolution would be necessary for the purpose [*Ram Kissendas Dhanuka v. Satya Charan Law*, (1950) 20 Com Cases 133].

It should be noted that section 259 stipulates that the approval of the Government will be necessary for the increase in the number of directors, and not for the appointment. The approval may be obtained to increase the number and the actual appointments can be made in future. Thus, the approval need not be to the names of the persons who would be appointed as directors.

In the case of a government company in which the entire paid up share capital is held by the Central Government or by one or more State Governments or by the Central Government and by one or more State Governments, the provisions of section 259 are not applicable. [Notification No. GSR 235, dated 31 January, 1978 issued under section 620.

Restrictions on Number of Directorships

Section 275 of the Companies Act prohibits the appointment of a person holding office of a director at the same time in more than fifteen companies.

Section 277 of the Act lays down that when a person holding office of a director in fifteen companies is appointed as a director of any other company, the appointment shall not take effect unless such person has, within fifteen days thereof, effectively vacated his office as director in any of the companies in which he was already a director and the new appointment shall become void immediately on the expiry of the fifteen days if he has not before such expiry, effectively vacated his office as director in any of the other companies.

Sub-section (2) provides that where a person already holding office of director in fourteen companies or less is appointed as a director, of some other companies, making the total number of his directorships more than fifteen, he shall choose the number of directorships which he wishes to continue to hold or to accept so however that the total number of the directorships, old and new, held by him shall not exceed fifteen. None of the new appointments of director shall take effect until such choice is made; and if choice is not made within fifteen days of the day on which the last appointment was made, all the new appointment shall become void.

Exclusion of Directorship for the purpose of Sections 275, 276 and 277

Section 278 of the Act lays down that directorship in the following companies shall be excluded for the purpose of calculation of the permissible maximum number of directorships for the purposes of Sections 275, 276 and 277:

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) an unlimited company;
- (c) an association not carrying on business for profit or which prohibits the payment of dividend; and
- (d) a company in which such person is only an alternate director.

9. APPOINTMENT OF DIRECTORS

Directors may be appointed in the following ways:

- (i) By subscribers to the Memorandum (First Directors) Section 254.
- (ii) By members in general meeting — Sections 255, 256, 257, 265.
- (iii) By Board of directors (Sections 260, 262 and 313)
- (iv) By Central Government (Sections 408 and 409)
- (v) By third-parties if the articles provide.
- (vi) By small shareholders, if the articles so provide.

Restrictions on Appointment or Re-appointment of Directors

Section 266 of the Act lays down that a person shall not be capable of being appointed director of a company by the articles, and shall not be named as a director or proposed director of a company in prospectus issued by or on behalf of the company, or as proposed director of an intended company in a prospectus issued in relation to that intended company, or in a statement in lieu of prospectus filed with the Registrar by or on behalf of a company, unless, before the registration of the articles, the publication of the prospectus, or the filing of the statement in lieu of prospectus, as the case may be, he has, by himself or by his agent authorised in writing—

- (a) signed and filed with the Registrar a consent in writing to act as such director, and
- (b) either—
 - (i) signed the memorandum for shares not being less in number or value than that of his qualification shares, if any; or

- (ii) taken his qualification shares, if any, from the company and paid or agreed to pay for them; or
- (iii) signed and filed with the Registrar an undertaking in writing to take from the company his qualification shares, if any and pay for them; or
- (iv) made and filed with the Registrar an affidavit to the effect that shares, not being less in number or value than that of his qualification shares, if any, are registered in his name.

Sub-section (2) of the said section provides that where a person has signed and filed as aforesaid an undertaking to take and pay for his qualification shares, he shall, as regards those shares, be in the same position as if he had signed the memorandum for shares of that number or value.

References in Section 266 to the share qualification of a director or proposed director shall be construed as including only a share qualification required within a period determined by reference to the time of appointment, and references therein to qualification shares shall be construed accordingly.

The director or the person named as a proposed director must sign and file with the Registrar of Companies his/her consent to act as such director, in e-Form No. 32.

This section, however, shall not apply to—

- (i) a company not having share capital;
- (ii) a private company;
- (iii) a public company which was originally formed as a private company;
- (iv) a prospectus issued by or on behalf of a company after the expiry of one year from the date on which the company was entitled to commence business.

Director Identification Number (DIN)

The concept of a Director Identification Number (DIN) has been introduced for the first time with the insertion of Sections 266A to 266G of Companies (Amendment) Act, 2006. As such, all the existing and intending Directors have to obtain DIN within the prescribed time-frame as notified.

Director Identification Number (DIN) is a unique Identification Number allotted to an individual who is an existing director of a company or intends to be appointed as director of a company pursuant to section 266A & 266B of the Companies Act, 1956

Step by step Process

Step by step process to be followed by the applicant is as under:

As per the revised procedure for DIN Allotment, any person intending to apply for DIN shall have to make an application in eForm DIN 1 and should follow the procedure as provided in Director Identification Number Rules, 2006

Documents required to be attached with DIN 1

- High resolution photograph of the applicant
- PAN is mandatory now. So copy of pan is mandatory for identity, name, father's name and date of birth. Proof of father's name is not required in

the case of foreign nationals

- Copy of passport is mandatory as an id proof in the case of foreign nationals.
- Present Address proof which should not be older than 2 months
- Annexure – 1 as per the format given on the website www.mca.gov.in i.e. verification of applicant in case of Form DIN – 1.

For DIN1 eForm, only electronic payment of the fees shall be allowed (I.e. Netbanking/Credit Card). No challan payment will be accepted under revised procedure of DIN allotment.

In case, DIN 1 gets certified by the professional (i.e. CA(in whole time practice)/ CS(in whole time practice)/ CWA (in whole time practice)/secretary (who is member of ICSI) in whole time employment of the existing company in which applicant is to be associated), the DIN will be approved by the system immediately online (in case it is not potential duplicate).

On approval of DIN, intimate your DIN to all the company (ies) (within a period of 30 days from the date of approval) in which you are a Director, in form DIN-2.

After the Director has intimated the DIN allotted to the company(ies). The Company(ies) is/are then required to intimate the DINs of its directors to the ROC in Form DIN-3 within a period of seven days of receiving form DIN-2.(Filing of DIN-3 is applicable only in cases, where the date of appointment of director(s) in such company(ies), is prior to September 1 , 2007)

If there is any change in the particulars submitted in form DIN-1, applicant can submit e-form DIN-4 online. The e-Form DIN-4 is required to be digitally signed by a Chartered Accountant or a Company Secretary or a Cost Accountant in whole- time practice or Secretary (who is member of ICSI) in whole time employment of the existing company.

(i) Appointment of First Directors

First director means the director of the company who assumes office from the date of incorporation of the company. The first directors of a company may be named in its articles of association. In case no directors are so named in the articles, the articles may authorise the subscribers to the memorandum to appoint the first directors.

Section 254 of the Act, provides that in the absence of any such provision in the articles of association, the subscribers of the memorandum who are individuals, shall be deemed to be the first directors of the company until the directors are duly appointed in accordance with Section 255. If the articles provide for any share qualification, only such of the subscribers as possess the necessary share qualification shall be deemed to be directors. This provision relating to share qualification is applicable only to a public company and not to a private company unless the articles make it applicable.

If all the subscribers to the memorandum are bodies corporate, none of the subscribers can be deemed to be directors, and the company will have no directors until the first directors are appointed under Section 255, in the absence of other

provisions in the articles. The articles at the time of registration may contain the names of the first directors until directors are appointed at the first general meeting.

(ii) Appointment of directors by members in General Meeting

Section 255 of the Act, provides that unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company, or of a private company which is subsidiary of a public company, shall be persons whose period of office is liable to determination by retirement of directors by rotation and except as otherwise expressly provided in the Act, be appointed by the company in general meeting. Any fraction is to be rounded off to next higher number.

Sub-section (2) of the said section provides that the remaining directors in the case of any such company, and the directors generally in the case of a private company which is not subsidiary of a public company shall, in default of and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

When there are no validly appointed directors functioning, the shareholders have the right to appoint directors at the annual general meeting [*Viswanathan (B.N.) v. Tiffins Barytes Asbestos & Paints Ltd.*, (1953) 23 Com Cases 29].

Section 256 of the Act, provides that in the case of a public company or a private company which is subsidiary of a public company, at the first annual general meeting held after the holding of the general meeting at which the first directors are appointed in accordance with Section 255 and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, shall retire at every annual general meeting or if their number is not three or multiples of three then the number nearest to one-third, shall retire from office. Those directors who have been longest in office since their appointment shall retire first. As between person who became directors, on the same day, retirement among themselves, be determined by lot.

Directors nominated by Financial Institutions pursuant to their loan agreements are not liable to retirement. Also, the directors appointed by the Central Government in pursuance of Section 408 of the Act shall also not be liable to retire by rotation. Articles of most companies contain an express provision excluding the managing or whole-time director from the requirement of retirement by rotation and provide that a person shall not be liable to retire by rotation as long as he continues to hold the office of the managing or whole-time director.

Where the articles of a company provided that every year subsequent to the first annual general meeting one-third of the directors or if their number is not a multiple of three, then the number nearest to but not exceeding one-third, shall retire from office. The strength of the Board became reduced to two and the question was whether either of them ceased to be a director under this article. It was held that in this case there are two directors and therefore one cannot find a number which is nearest to but does not exceed one third [*Mosely v. David Mosely & Sons Ltd.* (1939) 9 Comp Cas 204]. In another similar case, it was held that one of the two directors should have retired at the annual general meeting [*B M Viswanathan v. Tiffins Barytes Asbestos Paints Ltd. (Supra)*].

Sub-section (3) of Section 256 of the Act provides that where a director retires by rotation at the annual general meeting, the company at the same meeting may appoint (i) the retiring director, or (ii) some other person in the vacancy.

If at the said annual general meeting the vacancy is not so filled and the meeting has not expressly resolved not to fill the vacancy, the meeting, though it has disposed off all other matters on the agenda, shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.

Section 256(4) provides that if at the adjourned meeting also, the vacancy is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring directors shall be deemed to have been re-appointed at the adjourned meeting except in the following cases:

- (a) at that meeting or at a previous meeting a resolution for the re-appointment of such a director has been put to the meeting and lost;
- (b) the retiring director has, by a notice in writing addressed to the company or its Board of directors, expressed his unwillingness to be so appointed;
- (c) he is not qualified or is disqualified for appointment;
- (d) a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of the Act; or
- (e) the proviso to Sub-section (2) of Section 263 is applicable to the case.

This sub-section deals with a meeting adjourned because no decision is taken on filling up a vacancy caused by retirement of a director and not with a meeting adjourned for lack of quorum as provided in Section 174. The meeting contemplated in this sub-section is a meeting capable of taking a decision. Section 174 does not apply to a case coming within this sub-section. If a meeting is adjourned for want of quorum and no decision is taken at the adjourned meeting on re-appointment of a director, the director is not deemed to be re-appointed by virtue of sub-clause (b) of this sub-section [*Cardamon Marketing Co.Ltd. v. Krishna Iyer* (N) (1982) 52 Com Cases 299 (DB) (Ker)].

Where no annual general meeting is called or held, there is no scope for the application of the deeming provision of clause (b) at all.

When a general meeting is adjourned for the purpose of taking a poll, the provisions of Sub-section (4)(a) and (b) relating to automatic re-election of retiring directors are not attracted for the time being [*Srinivasan (M.K.) v. W.S. Subramanya Ayyar*, (1932) 2 Com Cases 147].

The re-appointment as above shall be effective from the day of the adjourned meeting.

In case the vacancy is not filled at the annual general meeting and also the retiring directors do not get automatically re-appointed, the vacancies may be filled by the Board of directors.

The directors due to retire by rotation at an annual general meeting vacate office

at the latest on the last day on which the meeting was due or ought to have been held. In case the meeting is not called by the directors, they cannot be allowed to take advantage of their own default and cannot extend their directorship after the date on which the meeting should have been called and held [*Ananta Lakshmi Amal v. Indian traders Invest Ltd.* AIR 1953 Mad. 467, (1952) Comp. Cases 324].

Additional directors, hold office till the next annual general meeting and, therefore, they would not be, included in the whole number of directors for the purpose of computing the proportion of directors who should retire at the meeting. [*Eyre v. Milton Proprietary Ltd.*, (1935) All ER Rep 286].

Re-election of directors - filing of return

The provisions of Section 303 (2) requiring the filing of a return to the Registrar of any change in the particulars of directors are not applicable to directors who are re-elected after retirement and, therefore, no document in reference to them is necessary. [*Krishna Mills Ltd. v. The State*, (1957) 27 Com Cases 388, 389].

Appointment of Person other than Retiring Director

Section 257 contains provision regarding the right of persons other than the retiring directors to stand for directorship and provides for the machinery for the election of such persons. It enables a person to stand for directorship at any general meeting and not necessarily only at an annual general meeting [*Re Motion Pictures Association* (1974) 44 Comp Cas 298 (Del)].

A person who is not retiring director is also eligible for appointment as director. Section 257 of the Act provides that a person (even a non member) other than a retiring director may give a notice in writing to a public company or a private company which is subsidiary of a public company not less than fourteen days before a general meeting about his candidature as a director or any member may give such notice signifying his intention to propose him as a candidate for that office. Such notice should be accompanied with a deposit of five hundred rupees, which shall be refunded to such person or, as the case may be, to such member, if the person succeeds in getting elected as a director. The Department of Company Affairs (Now, Ministry of Company Affairs) has vide circular No. 5/89 dated 15.9.1989 clarified that if in terms of Section 257, the person does not get elected, as a director then he or the member proposing him, as the case may be will not be entitled to the refund of Rs. 500 and the amount deposited shall stand forfeited to the company.

On receipt of such a notice the company must inform its members of the candidature of a person or the intention of a member to propose such person as a candidate either by serving individual notice on the members or by advertising not less than seven days before the meeting in at least one English Language newspaper and one regional language newspaper circulating in the place where the registered office of the company is situated. (Sub-section 1A to Section 257)

A notice given to members under Sub-section (1A) not less than seven days in advance of the election is valid notwithstanding that it does not comply with the requirement of twenty one days set out in Section 171. Appending an explanatory note to the notice under Sub-section (1A) is valid compliance with Section 173(2) [*Pazhamalai (S.) v. Aruna Sugars Ltd.*, (1984) 55 Com Cases 500 (Mad)].

Section 257 is a specific provision giving a right to an individual member to give notice thereunder. The specific right that has been given under Section 257 does not provide that the implementation of such a right will have to be in accordance with the procedure laid down in Section 188 of the Act. Sections 188 and 257 cover different fields [*Gopal Vyas v. Sinclair Hotels and Transportation Ltd.* Comp Cas. 68 (1990) 516 (Cal.)].

The Department of Company Affairs (Now, Ministry of Company Affairs), in this regard, has expressed the views that if a person who is appointed as an additional director wants to be elected as a director at the next annual general meeting, the provisions of section 257 will have to be complied with since he cannot be considered to be a director retiring by rotation at that meeting (*Letter No. 8/3 (270)/63/PR dated 27-7-1963*).

Applicability of the provisions of Section 257 to a private company

Section 257(1) does not apply to a private company which is not subsidiary of a public company. Thus a private company, unless its articles so require, is not bound to receive a notice of candidature of a person for directorship at a general meeting and inform the same to its members in respect of convened general meeting. The proposal to appoint a person as a director can begin straightaway at the meeting itself. Affirmed in *K. Meenakshi Amma v. Sree Rama Vilas Press and Publications Ltd.*, (1992) 73 Com Cases 285 at 295 (Ker-DB). Appointment of director other than the retiring one in general meeting will, in case of a private company not being a subsidiary of a public company, be governed by its Articles of Association.

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

A person who is not a retiring director is not eligible for appointment as director.

- True
- False

Correct Answer: False

A person who is not a retiring director is also eligible for appointment as director. Section 257 of the Act gives power to shareholders to nominate any person including himself/herself for election as a director.

Appointment of Directors to be voted individually

The directors are usually elected by shareholders at a general meeting by an ordinary resolution passed by simple majority of votes. Two or more directors should not be elected *en bloc* or by a single resolution. Section 263(1) of the Act, provides that in case of public company or a private company which is a subsidiary of a public company, a motion shall not be made for the appointment of two or more persons as directors of the company by a single resolution, unless a resolution that it shall be so made has first been agreed to by the meeting without any vote being given against it.

Therefore, if two or more directors are to be appointed or elected by a single resolution, it is necessary first to pass a resolution authorising their appointment or election in that manner without even one dissentient vote being given against such resolution.

Sub-section (2) provides that resolution moved in contravention of Sub-section (1) shall be void whether or not objection was taken at the time of its being so moved. So when a resolution re-electing the retiring directors becomes void for the reasons above, the provisions for the automatic re-appointment of the directors retiring by rotation in default of another appointment as provided in Section 256(4) shall not apply.

The provision gives discretion to the meeting as regards the rejection of a particular candidate in the list.

The object of the prohibition of a composite motion is that it will enable the shareholders to appoint a particular individual standing for directorship, without being compelled to vote for candidates in a batch.

Contravention of the provision of Section 263

The effects of the contravention of Section 263 would be as follows:

- (1) The appointment of all the directors not voted on individually will be void even if no body objected to it at that time. [*Raghunath Swarup Mathur v. Raghuraj Bahadur Mathur*, (1967) 37 Com Cases 304 : 91966) 2 Comp LJ 100 (All)];
- (2) The appointment would not invalidate the acts of directors where defect is afterwards discovered (Section 290).
- (3) The provision for the automatic re-appointment of retiring directors provided in Section 256 will not have effect in such case; that is to say, where an appointment is void by reason of the application of Sub-section (2), the vacancy created thereby cannot be filled by the retiring director under the provision for automatic re-appointment provided in Sub-section (4) of Section 258 of the Act.

Principle of Proportional Representation

Normally, directors are appointed by simple majority by way of an ordinary resolution. As a result of this method of simple majority a substantial minority may not be able to succeed in placing even a single director of its choice on the Board.

Section 265 of the Act affords an opportunity to the minority shareholders to have their representatives on the Board of directors. In accordance with the said Section, a public company or a private company, may provide in its articles for the appointment of not less than two-thirds of the directors, according to the principle of proportional representation, whether by single transferable vote or by a system of cumulative voting or otherwise. The appointments are made once in three years and any casual vacancies can be filled in by the Board of directors as in other cases.

The directors appointed according to this principle hold office for three years and cannot be removed by the company in general meeting under Section 284.

(iii) Appointment of Directors by the Board

(a) Additional Directors : The Board of directors of a company may appoint additional directors. Section 260 of the Act lays down that if the articles of association

of a company empower its directors to appoint additional directors, the Board may exercise such power. Such additional director shall hold office only up to the date of the next annual general meeting of the company. The Section further provides that the number of additional directors together with the existing directors shall not exceed the maximum number fixed for the Board by the articles.

The power of the Board of directors to appoint an additional director is not affected by the provisions of Section 255 (Section 260). The restriction imposed by Section 255 regarding the proportion of directors liable to retire by rotation and non-rotational need not be complied with while appointing an additional director.

If the annual general meeting of a company is not held or cannot be held, the person appointed as additional director vacates his office on the last day on which annual general meeting should have been held in terms of Section 166 of the Act. He cannot continue in office thereafter on the ground that the meeting was not or could not be called within the time prescribed in the Section [*Krishna Prasad Pilani v. Colaba Land and Mills Co.* 1959 Comp. Case 273].

The expression “up to date of the annual general meeting” means “up to the date when the next annual general meeting ought to be held at the latest” [See also *Consolidated Nickel Mines Ltd. In Re*, (1914) 1 Ch 883; 186 followed in *Anantalakshmi (A) Ammal v. The Indian Trades and Investments Ltd.*, (1952) 22 Com Cases 324 (Mad)].

Section 260 applies to all companies, public as well as private – *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd.* AIR 1981 SC 1298.

Unlike in the case of the casual vacancies which can be filled only at a regular meeting of the Board, the appointment of additional director may be made either at a meeting of the Board or by passing a resolution by circulation as provided in Section 289.

Section 303(2) requires a company to file with the Registrar any change among its directors specifying the date of the change within thirty days thereof. Only one copy of e-Form 32 is required to be filed with the Registrar through e-filing. Whether the appointment of an additional director appointed under Section 260 or a director appointed in a casual vacancy under Section 262 as a director by the company in its annual general meeting will constitute a change within the meaning of Section 303(2) of the Act. The above question was examined by Ministry of Corporate Affairs, earlier the *Department of Company Affairs* which has clarified that where an additional director or a director appointed in a casual vacancy is appointed as director of the company in the annual general meeting, the nature of his appointment changes radically. It would, therefore, be in the interest of such directors that such changes are notified to the Registrar under Section 303(2) of the Companies Act, 1956.

“In the opinion of Ministry of Corporate Affairs, earlier Department of Company Affairs where all the directors of a company retire at the annual general meeting and are re-appointed at the meeting to the same respective offices as before, such re-appointments will not be deemed to constitute a ‘change’ within the meaning of section 303(2) and no return therefor need to be filed. This does not, however, extend to additional directors (section 260) or directors appointed to the casual vacancies (section 262) when they are appointed for a full term at the annual general meeting” [Company News and Notes dated July 1, 1963].

Power of general meeting to appoint additional directors

The power to appoint additional director by the Board is to be delegated by the Articles of Association of the Companies and unless the articles do so, there is no reason why the company in general meeting may not exercise the power [*Blair Open Hearth Furnace Ltd. v. Reigart*, (1913) 108 LT 665]. Thus, the articles can be so framed so as to delegate the power of appointing additional directors to the Board and not to the general meeting and in such a case an appointment made by a general meeting would not be effective. There are exceptions to this:

- (1) The general meeting will have the power to appoint additional directors where the directors have not filled the vacancies;
- (2) When they are not able to do so either because there is a deadlock in the Board; or because there is no validly appointed director in office. [*Foster v. Foster*, (1916) 1 Ch 532].

Judicial non-interference in appointment of directors

Courts do not generally interfere in the matter of appointment of directors because that would amount to interference in the functioning of corporate democracy. A director appointed by shareholders participated in the meetings of the Board as well as general meetings where certain other directors were appointed. Subsequently, he applied for an injunction to restrain the functioning of the new appointees. The court refused to oblige him. Even if the appointment was, as alleged, the result of a conspiracy that could be sorted out in a regular suit. *Manoj Kumar Sonthalia v. Nariman Point Building Service and Trading P. Ltd.*, (1995) 84 Com Cases 559 (Mad). The court followed its own earlier decision in *Vivek Goenka v. Manoj Santhalia*, (1995) 83 Com Cases 897 (Mad) where also similar appointments were made and no relief against them was allowed because of no irregularity.

(b) Filling up Casual Vacancies – Casual vacancy means any vacancy, which occurs by reason of death, resignation, disqualification, failure of an elected director to accept the office or for any reason other than retirement by rotation. Section 262 empowers the Board to fill casual vacancies in the case of a public company or a private company, which is a subsidiary of a public company. Thus, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, subject to any regulations in the articles of the company, be filled by the Board of directors at a meeting of the Board.

Where a casual vacancy is filled by the Board and the person appointed to such casual vacancy also vacates, then the resulting vacancy is not a casual vacancy and cannot be filled by the Board. It may be noted that the Section 262 only applies to a casual vacancy in the office of a director appointed by the company in general meeting. The Board in such a case can only appoint an additional director, if the Article have any provision in this regard.

The Board of directors shall have the power at any time and from time to time subject to the provisions of Section 260 of the Companies Act, 1956 to appoint any person to be a director to fill a casual vacancy among directors of the company.

As per Sub-section (2) of Section 262, if the director fills up a casual vacancy, the person appointed will hold office not until the next annual general meeting only but for the entire period for which the person in whose place he has been appointed would have held office. Thus, if 'A' is a director and vacates his office and 'B' is appointed in his place, B would continue for the whole period for which 'A', if he had not vacated, would have continued. However, 'B' will not be eligible for re-appointment as 'a director retiring by rotation'.

Filling of casual vacancy by a private company - Section 262 does not apply to a private company which is not a subsidiary of a public company. Such a company will fill casual vacancies as provided by its own articles and/or under Section 255(2) i.e. in a general meeting. It need not follow the provisions of Section 262.

Filling of Casual Vacancy of a Director created by resignation – Query to MCA:

"X, a director of a company, was appointed at the annual general meeting. Due to some reason, X resigned from the Board and casual vacancy thus created was filled by the appointment of Y at a meeting of the Board of directors. Necessary return concerning this change was filed with the Registrar. Later on, Y resigned and the directors again invited X to fill the vacancy created by the resignation of Y. The question is: Is the action of the Board in appointing X, in the second instance, in accordance with the provisions of Section 262(1) and particularly considering the fact that the appointment of X consequent upon the resignation of Y, for the purpose of filling the casual vacancy at a Board meeting does not, in effect, satisfy the statutory requirement which states "if the office of any director appointed by the company in general meeting is vacated?"

MCA gave the following reply :

"The Department's view on the point raised is that the appointment of X, by the Board, in the second instance, in the vacancy caused in the Board by the resignation of Y cannot, strictly speaking, be deemed to be an appointment to a casual vacancy in the office of director appointed by the company in general meeting, within the meaning of Section 262(1) in as much as the appointment of Y himself was not originally made by the company in general meeting. However, in the interest of the smooth working of the company, if the casual vacancy is in an office which was filled by election at a general meeting, the Department would have no objection to the Board of directors of the company filling that casual vacancy as many times as may be necessary." [*Company News and Notes dated July 1, 1963*].

The words "director appointed by the company in general meeting" used in Section 262(1) must be read with the following words i.e., "is vacated before his term of office will expire". In *M.K. Srinivasan v. W.S. Subrahmanya Ayyar* [1932] Comp. Cas 147. The director did not assume office i.e. he dies after his appointment of the general meeting but before assuming the office. In this case here is no question of someone vacating any office if he never even assumed it.

Power to fill casual vacancies is exercisable by the Board even when the membership of the Board has fallen below the statutory minimum. Even the holding of a general meeting to appoint directors will not extinguish the directors power to fill casual vacancies.

This power, like all other powers of directors, should be exercised in good faith in the interest of the company as a whole. *Ananthalakshmi Ammal (A) v. Indian Trades & Investments Ltd.*, (1952) 22 Com Cases 324.

(c) Alternate director - The Board of directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint an alternate director, in accordance with Section 313 of the Companies Act, 1956, to act for a director during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held.

An alternate director occupies the position of director and even though he is called an alternate director, he is a director and performs same duties and is subject to the same liabilities as of any director. However, in calculating for the purposes of Section 275, the number of companies of which he is a director, a company in which he is an alternate director shall not be included [Section 278(1)(d)]. An alternate director may be appointed as a managing or whole-time director. Therefore, no new office of the director is created by his appointment. Provisions of the Act not applicable to the alternate director are as follows:

- (1) Appointment of an alternate director is not considered as an increase in the strength of the Board of directors.
- (2) Alternate directorship held by a person cannot be counted for maximum number of directorships, which a person can hold.
- (3) An alternate director is not required to hold any qualification shares.

It is the prerogative of the Board of directors to appoint an alternate director. Neither the shareholders of the company nor any other person can exercise the power to appoint alternate director.

Vacation of office of alternate director – An alternate director shall not hold office as such for a period longer than that 'permissible' to the original director in whose place he has been appointed and shall vacate office as and when the original director returns to the State in which meetings of the Board are ordinarily held.

MCA has clarified that the alternate director vacates his office whether or not the original director attends the Board meeting on his return to the State [*Letter No. 6/16(313)/68-PR, dated 5-2-1968*].

The word 'permissible' used above has to be understood not only in the sense of his term of office by virtue of his appointment but also in the sense that there can be a situation when it is no longer permissible for the original director to hold the office despite the fact that the period of his appointment is yet to come to an end. Thus, if the original director suddenly dies, the office is automatically vacated and the alternate director, unless reappointed, in the casual vacancy caused by the death of the original director, will also vacate his office. Again, if the original director vacates his office by virtue of any of the provisions of Section 283, the alternate director also automatically vacates the office. Suppose that the original director, as per his terms of appointment, was entitled to hold the office of a director for a period of three years, which may be maximum permissible period under the normal circumstances. But then, it may happen that this maximum permissible period is curtailed by virtue of any

other provisions of the Act. In that event, the maximum permissible period is also reduced for the alternate director. (A.M. Chakraborti, Taxmann, 1994 Edition, page 979).

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

The shareholders of the company can exercise the power to appoint an alternate director.

- True
- False

Correct Answer: False

Neither the shareholders of the company nor any other person can exercise the power to appoint an alternate director. Only the Board of Directors can appoint an alternate director.

(iv) Appointment of Directors by Central Government

Section 408 of the Act, vests overriding powers in Central Government to nominate directors. Sub-section (1) of this section provides that notwithstanding anything contained in this Act, the Central Government may appoint such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interests of the company, or its shareholders or the public interests to hold office as directors thereof for such period not exceeding three years on any one occasion, as it may think fit, if the Company Law Board¹, on a reference made to it by the Central Government or on an application of not less than one hundred members of the company or of the members of the company holding not less than one-tenth of the total voting power therein, is satisfied after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any member of the company or in a manner which is prejudicial to the interest of the company or to public interest. “The section opens with the words ‘notwithstanding anything contained in this Act’. This is a non obstante clause which vests overriding powers in the Government to nominate directors to prevent mismanagement or oppression”. [*Oriental Industrial and Investment Corpon. Ltd. v. Union of India*, (1981) 51 Com Cases 487, 493 (Del)].

The directors appointed under Section 408 may or may not be the members of the company. The period of three years mentioned herein means full term of three years excluding the period during which an injunction by court on instance of company restraining director for acting operates [*Union of India v. Shri Changdeo Sugar Mills Ltd.* (1984) 55 Comp. Cas. 42 (Bom.)]

Alternatively, and in lieu of appointing directors as aforesaid, the Company Law Board may, if the company has not availed itself of the option given to it under Section 265, i.e. appointment of directors by proportional representation, direct the company to alter its articles in the manner provided in that Section and make fresh appointment of directors in pursuance of the articles so amended, within such

time as may be specified in that behalf by the Company Law Board [proviso to Section 408(1)].

In case the Company Law Board passes an order under the proviso above, it may, if it thinks fit, direct that until new directors are appointed in pursuance of the order aforesaid, such number of persons as the Company Law Board may, by order specify as being necessary to effectively safeguard the interests of the company, or its shareholders or the public interest, shall hold office as additional directors of the company and on such directions, the Central Government shall appoint such additional directors [Section 408(2)].

The power of the Central Government, to appoint directors under Section 408 of the Act is not absolute, but is circumscribed by the limitations mentioned in that section. The exercise of its power is dependent on the establishment, in an objective manner that it is necessary to make the appointment in order to prevent the affairs of the company being conducted in a manner which is oppressive to any member of the company or in a manner which is prejudicial to the interests of the company or the public interest. Since the exercise of these powers has grave consequences and seriously affects the reputation and credibility of the management of the company, the power must be exercised only when the requisite conditions are fully complied with. The power cannot be exercised in a whimsical or arbitrary manner [*South India Viscose Ltd. v. Union of India* (1982) 52 Comp. Case. 247, Delhi].

For the purpose of reckoning two-thirds or any other proportion of the total number of directors of the company, any director or directors appointed by the Central Government shall not be taken into account.

Any director appointed by the Central Government under Section 408 shall not be required to hold any qualification shares and not be liable to determination by retirement of directors by rotation. But they can be removed by the Central Government at any time and other persons can be appointed by it in their place.

In addition to the aforesaid powers of the Central Government to appoint directors, it has, as the shareholder of government companies, the right to appoint directors of such companies.

Sub-Section (5) of Section 408 provides that no change in the Board of directors, after a person is appointed or directed to hold office as a director or additional director under this section shall, so long as such director or additional director holds office, have effect unless confirmed by the Company Law Board.

The Central Government may also issue such directions to companies, where Government directors have been appointed, as it may consider necessary or appropriate in regard to their affairs. Such directions may include directions to remove an auditor already appointed and to appoint another auditor in his place, or to alter the articles of the company, and upon such directions being given the appointment, removal or alteration as the case may be, shall be deemed to have come into effect as if the provisions of this Act in this behalf have been complied with without requiring any further act or thing to be done. The Government directors may be required to report to the Central Government from time to time with regard to the affairs of the company.

The Company Law Board have also powers under Section 409 of the Companies Act to prevent change in the Board of directors of a company, which is likely to affect the company prejudicially. It provides that where a complaint has been made to the Company Law Board by its managing director or any other director or the manager of the company that as a result of a change which has taken place or is likely to take place in the ownership of any shares held in the company, a change in the Board of directors is likely to take place which if allowed, would effect prejudicially the affairs of the company, the Company Law Board may, if satisfied, after such inquiry as it thinks fit to make that it is just and proper so to do, by order, direct that no resolution passed or that may be passed or no action taken or that may be taken to effect a change in the Board of directors after the date of complaint, shall have effect unless confirmed by the Company Law Board and any such order shall have effect notwithstanding anything to the contrary contained in any other provision of this Act or in the memorandum or articles of the company or in any agreement with, or any resolution passed, in general meeting by or by the Board of directors of the company.

The Company Law Board shall have power when any such complaint is received by it, to make an interim order to the effect set out aforesaid before making or completing the inquiry aforesaid.

Nothing contained aforesaid shall apply to private company unless it is a subsidiary of a public company.

Application to the Company Law Board to Prevent Oppression and Mismanagement.

An application under Section 408 and Section 409 of the Act is required to be made to the principal Bench of the CLB in Form No. 1 in Annexure II to the CLB Regulations with a fee of Rs. 500. The application is to be accompanied with the following documents.

1. Documentary and/or other evidence in support of the statements made in the petition as are reasonably open to the petitioner(s).
2. Documentary evidence in proof of the eligibility and status of the petitioner(s) with the voting power held by each of them.
3. Affidavit verifying the petition.
4. Bank draft evidencing payment of application fee.
5. Memorandum of appearance with copy of the Board resolution or the executed vakalatnama, as the case may be.
6. Three copies of petition.

(v) Appointment of Directors by Third Parties (Nominee Directors)

Sometimes financial institutions or banks or other lenders, etc., nominate a director to represent their interest on the Board. The lending institutions assume a pivotal role in financing the various projects of the companies. Such Financial Institutions have to safeguard their interests. They have to ensure that the money is only used for the purposes for which it was borrowed. The right and the terms of

nominating the directors on the Boards of companies is usually contained in the agreement itself. Special legislations governing certain public financial institutions and State financial corporations envisage the appointment of certain directors on the Boards of borrowing companies and such a provision has an overriding applicability to the Companies Act.

Nominee directors can be appointed only if a provision to that effect exists in the Memorandum of Association or Articles of Association of the company unless where a statute provides for such nomination. Therefore, it would be necessary for the company to specifically provide in its Articles, or amend its Articles to provide, for appointment of a non-rotational director by the assisting financial institution(s).

As per Section 255 of the Act, it should be ensured that the total number of non-rotational directors does not exceed one-third of the total strength of the Board. The company's articles may include provisions relating to the following:

- (1) The nominee director may not be required to hold qualification shares and shall not be liable to retire by rotation.
- (2) Every such director shall be entitled to attend all general meetings, Board meetings and Committee meetings.
- (3) The nominee director shall be paid normal fees and expenses to which other directors are entitled.

The fees, commission monies and remuneration in relation to such nominee directors shall accrue to corporation(s) and the same shall accordingly be paid by the company directly to the respective corporation(s) of which nominee directors are employees. If they are not employees of nominating institutions, fees, commissions or remuneration shall be paid to them.

Sometimes a company may not accept the appointment of a director nominated by the third party. The third party might insist that the director nominated by it must be accepted and may thus refuse to provide an alternative. In *British Murac Syndicate Ltd. v. Alperton Rubber Co. Ltd.* [1915] 2 Ch. 186, it was held that the company shall be compelled to accept the appointment unless the appointee is unfit to act as director, e.g., where he has conflicting interests.

Liability of nominee directors – Nominee directors are in the same position and they owe same duties to the company as any other director.

However, by virtue of special provisions in the respective Acts governing different financial institutions, the directors nominated by the financial institutions have been given immunity from action for any liability as a director in the company and administrative instructions have also been issued to the Department of Company Affairs (Now Ministry of Corporate Affairs) not to launch any prosecution against such directors.

Director nominated by a shareholder

It has been held that there is nothing wrong if a member holding large shareholding nominates a director on the Board of a company to represent his interests. However, such interests should be subservient to the interest of the

company and the director should be free to exercise his best judgement in the interest of the company, which he serves. But if he agrees to subordinate the interests of the company to the interests of his patron his conduct will be oppressive to the other shareholders for which the patron, can be brought to book [*Bowling vs. Association of Cinematograph, Television and Allied Technicians* (1963) 1 AIL ER 716 (1963) I Comp LJ 344].

(vi) Appointment of a Director by Small Shareholders

The Companies (Amendment) Act, 2000 had inserted the following proviso to Section 252(1) of the Act:-

Provided that a public company having —

- (a) a paid-up capital of five crores rupees or more;
- (b) one thousand or more small shareholders,

may have a director elected by such small shareholders in the manner as may be prescribed.

Explanation — For the purposes of this Sub-section “small shareholders” means a shareholder holding shares of nominal value of twenty thousand rupees or less in a public company to which this section applies.

This amendment came into force with effect from December 13, 2000. The Government prescribed the Companies (Appointment of the Small Shareholders' Director) Rules 2001 vide notification No. G.S.R. 168(E) dated 9th March, 2001 for the manner of appointment of such director.

(For the text of these Rules see Annexure II).

Accordingly, a public company having paid-up share capital (Preference and/or Equity Capital) of Rs. five crores or more may have a director from amongst small shareholders elected *suo-moto* or upon notice of small shareholders who are not less than one tenth of total small shareholders. Such notice duly signed by at least 100 small shareholders should be served upon the company at least 14 days before the general meeting at which such appointment is intended.

The listed public company shall elect, small shareholders' director through the postal ballot whereas the unlisted public company on the recommendation by the majority of the small shareholders for the proposed candidate subject to other conditions and disqualifications prescribed under the said Rules.

Tenure of such director shall be for a maximum period of three years. On expiry of his tenure, the same person, if so decided by small shareholders, may be elected for another period of three years. Such director shall be treated as director for all purposes but he/she cannot be appointed as managing or wholetime director. An individual can not hold office of the small shareholders' director at the same time in more than two companies. Such director shall have to vacate the office as provided in the Rules and he can also be removed in pursuance of Section 284 of the Act.

10. REMOVAL OF DIRECTORS

A director may be removed from office before the expiry of his term by—

(a) Shareholders of the Company; (b) Central Government; or (c) Company Law Board.

(a) Removal by shareholders

Pursuant to Section 284(1) of the Act, the shareholders of a company may, by passing an ordinary resolution at a general meeting, remove a director before the expiry of the period of his office. However, the following directors cannot be removed by the company unless otherwise stipulated in the terms of their appointment:

- (a) a director appointed by the Central Government under Section 408;
- (b) a director of a private company holding office for life on the first day of April, 1952 whether or not he is subject to retirement under an age limit by virtue of the articles or otherwise;
- (c) where the company has availed itself of the option to appoint not less than two-thirds of the total number of directors according to the principle of proportional representation under Section 265;
- (d) a director appointed by a Financial Institution/Bank under the terms of a loan agreement.

The right given by Section 284 is a statutory right which cannot be taken away by the memorandum, articles or by any contract or any other document and if it is sought to be taken away, such a provision will be void [see Section 9].

In the case of *Ravi Prakash Singh v. Venus Sugar Ltd.* [(2008) 84 SCL 75 (Del)], the judgment made it clear that where articles of association confer power on the board of directors to remove a director, such power is not affected by the provisions of section 284. The articles of association are in the nature of an agreement between the shareholders who are the joint owners of the company. If some specific methodology is devised by consent, nothing precludes the members/shareholders from doing so.

In *Tarlok Chand Khanna v. Raj Kumar Kapoor* (1983) 54 Comp. Cas. 12 (Delhi), it was held that apart from the directors appointed by the Central Government under Section 408, life directors holding office on 1.4.1952 and nominee directors appointed by the financial institutions, a company has full power under Section 284 to remove a permanent director even if articles of association put restrictions on removal of permanent directors.

The shareholders cannot be restrained from calling a general meeting to remove existing directors and appoint new directors. [*Life Insurance Corporation of India v. Escorts Ltd.* (1986) 59 Comp. Cas. 548 (SC)]. It has been held to be a good ground for removing a director where it was found as a fact that the director had made misleading complaints to various Government Authorities which resulted in raids on the company's premises and the concerned authorities found nothing wrong and

gave a clean chit to the company. [*Vinod Kumar Mittal v. Kaveri Lime Industries Ltd.* (2000) 100 Com. Cases 66].

The Civil Court has no jurisdiction to entertain the suit for removal of directors of a limited company as it relates to the internal management of the company which is governed by the Act. In *Khetan Industries Private Ltd. v. Manju Ravindra Prasad Khetan* AIR 1995 Bom 43, one of the two issues before the High Court was whether the Civil Court has jurisdiction to entertain a suit for removal of directors of a Company. The Court held that the shareholders have a right to remove directors under Section 284 of the Act, which provides a machinery for enforcement of the right and Civil Court has no jurisdiction to entertain a suit for removal of directors.

To remove a director under Section 284 of the Act, certain essential requirements are to be followed. A special notice shall be required of the intention to move any resolution for the removal of a director or to appoint some other person in his place [Section 284 (2)]. On receipt of the notice the company shall forthwith send a copy of the same to the director concerned and the director concerned (whether or not he is a member of the company), shall be entitled to be heard on the resolution at the meeting [Section 284(3)]. Where no special notice of resolution to remove the directors in question was given, the resolution passed in extraordinary general meeting removing the directors was held to be invalid [*Bhankerpur Beverages (P.) Ltd. v. Sarabhjit Singh* (1996) 86 Comp. Cas. 842 (P&H)]. Non-compliance of these requirements would render the resolution passed in the general meeting invalid.

Where the directors attempted to avoid their removal by omitting to call a meeting or by not attending with a view to creating a situation of "no quorum", the court [in India the Company Law Board] will convene the necessary meeting under Section 186, [See *Re, El Sombrero Ltd.*, (1958) 3 All ER 1].

In *Major General Shanta Shamsher v. Kamani Brothers*, AIR 1959 Bom 201: (1959) 29 Com Cases 501, the appointment of a managing or other director was revoked by the Board of directors and Section 284 would not be attracted in the case. Hence, there is no scope in this case of applying Section 284 when the director was not to be disturbed from his office as a director and the business proposed to be transacted related only to the removal from his managerial position. He could not question the meeting on that ground, nor any other person could do so on that cause.

The company must give intimation to the concerned director of the resolution of his removal by sending a copy of special notice received by it forthwith on receipt thereof. The director shall have the right to be heard on the resolution at the meeting [Section 284(3)]. The director who is sought to be removed, can make a representation in writing against his removal and request the company to notify it to the company's members. The company is duty bound to do so, in the manner stipulated in Section 284(4)(a) and (b), unless it is received by it too late. If a copy of the representation is not sent to the members, as aforesaid because they were received too late or because of the company's default, the director may require that the representations shall be read out at the meeting.

The provisions of Section 173(2) as to the explanatory statement are not applicable in respect of the resolution for the removal, because the company is merely acting in pursuance of a special notice received by it to move the resolution, it

is not a resolution proposed by the company [*Life Insurance Corporation of India v. Escorts Ltd.* (1986) 59 Comp Cas 548 (SL)].

However, a copy of the representation need not be sent to the members and representations need not be read out at the meeting, if on the application either of the company or of the aggrieved party, the CLB is satisfied that the rights conferred by the sub-section are being abused to secure needless publicity for defamatory matter.

The company shall in its general meeting discuss the proposal and pass the necessary resolution.

A vacancy caused by such removal may be filled at the same meeting provided special notice of the proposed appointment has also been given. The director so appointed shall hold office till the removed director could have held office had he not been removed. If the vacancy is not filled in, at the meeting, it may be filled in by the Board as a casual vacancy. However, the director, who has been removed shall not be appointed.

Section 284, however, does not deprive a person removed thereunder of any compensation or damage payable to him in respect of the termination of his appointment as director or of any appointment terminating with that as director.

The Company Secretary shall also take steps to record the necessary particulars obtained from the person concerned in the relevant registers and also advise the new director to take qualification shares, if required. Section 284 is also not attracted when *en bloc* replacement of all the directors is sought under Section 402 as a part of the relief against oppression and mismanagement [*Shoe Specialities Ltd. v. Standard Distilleries and Breweries P. Ltd.* (1997) 1 Comp. LJ 243: (1997) 90 Com Cases 1 at 36 (Mad-DB)].

Section 284 is attracted only where some charges against an individual director are made and the company seeks removal of that director.

In *Ravi Prakash Singh v. Venus Sugar Ltd. & Ors.* [(2007) 140 Comp Cas 823 (Delhi)], a public limited company was incorporated for setting up a project for the manufacture of white crystal sugar. The director was a part of the company's management according to the prospectus of the company. Disputes having arisen between the director and the management, a letter was issued to him informing that his nomination as director by the co-promoter was withdrawn and he would cease to be a director with effect from June 29, 1993. A resolution was passed thereafter on June 29, 1993, whereby the director was removed from the board of directors. In a suit for declaration and permanent injunction the director challenged his removal. Dismissing the suit it was held that the articles of association of a company are in the nature of an agreement between the shareholders who are the joint owners of the company. If some specific methodology is devised by consent, nothing precludes the members or shareholders from doing so. Admittedly, the director was liable to retire by rotation. According to article 112(h) of the Articles of Association both the company and the co-promoters had the right to remove or withdraw their nominees from the board of directors and to provide substitutes. In furtherance of the power, the co-promoters had exercised their rights and issued the letter dated June 11, 1993, seeking to withdraw his nomination as director of the co-promoters of the company. Such nomination was not in the realm of nomination by the Central Government under section 408 of the Companies Act, 1956, and the exception to

section 284 of the Act would also be attracted where there was such provision in the articles of association of the company. Therefore, the removal of the director from the board of directors was proper.

(b) Removal of directors by the Central Government

Chapter IVA of the Act comprising Section 388B to 388E contains provisions regarding power of the Central Government to remove managerial personnel of a Company from office on the recommendation of the Company Law Board. The Central Government may state a case against the person and refer the same to the Company Law Board with the request that Company Law Board may inquire into the case and record the decision as to whether or not such person is a fit and proper person to hold the office of director or other management office. The Central Government may make such a reference to the Company Law Board where it is of the opinion that there are circumstances suggesting:

- (a) that any person concerned in the conduct and management of the affairs of company is or has been in connection therewith guilty of fraud, misfeasance persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or
- (b) that the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or
- (c) that a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or
- (d) that the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

Formation of the opinion by the Central Government as stated above is subjective process and cannot be questioned ordinarily [*Alok Prakash Jain v. Union of India* (1973) 43 Comp Case 68]. However, if the *bona fides* of the Government are challenged and if the Government is called upon to explain, such materials must be disclosed to the Company Law Board.

The person against whom the case is presented under this section is joined as a respondent to the application. The application shall contain a concise statement of circumstances and materials as the Central Government may consider necessary for the purpose of the inquiry. The application shall be signed and verified in the manner as laid down in the Code of Civil Procedure, 1908 for signing and verification of the plaint in a suit by the Central Government. The Company Law Board may at any stage allow amendments to such application presented by the Central Government. The Company Law Board may by interim order direct that the respondent shall not discharge any duty of his office until the further order of the Company Law Board and appoint suitable person in place of the respondent to discharge the duties of the

office held by the respondent, subject to such terms and conditions as the Board may specify in the order. Every such person is treated as a public servant within the meaning of Section 21 of the Indian Penal Code (Section 388C).

At the conclusion of the hearing of the case, the Company Law Board shall refer its decision stating specifically whether or not the respondent director is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company. After such an order is made under Section 388D, the Central Government shall, by an order, remove the respondent from the office. The person against whom an order is made becomes disqualified from holding the office of director or any other office connected with the conduct and management of the affairs of the company for five years from the date of the order of removal. Further, the Central Government may, with the previous concurrence of the Company Law Board, permit such person to hold office before the expiry of such period of five years.

The removed director shall not be entitled to or be paid any compensation for the loss or termination of office. The company with the previous approval of the Central Government appoint another person in place of the respondent who has been removed.

In *Maruti Udyog Ltd. v. R.C. Bhargava* [1998] 17 SCL 269, the CLB, Principal Bench New Delhi dismissed the petition under Section 388B as the reference was made by the Central Government after 5 to 13 years of occurrences of matters. The Bench held that no period of limitation exists for making a reference to CLB but gross and inordinate delay in the absence of justifiable ground to making of the reference renders it liable to be dismissed.

(c) Removal by Company Law Board

Where on an application to the Company Law Board for prevention of oppression under Section 397 and mismanagement under Section 398 of the Act, the CLB finds that the relief ought to be granted, it may by order, terminate or set aside any agreement of the company with a director or managing director or other personnel on such terms and conditions as it may think just and equitable. The Court may constitute an advisory board for proper management of the company. It can appoint a special officer or Administrator. [*Richardson and Cruddas Ltd. v. Haridas Mundra* AIR 1959 Cal. 695.]

Where the appointment of the director is so terminated or set aside, he cannot, except with leave of the Company Law Board, serve any company in a management capacity for a period of five years. He also cannot sue the company for damages or compensation for loss of office.

It was held in *Bennett Coleman & Co. Ltd. v. Union of India* (1977) 47 Comp Cas 92 (Bom) that the Court dealing with an application under Section 397 or 398 has the power to reconstitute the Board of the company concerned. In such an event the directors of the company would cease to be the directors.

11. RETIREMENT OF DIRECTORS

A director ceases to hold office if he retires by rotation at an annual general

meeting unless he offers himself for re-election and get re-elected at the same meeting. Special circumstances may justify continuation of directors who would have retired by rotation if a meeting was held. *Ambika Tea Co. Ltd. v. Manjushree Shah* (1988) Cal. LT 61 was cited in *Incab Industries Ltd. Re.* (1996) 4 Comp. LJ 482 at 484 (CLB) as an authority for the proposition that the directors to retire by rotation can continue as directors as there cannot be a vacuum in the Board of directors.

12. RESIGNATION OF DIRECTORS

The Companies Act does not make express provision for the resignation of a director. A director may resign his office in the manner provided by the articles. If the articles contain no provision regarding the resignation by a director, he may resign his office at any time by giving reasonable notice to the company, no matter whether the company accepts it or not [*Abdul Hug v. Katpadi Industries Ltd. A.I.R. 1960 Mad. 482*].

Thus, in the absence of any provision in the articles, resignation once made will take effect immediately when the intention to resign is made clear. In such a case the resignation tendered by a director unequivocally in writing will take effect from the time when such resignation is tendered.

In *Dushyant D. Anjaria v. Wall Street Finance Ltd.* (2001) Comp. Cas. 655 (Bom.), the Bombay High Court had held that the resignation of a Director would be effective from the date it was submitted because the letter brings out clearly his intentions to resign. However, if there was delay on the part of the company in intimating the ROC about the date of the resignation, the resigning Director could not be saddled with the responsibility and the liability for such delay. Prior to this in *Glossop v. Glossop* (1907) Ch. D. 370, it was held that the resignation of a director would become effective on and from the date it was tendered and from the Articles of Association of the Company, it would be clear that resignation of a Director would be effective from the date it was tendered.

The Chairman and Managing Director of a company resigned on 6.5.1996 as such but the company filed Form No. 32 to ROC stating the date of resignation as 15.3.97. The company, issued various cheques to its investors in repayment of their deposits after 6.5.1996, which were dishonoured. The investor filed a complaint against the former Managing Director. The High Court noted that the Articles of Association of the company provided that the resignation would be effective from the date it was tendered. The Court held that the Respondent had resigned on 6.5.1996 and shall not be responsible for any liability in connection with the cheques issued by the Company after the date of his resignation. [*Pandurang Camotim Sancoaltar v. Suresh Prabhakar Prabhu* (2003) 53 CLA 265].

A question arose that whether a resigning director is also liable to file Form No. 32 to ROC to inform him through notice that he has resigned as such. It was held that the director is not liable and the company secretary of the company is liable to file Form No. 32 and to give notice to ROC [*Saumil Dilip Mehta v. State of Maharashtra* (2003) 113 Comp. Cas. 443 (Guj.)].

In V. Thangavel v. Associated Business Credits Ltd & Ors. [(2006) 71 CLA 250 (CLB)] [Decided on 12.9.2005], the applicant was one of the directors of the respondent company and had resigned from the office. No Form 32 was filed. Subsequently the company was ordered to be wound up and came under the Official Liquidator. The petitioner filed a petition before the CLB seeking directions that the company should be directed to file the required Form No. 32. Petition was allowed by directing OL to file the form no. 32.

It was explained that a company has a statutory duty in terms of Section 303(2) to file with the Registrar of Companies a return in Form No. 32 with respect to any change among its Directors. Where the company had been ordered to be wound up, this statutory duty would fall upon the official liquidator, who would fulfil it with the leave of the winding up court as, in such cases, provisions of Section 446(1) were attracted. Accordingly petition was disposed of.

In N. Balasubramanian v. M/S Vegab Communications Pvt. Ltd. & Ors. [CLB] C.P. NO. 877/614(1)/SRB/2005 [Decided on 6.6.2006], the petitioner was the first director of the respondent company. He resigned from the board on 20.2.1995 and sent his resignation letter to the company. The company failed to file Form 32 with the ROC intimating the change in directorship of the company. Meanwhile, the ROC initiated prosecution proceedings against the company and directors including the petitioner on 1.7.2005. The petitioner approached the CLB seeking directions to the company to file the Form 32.

The Petition was dismissed. Bench viewed that the petitioner had reportedly resigned from the office of director of the Company with effect from 20.2.1995, but approached the CLB invoking the provisions of Section 614 after a delay of more than a decade. Though, the provisions of Section 614 did not specify any time limit to make an application before the Company Law Board so as to direct the company and any officer to make good the default in making the return, yet the petitioner was duty bound to explain the long delay in initiating the present proceedings. The belated action of the petitioner, pursuant to the show cause notice dated 1.7.2005 issued by the ROC, was not sufficient to exercise the powers vested in Section 614. In the absence of any justifiable ground, the company petition was dismissed on account of laches on the part of the petitioner, in due enforcement of his right under Section 614 and in the light of the reports of the ROC.

On the question whether the articles of a public company can validly contain a provision to the effect that the office of a director shall be vacated if he resigns by notice in writing, the Patna High Court has held that in view of the provisions contained in Section 283 of the Act, a public company cannot include in its articles a provision for resignation as an additional ground for vacation of office of a director. Rejecting the contention that it is an inherent/absolute right of any person to tender resignation and he cannot be compelled against his wishes to continue to function in the office for a day longer than he desires, the learned judge has held that vacation of office of a director by resignation cannot be a ground to be included in the articles of a public company [*The Registrar of Companies v. Bihar Investment Trust Ltd.* (1978) 48 Comp Cas 579 (Pat)].

In the case of *T. Murari v. State of Madras* (1976) 46 Comp. Case 613, it has

been held that the resignation of a director is irrevocable. The director who has tendered resignation cannot withdraw it. However, he may do so with the consent of the general meeting. The resignation of a director may even be oral (*Latchford Premier Cinema Ltd. v. Ennion and Paterson* 1931 2 Ch. 409). It was held that even the resignation tendered orally at a general meeting and accepted at the meeting, was effective.

A notice of resignation sent by a third party is not a valid letter of resignation [*Registrar of Companies, Orissa v. Orissa Paper Products Ltd.*, (1988) 63 Com Cases 460.]

Where out of the two directors one died and the other wanted to resign, it was held that a letter of resignation left at the office of the company under intimation to ROC was enough to make the resignation effective and it was not necessary that the surviving director should first co-opt a director in the exercise of power of co-option under the articles [*S.S. Lakshamana Pillai v. ROC*, (1977) 47 Com Cases 652 (Mad)]. Resignation will not however, relieve him of any liability, which he may incur while in office.

Where a director started a competing business and requested the company by means of a letter stating his desire to be treated as a sleeping partner and the other directors, accepted it and relieved him from directorship. It was held that they could not be liable for misreading the letter, as they understood the letter to be a resignation [*Fateh Chand Kad v. Hindsons (Patiala) Ltd.*, (1957) 27 Com Cases].

A managing or whole-time director, however, cannot resign merely by giving a notice. His resignation is governed by the terms and conditions of his appointment. In this case, a formal acceptance of the resignation is essential so as to make it effective for he has to be relieved of his duties and obligations [*Achutta Pai v. Registrar of Companies*, (1966) 36 Comp. Cas 598 Ker].

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

If there was a delay on the part of the company in intimating the Registrar of Companies (ROC) about the date of the resignation, the resigning director will be responsible for such delay.

- True
- False

Correct Answer: False

If there were a delay on the part of the company in intimating the ROC about the date of the resignation, the resigning director would not be responsible for such delay.

13. PENALTY FOR WRONGFUL WITHHOLDING OF COMPANY’S PROPERTY

No managing director, whole time director or any employee of the company can refuse to vacate the company’s accommodation after he has vacated the office.

Section 630 of the Companies Act, 1956 provides penalty for wrongful withholding of the company's accommodation which is given to him for the personal use only till such time he continues to be the director or in the employment of the company.

Section 630(1) of the Companies Act provides that if any officer or employee of a company:

- (a) wrongfully obtains possession of any property of a company; or
- (b) having any such property in his possession, wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the articles and authorised by this Act;

he shall, on the complaint of the company or any creditor or contributory thereof, be punishable with fine which may extend to ten thousand rupees.

The Court trying the offence may also order such officer or employee to deliver up or refund, within a time to be fixed by the Court, any such property wrongfully obtained or wrongfully withheld or knowingly misapplied, or in default, to suffer imprisonment for a term which may extend upto two years [Section 630(2)].

In Krishna Avtar Bahadur v. Col. Irwin Extross and others (1986) 59 Comp. Cas. 417, the Court held that the flat which was occupied by the officer during the terms of his employment with the company belonged to the company and the officer was entitled to occupy it only during the term of his employment with the company. After the termination of his service he could not claim to continue to occupy the premises on the ground that he was a tenant thereof.

In Govind T. Jagtiani v. Sirajuddin S. Kazi and another (1984) 56 Comp. Cas. 329, the Bombay High Court held that the provision of Section 630 of the Act, apply not merely to the existing officers and employees but also to ex-employees and ex-officers. The Court held that the entitlement of an officer to the property of the company is contingent on the right and capacity of the officer by virtue of his employment which is transformed into the actual possession of the property and the duration of such right would be co-terminus with the terms of employment. If the property is held back the retained possession would amount to wrongful withholding of the property of the company.

The Calcutta High Court in the case of *Amrit Lal Chum v. Devi Ranjan Jha* (1987) 61 Comp. Cas. 211 deciding a similar issue has given an altogether different decision and held that Section 630 applied only to serving officers and employees of a company. Clause (b) of Sub-section (1) of Section 630 reads as "having any such property in his possession wrongfully withheld it or knowingly applies it to purpose other than expressed or directed in the articles and authorised by this Act. "The articles and authorised by this Act" are most likely to be known by the employees of the company. It is necessary to confine the application of this clause of existing officers and employees of the company. The reference in Sub-section (2) of Section 630 is also to "such officers and employee of the company". The order of delivering up or refund can be passed only on an officer or employee of the company. That is possible when the accused is an officer of the company on the date of mandamus. If

the accused is not such an officer or employee such order or refund cannot be passed on him. When it is not possible to secure compliance with the direction the Court is expected to order for imprisonment in default of compliance. This suggests that the provisions of the section are restricted in their operation against existing officers and employees of the company over whom the company has some hold or authority.

But the Supreme Court has in the case of *Baldev Krishna Sahi v. Shipping Corporation of India* (1987) AIR 1987 SC 2245 while deciding the applicability of Section 630 overruled the above decision and held that the term 'officer or employee of a company applied not only to existing officers or employees of a company but also to 'past officers or employees' of the company. The court held that the Section is in two parts. It creates two distinct and separate offences. First of these is the one contemplated by clause (a), namely, where an officer or employee of a company wrongfully obtains possession of any property of the company during the course of his employment to which he is not entitled. Normally, it is only the present officers and employee who can secure possession of any property of a company. It is also possible for such officer or employee after termination of his employment to wrongfully take away possession of any such property. Although it primarily refers to the existing officers and employees, it may also take in past officers and employees.

In contrast clause (b) contemplates a case where an officer or employee wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the articles and authorised by the Act. It may well be that an officer or employee may have lawfully obtained possession of any such property during the course of his employment but wrongfully withholds it after the termination of his employment. That appears to be one of the functions of clause (b). Clause (b) also make it an offence if any officer or employee of a company having any property of the company in his possession knowingly applies it to purpose other than those expressed or directed in the article and authorised by the Act. That would primarily apply to the present officers and employees and may also include past officers and employees. There is, therefore, not warrant to give a restrictive meaning to the term 'officer or employee' appearing in Sub-section (1). It is evident that clauses (a) and (b) are separated by the word 'or' and, thereof, are clearly disjunctive.

In the case of *Dr. S.K. Ghosh Alias Dr. S.N. Gupta v. Siemens India Ltd.* (1990), the Bombay High Court has held that the retirement benefits of an employee cannot be withheld by a company on the employee's failure to surrender possession of the flat allotted to him. The Court observed that pension being the incidence of service which an employee earns after a life long service rendered by the employee, this right cannot be frittered as the very livelihood of the employee depends upon receiving his retirement benefits.

In *Arun Kumar Dass v. State* (1990) 68 Com. Cas. 482, the Calcutta High Court held that the offence of the wrongfully withholding the property of the company is a continuing offence and it continues so long as the property is withheld. This view was also taken by the Supreme Court in the case of *State of Bihar v. Deokaran Nenshi*, wherein it held that a continuing offence was one on which was susceptible of

continuance and was distinguishable from one which was committed once and for all. Section 630(1)(b) of the Act provides that if any officer or employee of the company having any property of the company in his possession wrongfully withholds it, he shall on the complaint of the company or any other person specified therein, be punishable with fine extending up to Rs. 10,000. Clearly therefore, the offence consists of wrongfully withholding property of the company and necessarily the offence must continue so long as the property is so withheld.

Subsequently in *Gokak Patil Volkart Ltd. v. Dundayya Gurushiddaiah Hiremath* (1991) 71 Com Cases 403 (SC), the Supreme Court held that the offence under this section is a continuing one. The Court observed that it is not an instantaneous offence and limitation beings with the cessation of the criminal act i.e. with the delivering up or refund of the property.

However, recently, in the case of *Chandrasingh Jaisingh Mahida v. State of Gujarat & Anr.* [(2008) 146 Comp Cas 69(Guj.)], it was held that though refusal to vacate the company's quarters constitute a continuing offence, the fact that the offence was a continuing one would come to the aid of the company for the purpose of overcoming the bar of limitation under section 468(2)(a) of the Code of Criminal Procedure, 1973, but could not come to the aid of the company while considering the bar under section 300 of the Code in as much as when on the same set of facts and for the same offence, the petitioner had already been acquitted after trial, he could not be tried again for the same offence for a subsequent period.

The object of Section 630 of the Companies Act, 1956 has been set forth by the Supreme Court in *Smt. Abilash Vlnod Kumar Jain v. Cox & Kings (India) Ltd.*, (1995) 17 CLA 90, stating that the provisions of Section 630 were designed to protect the property of a company and to prevent its officers or employees from wrongfully obtaining or keeping such property. The provisions of the section were quasi criminal in nature and had been enacted with the object of providing speedy relief to a company when its property was wrongfully obtained or wrongfully withheld by an employee or officer or any one claiming under them.

In *Gopika Chandrabhushan Saran & Anr. v. XLO India Ltd. & Anr.* [(2009) 148 Comp Cas 130 (SC)], the appellants are the legal heirs of the deceased managing director of the company. The company allotted the house to its managing director and he since died, demanded the house from the appellants. After contending before various lower courts the issue ultimately came before the Supreme Court. Dismissing the appeal of the legal heirs of MD, the Court held that, Section 630 of the Act will cover within its ambit not only the employee or officer but also the past employee or the past officer or the heirs of the deceased employee or anyone claiming under them in possession of the property. The legal heirs or representatives in possession of the property acquire the right of occupancy in the property of the company, by virtue of being family members of the employee or officer during the employment of the employee or the officer and not on any independent account. They, therefore, derive their colours and content from the employee or the officer only and have no independent or personal right to hold on to the property of the company.

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

Section 630 applies to the existing officers and employees of a company but not to ex-employees and ex-officers.

- True
- False

Correct Answer: False

Section 630 applies not merely to the existing officers and employees of a company but also to ex-employees and ex-officers.

14. VACATION OF OFFICE OF DIRECTORS

Section 283 of the Companies Act, provides that the office of a director shall become vacant, if—

- (a) he fails to obtain within two months from the date of his appointment or ceases to hold at any time thereafter, the share qualification, if any required of him by the articles of the company;
- (b) he is found to be unsound mind by a Court of competent jurisdiction;
- (c) he applies to be adjudicated an insolvent;
- (d) he is adjudged an insolvent
- (e) he is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months;
- (f) he fails to pay any call in respect of shares of the company held by him, whether along or jointly with other within six months, from the last date fixed for the payment of the call unless the Central Government has, by notification in the Official Gazette removed the disqualification incurred by such failure;
- (g) he absents himself from three consecutive meeting of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board. Where there was no proof that notices of Board meetings were served on directors, directors could not be removed on ground that they abstained from attending meetings [*Vijay Krishna Jaidka v. Jaidka Motor Co. Ltd.* [1996] 10 SCL 244 (CLB-Delhi)].
- (h) He (whether by himself or by any person for his benefit or on his account) or any firm in which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee security for a loan from the company in contravention of Section 295;
- (i) He fails to disclose to the Board his interest in any contract or arrangement entered into by the company as required by Section 299;
- (j) He becomes disqualified by an order of the Court under Section 203 which restrains fraudulent persons from managing companies.

(k) He is removed in pursuance of Section 284.

(l) He becomes director by virtue of an office or employment in the company, on ceasing to hold that office or employment.

In the case of (d), (e) and (J) above, the disqualification referred to in these clauses shall not take effect for thirty days from the date of adjudication, sentence or order or if an appeal or petition is preferred within the thirty days aforesaid against the adjudication, sentence or conviction result in the sentence or order until the expiry of seven days from the date on which such appeal or petition is disposed of. In case, within the seven days aforesaid, any further appeal or petition preferred in respect of the adjudication, sentence, conviction, or order and the appeal or petition if allowed, would, result in the removal of the disqualification, then the person shall remain a director until such further appeal or petition is disposed of.

In *Fateh Chand Kad v. Hindsons (Patiala) Ltd.* (1986) 3 Comp L J 234 (MP) ; it was held that when the law provides that a director shall vacate office on the happening of some event the director automatically vacates his office on the happening of that event, the Board has no power to waive that event.

A private company which is not a subsidiary of a public company may by its articles provide additional grounds for vacation of office of director. A public company cannot, however, add to the disqualifications mentioned in Section 283 of the Act. [*Cricket Club of India Ltd. v. Madhav L. Apte* (1975) 45 Comp. Cas. 574].

In Clause (g) above the words absent himself imply voluntary or deliberate absence and do not cover cases of involuntary absence such as caused by illness etc. or due to causes beyond his control.

It should be noted that the disqualifications leading to the vacation of office of a director as mentioned in Section 283 are the statutory disqualifications and no director and no company is immune from them. The articles of any company cannot detract from the provisions of this section [*Somesh Chander Manilal Nanavati v. Jivanlal C Chinai* (1956) 26 Comp Cas 148]. This is true irrespective of whether the company is a private company or a public company [*Coal Products P.Ltd. v. Ram Avtar Jatan* (1969) 39 Comp Cas 223].

In *K. Radha Krishan v. Thirumani Asphalts & Flats (P) Ltd.*, (1998) 28 CLA 396 (Mad), the petitioner, who was a director of the company was removed from his office by the respondent company for the reason of absenting himself consecutively from three Board's meetings. The question before the Court was whether company court has power to give a declaration that he continued as director. It was held that Section 283 only sets out the circumstances on the occurrence of which the office of the director shall become vacant. The section does not contemplate any application being made to the company Court either to declare that the office has been vacated or continued. The company court cannot, therefore, entertain a petition to declare that the petitioner continues to be a director and that he has not vacated the office.

Further, Section 209A which provides for the inspection of books of accounts etc. of companies also contain provisions for vacation of the office of the director. As per

Sub-section (9) of the said section, if any director is convicted of any offence under this section, he shall be deemed to have vacated his office from the date of his conviction.

Where a person who is deemed to have vacated the office of director held by him by virtue of Section 283 of the Act continues to function as a director, he is liable to be punished with fine which may extend to Rs. 5000 for each day on which he functions as a director.

In the case of *Marble City Hospital And Research Centre P. Ltd. V. Sarabjeet Singh Mokha [2010] 155 Comp Cas 13 (MP)*, a director of a company was informed by a notice that he had ceased to be a director in terms of section 283(1) (g) of the Act. The director filed a petition alleging oppression on the grounds that no notices of meetings were served on him and in reply to the petition the company disclosed that by issue of further shares the respondent's shareholding had been reduced. The director challenged the allotment of the shares on the grounds that it was oppressive to him.

It was held by the Court that mere filing of postal certificates would not give rise to a presumption of service of notices. There was no evidence regarding posting of the letter or documenting its posting or affixing adequate stamps. The onus of proving the fact that the notices were sent was on the company and it had failed to discharge this onus. Therefore, the sending of notices for the five board meetings and its service on the director, who was one of the founder directors of the company, was not proved. Also, the allotment of shares had been made without proper notice to the director. Therefore, the removal of the director was not valid.

15. REMUNERATION OF DIRECTORS

Directors are not the servants of the company and in the absence of a specific agreement, are not entitled to remuneration for their services. Lindley L.J. in *Re. George Newman and Co. (1895) 1 Ch. 674*, observed: "Directors have no right to be paid for their services, and cannot pay themselves or each other, or make presents to themselves out of the company's assets, unless authorised so to do by the instrument which regulates the company (i.e. the articles) or by the shareholders at a properly convened meeting". In short, directors are not entitled to payment in the absence of express provisions.

The remuneration paid to directors is subject to the provisions of Section 198, 309 and Schedule XIII of the Companies Act.

The term managerial remuneration has not been defined in the Act. A reference to Sections 198, 309 to 311 and 387 suggests that directors of the company and manager, if any, constitute managerial personnel and naturally includes a managing director or a whole time director and they are entitled to receive managerial remuneration. Even a person carrying administrative designation of manager like general manager as an executive will not be included as a managerial personnel.

Meaning of Managerial Remuneration - To remunerate means to pay, recompensate, or reward for work, etc. Managerial remuneration may take the form

of monthly payments, say, salary or a specified percentage of net profits or a commission and/or by way of a fee for each meeting of the Board (called sitting fee) Besides, as per Explanation of Section 198(4), the expression 'remuneration' shall also include:

- (a) any expenditure incurred by the company in providing any rent free accommodation, or any other benefit or amenity in respect of accommodation free of charge, to any of its directors or manager;
- (b) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the persons aforesaid;
- (c) any expenditure incurred by the company in respect of any obligation or service, which, but for such expenditure by the company, would have been incurred by any of the persons aforesaid; and
- (d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for any of the persons aforesaid or his spouse or child.

Again, payment received by a director for holding an office or place of profit under the company is not managerial remuneration. This has been made clear by the specific provision of Sub-section (1) of Section 309.

Section 198(1) lays down 11% of the net profits as the overall ceiling on the total managerial remuneration payable by a public company or a private company, which is a subsidiary of a public company, to its directors (which means all directors including managing and whole-time directors) and manager. Section 309(1) provides that the remuneration payable to the directors of a company, including any managing or whole-time director shall be determined in accordance with and subject to the provisions of Section 198 and this section either by the articles of the company or by a resolution or, if the articles so require by a special resolution passed by the company in general meeting and the remuneration payable to any such director determined as aforesaid shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity.

According to Sub-section (3) of Section 309, a director which is either in the whole time employment of the company or a managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other.

However, except with the approval of the Central Government such remuneration shall not exceed five per cent of the net profits for one such director, and if there is more than one such director, ten per cent for all of them together.

Therefore, remuneration payable to managing director, whole time director and manager who are in the whole time employment of the company shall not exceed five per cent of the net profits for one such director, and if there is more than one such director, ten per cent for all of them together.

Remuneration to Non-Executive Directors

Section 309(4) provides that a director who is neither in the whole-time employment of the company nor a managing director may be paid remuneration

either:

- (a) by way of a monthly, quarterly or annual payment with the approval of the Central Government; or
- (b) by way of commission, if the company by special resolution authorises such payment.

Provided that in either case, the remuneration paid to such director, or where there are more than one such directors, to all of them together shall not exceed:

- (i) one per cent of the net profits of the company, if the company has managing or whole-time director or manager;
- (ii) three per cent of the net profits of the company in any other case.

The company in general meeting may, by a special resolution and with the approval of the Central Government, authorise the payment of commission at a rate higher than one per cent or, three per cent of its net profits as the case may be. The special resolution by which payment is sanctioned will remain in operation for not more than five years, but may be renewed for five years term from time to time provided the renewal is made in the last year of the previous term. However, the approval of Central Government will be necessary for payment of any remuneration to non-executive directors in terms of Section 310.

A company shall not require approval of the Central Government for making payment of remuneration by way of commission to its Non-whole time Director(s) in addition to the sitting fee if the total commission to be paid to all those Non-whole time Directors does not exceed 1% of the net profit of the company if it has a whole time director(s) or 3% of the net profit of the Company if it does not have a Managing Director or Whole-time director(s).

Sitting Fee

A director may receive remuneration by way of a fee for each meeting of the Board, or a committee thereof attended by him [Section 309(2)]. This is known as sitting fee. Sitting fee is not taken into account for computing the overall managerial remuneration under Section 198.

According to Section 310, sitting fee shall not exceed such amount as may be prescribed by the Central Government (presently, twenty thousand rupees – vide Rule 10B of General Rules & Forms). Companies will have discretion to pay such amount by way of sitting fee as may be considered appropriate within this revised ceiling of Rs. 20,000 as under:

Eligibility for Payment of Sitting Fees

(i)	Companies having a paid up capital and free reserves of Rs. 10 crores and above	Upto Rs. 20,000/- per meeting.
(ii)	Companies having a turnover of Rs. 50 crores and above.	Upto Rs. 20,000/- per meeting.
(iii)	Other companies.	Upto Rs. 10,000/- per meeting.

[Notification No. GSR 580(E) dated 24.07.03].

Guarantee Commission – whether remuneration - Guarantee commission received by the director is for personal liability which the director undertakes. Therefore, guarantee commission is not remuneration within the meaning of Section 309 – *Suessen Textile Bearings Ltd v. Union of India* [1984] 55 Comp. Cas 492 (Delhi).

Sitting fee and travelling expenses for attending Board meeting [Sub-section (2)]

Where the articles contain a provision identical with Article 65 of Table A in Schedule I to the Act, the directors may be paid travelling, hotel or other expenses incurred by them in attending meetings of the Board or any Committee thereof or general meetings of the company or in connection with the business of the company.

Expenses on travelling are generally reimbursed and any excessive unreasonable payment may make the directors liable for breach of fiduciary duty. In the absence of such an article in the articles of association of a company, travelling expenses cannot be paid [*Young v. Naval Military and Civil Services Co-op Society of South Africa* (1905) 1 KB 687]. Expenses may even be authorised by the company in general meeting.

As seen earlier, Section 309(2) of the Companies Act provides that a director may receive remuneration by way of fee for each meeting of the Board of directors or for a Committee thereof attended by him. The emphasis in this regard is on 'attending' the meeting and not on the 'actual holding' of the meeting. If the meeting of the Board could not be held for want of quorum or for any other reason not within the control of the director concerned, that does not mean that the director did not attend the meeting.

In view of the above, sitting fees, travelling allowances, etc., are payable to a director who was present at the meeting of the Board with a view to participating in its proceedings though no business could be transacted at that meeting for want of quorum. (Circular No 1 of 1972 dated 2-2-1972).

On the question whether the condition restricting travelling and daily allowances which may be paid to the directors of the company for performing journeys on the business of the company, to the limits laid down in rule 6D of the Income Tax Rules, should be imposed, the Department of Company Affairs has clarified that having regard to the various practical difficulties faced by the companies in complying with the aforesaid condition, no such condition need be imposed. It has, however, been advised to ensure that the payment is on the basis of actual expenditure and it should be kept to the minimum (Circular No. 5 of 1975 dated 1 February, 1975).

Meeting of two or more companies on same day and same premises

Whether a director attending the Board meetings of two or three companies on the same day and in the same building was entitled to draw travelling allowance from all the companies or from one of them only.

It was clarified that since the travelling allowance should not be a source of profit, the director concerned should claim only as much as would cover his actual expenses and, if he so chooses, he may reimburse himself from each of the companies proportionately so that the total amount drawn by him from all the

companies put together does not exceed the expenses actually incurred by him. He may, however, draw the sitting fee from each of the companies in full (Company News & Notes, dated August 1, 1963).

Unauthorised Remuneration – Sub-section (5A) of Section 309, which was inserted by the Companies (Amendment) Act, 1960, provides that if any director draws or receives directly or indirectly by way of remuneration any sums in excess of the limits prescribed by that section or without prior sanction of the Central Government where it is required he shall refund such sums to the company and until such sums is refunded, hold it in trust for the company. This sub-section refers to remuneration received by a director directly or indirectly. Indirect remuneration can include remuneration paid to a director for any office held by him such as technical advisor.

Remuneration for non-managerial services of directors

Section 309, provides that subject to the general provisions of Section 198, the remuneration be determined by the Articles, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting. The remuneration so payable shall be inclusive of the remuneration payable for services rendered by a director in any other capacity except where:

- (a) the services are of a professional nature, and
- (b) in the opinion of the Central Government, the director possesses the requisite qualification for the practice of the profession.

Remuneration to Director in a Professional Capacity – While Sub-section (1) of Section 309 brings within its purview the remuneration payable to any director for services rendered by him in any capacity, its proviso excludes any remuneration for professional services rendered by a director provided the Central Government has expressed an opinion that the director possesses the requisite professional qualification. Exception under this proviso will be made only in respect of those directors who possess the requisite qualification for practising the profession in respect of which they render special services [Tenth Annual Report of the Department of Company Affairs for the year ended 31.3.66]. While a director is a medical man or an engineer or a legal advisor or a company secretary having the membership of the Institute of Company Secretaries of India or is a professionally qualified accountant being a member either of the Institute of Chartered Accountants or the Institute of Costs and Works Accountants, the remuneration received by him in such professional capacity will not be hit by the provisions of section 309 provided the Central Government is of the opinion that the director holds the position by virtue of which he can render services in his professional capacity. There is nothing in Section 309 of the Act which empowers the Central Government to put any restriction on the remuneration payable to him in respect of the professional services; the remuneration being excluded from managerial remuneration – [*Strip Consultants Ltd., v. Union of India* [1987] 61 Comp. Cas 784 (Delhi) and *Sree Gajanana Motor Transport Co. Ltd v. Union of India* [1992] 73 Comp. Cas 348 (Kar)].

Additional remuneration from subsidiary, when prohibited – Sub-section (6) of Section 309 specifies that no director of a company who is in receipt of any

commission from the company and who is either in the whole time employment of the company or a managing director shall be entitled to receive any commission or other remuneration from any subsidiary of such company.

The provisions of Sub-section (6), which prohibit a director from receiving any commission or other remuneration from the subsidiary of the company of which he is the director, are subject to a number of conditions to be fulfilled. *First*, the director concerned must be in receipt of commission from the holding company. *Secondly*, he should not be an ordinary director but should be either a managing or whole-time director. There is, therefore, no bar against an ordinary director receiving remuneration or commission both from the holding and subsidiary companies. The prohibition would also not apply to a manager if he is not a director. Where, however, the manager is a director and is in whole-time employment, then the prohibition may be attracted. Again, there is no bar against receiving commission or other remuneration from the subsidiary so long as remuneration other than by way of commission is received from the holding company. A person who is an executive and not a director in the holding company may receive both commission and other remuneration from the subsidiary in the capacity of manager or whole time director of the subsidiary. Similarly, an executive working in the subsidiary company may draw remuneration from the subsidiary and also from the holding company by way of both commission and other remuneration by working as a director in the holding company. Further, a director of the holding company can draw perquisites and remuneration in any form other than in the form of commission while at the same time drawing commission and other remuneration from the subsidiary company.

Applicability of the Provisions of Sections 309 and 198 to Private Companies

The provisions relating to managerial remuneration, as aforesaid shall not apply to a private company unless it is a subsidiary of a public company [Section 198(1) and Section 309(9)].

The Companies (Amendment) Act, 1988 introduced Schedule XIII under Sections 269 to replace the administrative guidelines in respect of managerial remuneration issued by the Central Government. Accordingly, it is now open to a public company or a private company which is subsidiary of a public company, to appoint its managerial personnel so long as the same is in accordance with the conditions laid down in Schedule XIII without seeking the prior approval of the Central Government.

Remuneration payable by companies having profits – Subject to the provisions of Sections 198 and 309, a company having earned profits in a financial year may pay any remuneration by way of salary, dearness allowance, perquisites, commission and other allowances, which shall not exceed 5 per cent of its net profits for one such managerial person, and if there is more than one such managerial persons 10 per cent for all of them together.

A person who is a managerial person in more than one company shall be able to draw remuneration from one or both the companies provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

Remuneration payable by companies having no profits or inadequate profits

– Where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and any other allowance, not exceeding the ceiling limits specified in Section II of Part II of Schedule XIII. The ceiling limits are calculated on the following scales:

<i>Where the effective capital of a company is</i>	<i>Monthly remuneration payable shall not exceed</i>		
	<i>Option A (Rs.)</i>	<i>Option B (Rs.)</i>	<i>Option C (Rs.)</i>
		<i>Not exceeding</i>	<i>Exceeding</i>
(i) less than Rs. 1 crore	75,000	1,50,000	1,50,000
(ii) Rs. 1 crore or more but less than Rs. 5 crores	1,00,000	2,00,000	2,00,000
(iii) Rs. 5 crores or more but less than Rs 25 crores	1,25,000	2,50,000	2,50,000
(iv) Rs. 25 crores or more but less than Rs 50 crores	1,50,000	3,00,000	3,00,000
(v) Rs. 50 crores or more but less than Rs 100 crores	1,75,000	3,50,000	3,50,000
(vi) Rs. 100 crores or more	2,00,000	4,00,000	4,00,000

The amendments notified to Schedule XIII w.e.f. 16th January, 2002, provided three options to the companies within which they could pay the remuneration to their managerial personnel. All, but with some riders. Each of the options prescribed have followed with few requirements to be complied with by the companies. Thus, if the company proposes to pay remuneration to its managerial personnel as per Option (A), they will have to comply with the requirements provided for Option A, similarly if it proposes to pay higher remuneration as per Option (B), then it shall comply all the requirements of Option (B).

However, if the company proposes to pay managerial remuneration to its personnel, which can be any amount higher than the amounts stated in Option (B), then it will have to comply with the requirements as stated and prescribed under Option (C).

To provide a clear cut understanding, while differentiating amongst them, we are providing herewith the requirements to be complied with under each of the three options provided.

CATEGORY I – General Companies

<i>Requirements</i>	<i>Option A</i>	<i>Option B</i>	<i>Option C</i>
1. Approval of remuneration by a Remuneration Committee	Yes	Yes	Yes
2. Before the appointment of the managerial personnel, the company has not defaulted for a continuous period of 30 days in the preceding financial year in the payment of its debts, public deposits, debentures or interest payable thereon.	No default	No default	No default
3. Period of appointment, not exceeding	—	3 years	3 years
4. Requirement of special resolution in general meeting	—	Required	Required
5. Notice to convene AGM to enclose a statement containing the following:			
(i) General Information of the Industry and Company	—	Yes	Yes
(ii) Information about the proposed appointee	—	Yes	Yes
(iii) Profitability details	—	Yes	Yes
(iv) Disclosures:			
(a) Information to shareholders about the remuneration	—	Yes	Yes
(b) Disclosures about “Corporate Governance”	—	Yes	Yes
6. Applicability of specified conditions in case of effective capital being negative	No	No	Yes
7. Prior approval of Central Government	No	No	Yes

Provided that the prior approval of the Central Government is obtained for payment of remuneration on the above scale if the company is a listed company or a subsidiary of a listed company.

Provided further that approval of Central Government is not required for a subsidiary of a listed company, if-

- (i) the Remuneration Committee and Board of Directors of the holding company give their consent for the amount of such remuneration of the applicant and for the said amount to be deemed remuneration by the holding company for the purpose of section 198 of the Companies Act, 1956 and;
- (ii) a special resolution has been passed at the general meeting of the company for payment of remuneration of the applicant and;
- (iii) the remuneration of the applicant is deemed to be remuneration paid by holding company and;

- (iv) all members of the subsidiary are bodies corporate :

Provided that a listed company or a subsidiary of a Listed company shall not require Central Government approval for the payment of remuneration to its managerial personnel, if the remuneration is fixed by Board of Industrial and Financial Reconstruction.

Provided that no approval of Central Government is required if the managerial person is not having any interest in the capital of the company or its holding company, directly or indirectly or through any other statutory structures and not having any direct or indirect interest or related to the directors or promoters of the company or its holding company at any time during last two years before or on the date of appointment and is having a graduate level qualification with expert and specialized knowledge in the field of his profession.

CATEGORY II – Special Economic Zones

The companies in Special Economic Zones, as specified by the Deptt. of Commerce from time to time, can pay a sum of Rs. 2,40,00,000 per annum or Rs. 20,00,000 per month to its managerial person, to be appointed under Section 209 of the Act, provided:

- (i) there is no public issue of shares or debentures by the company.
- (ii) these companies should not have committed any default in India in repayment of any of its debts, or public deposits, or debentures or interest payable thereon, for a continuous period of 30 days in any financial year.

Besides the aforesaid remuneration, managerial personnel of a company having no profits or having inadequate profits shall also be eligible to the following perquisites.

- (a) Contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961.
- (b) Gratuity payable at a rate not exceeding half a month's salary for each completed year of service, and
- (c) Encashment of leave at the end of the tenure.

In addition to these perquisites, an expatriate managerial person (including a non-resident Indian) shall also be eligible to the following perquisites:

- (i) Children's education allowance – In case of children studying in or outside India, an allowance limited to a maximum of Rs. 5,000 per month per child or actual expenses incurred whichever is less. Such allowance is admissible up to a maximum of two children.
- (ii) Holiday passage for children studying outside India/family staying abroad – Return holiday passage once in a year by economy class or once in two years by first class to children and to the member and to the members of the family from the place of their study or stay abroad to India if they are not residing in India with the managerial person.
- (iii) Leave travel concession – Return passage for self and family in accordance

with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Part III of the Schedule XIII provides that

1. The remuneration payable to a managerial personnel, as aforesaid, shall be subject to approval by a resolution of the shareholders in general meeting.
2. The auditor or the secretary of the company or when there is no secretary, then a secretary in whole-time practice shall certify that the requirements of Schedule XIII of the Act have been complied with and such certificate shall be incorporated in the return to be filed with the Registrar of Companies pursuant to Section 269(2).

Government companies exempted - The restrictions with regard to managerial remuneration contemplated under section 198 and 309 (including Schedule XIII) do not apply to Government Companies.

Meaning of effective capital – The expression “effective capital” for the purposes of Schedule XIII, means the aggregate of the paid up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long term loans and deposits repayable after one year (excluding working capital loans, overdraft, interest due on loans unless funded, bank guarantee etc., and other short term arrangements) as reduced by the aggregate of any investments (except in the case of investments by an investment company whose principal business is acquisition of shares, stock, debentures or other securities); accumulated losses and preliminary expenses not written off. However, when the appointment of the managerial person is made in the year in which the company was incorporated, the effective capital shall be calculated as on the date of appointment. In all other cases, it shall be calculated as on the last date of the financial year preceding the financial year in which the appointment is made.

Remuneration Committee – As is clear that w.e.f. 16th January 2002, appointment of all managerial persons is required to be approved through a resolution of the Remuneration Committee. Explanations IV and V have also been added to the Schedule XIII to the Act, by way of Notification No. GSR 36(E) dated 16th January, 2002, as under:

For the purposes of this section, "Remuneration Committee" means:-

- (i) In respect of a listed company, a committee which consists of atleast three non-executive independent directors including nominee director or nominee directors, if any; and
- (ii) in respect of any other company, a Remuneration Committee of Directors

Explanation V: The Remuneration Committee, while approving the remuneration shall:

- (a) take into account the financial position of the company, the trend in the industry, appointee's qualifications, experience, past performance, past remuneration, etc.

- (b) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and its shareholders.

Explanation VII : For the purpose of section II of this part, "Statutory Structure" means any entity which is entitled to hold shares in any company formed under any statute.

Increase in remuneration – Section 310 provides that any provision or an amendment thereof, either in the company's Memorandum or Articles or in an agreement entered into by the company or in any resolution of the shareholders or of the Board, which purports to increase or has the effect of increasing, whether directly or indirectly, the remuneration of any director, shall not have any effect (a) unless it is otherwise approved by the Central Government.

Thus, approval of the Central Government shall not be required if the fixation or the increase in remuneration is in accordance with the conditions specified in Schedule XIII. It may be noted that Schedule XIII does not specify any conditions for increase in remuneration. It simply specifies the limits within which salary, commission and other perquisites can be paid without Government approval.

Schedule XIII does, however, specify the conditions which must be fulfilled for making an appointment without Government approval. Clause (a) of Sub-section (1) of Section 310, therefore, in fact, means that in case an appointment or reappointment is made by fulfilling the conditions specified in Schedule XIII, read with Part III of that Schedule, approval of the Central Government will not be required, in so far as increase in remuneration is concerned.

As per clause 49 of the Listing Agreement, in case of every company, to which this clause is applicable the remuneration of non-executive directors shall be decided by the Board of directors. In terms of amended clause 49, the following information or particulars shall be disclosed in the Annual Report.

- (i) All pecuniary relationship or transactions of the non-executive director's *vis-à-vis* the company.
- (ii) Further the following disclosures on the remuneration of directors shall be made in the section on the Corporate Governance of the annual report:
 - All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
 - Details of fixed component and performance linked incentives, along with the performance criteria.
 - Service contracts, notice period, severance fees.
 - Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

16. OFFICE OR PLACE OF PROFIT

Section 314 of the Act, which contains regulatory provisions with regard to an office or place of profit to be held under a company by director and others was introduced by the Companies (Amendment) Act, 1960.

Sub-section (1) of Section 314 provides that except with the consent of the company accorded by a special resolution (a) no director of a company shall hold any office or place of profit, and (b) no partner or relative of such director, no firm in which such director, or a relative of such director, is a partner, no private company of which such director is a director or member, and no director or manager of such a private company can hold any office or place of profit carrying a total monthly remuneration of such sum as may be prescribed, except that of managing director, manager, banker or trustee for the debenture holders of the company—

- (i) under the company; or
- (ii) under any subsidiary of the company, unless the remuneration received from such subsidiary in respect of such office or place of profit is paid over to the company or its holding company.

The sum prescribed vide Sub-rule (1) of Rule 10C of Companies (Central Government's) General Rules and Forms 1956 is presently Rs. 10,000.

The first proviso to Sub-section (1) of Section 314 states that it shall be sufficient if the special resolution according the consent of the company is passed at the general meeting of the company held for the first time after the holding of such office or place profit.

It is further provided that in case a relative of a director or a firm in which such relative is a partner, is appointed to an office or place of profit under the company or subsidiary thereof without the knowledge of the director, the consent of the company may be obtained either in the general meeting aforesaid or within three months from the date of the appointment, whichever is later.

According to explanation to Sub-section (1) a special resolution shall be necessary for every subsequent appointment to such office or place of profit on a higher remuneration not covered by the special resolution, except where an appointment on a time scale has already been approved by the special resolution.

The provisions of Section 314(1) do not apply where a relative of a director or a firm in which such relative is a partner holds any office or place of profit under the company or a subsidiary thereof having been appointed to such office or place before such director becomes a director of the company.

The term relative has the meaning assigned to it under Section 6 of the Act. The Madras High Court, in *A.R. Sundaram v. The Madras Purasawalkam Hindu Janhopakara Aswatha Nidhi Ltd.* (1984) 1 Comp. L.J. 402 (Mad.) after analysing clauses (a) and (b) of Sub-section (1) of Section 314 held that the first proviso of Sub-section (1) deals with a case of a director holding any office or place or profit, while the second proviso deals with relative of such director. Thus, the second proviso has to be read in conjunction with Section 314(1)(b). If so read, it is amply clear that the prohibition under Section 314(1)(b) is restricted to a relative of such director meaning thereby the director holding any office or place of profit referred to under Section 314(1), but not any ordinary director. Therefore, according to this judgement, Section 314 is not attracted where an ordinary sitting director's (a director who does not hold any office or place of profit under the company) relative holds any office or place of profit as the relative is not a relative of such director who is holding office or place of profit under the company.

With due respect to the Hon'ble Court it may be stated that the above interpretation appears to be very restrictive.

Section 314(1B) provides that notwithstanding anything contained in Sub-section (1)—

- (a) no partner or relative of a director or manager;
- (b) no firm in which such director or manager, relative of either, is a partner;
- (c) no private company of which such a director or manager, or relative of either, is a director or member;

shall hold any office or place of profit in the company which carries a total monthly remuneration of such sum as may be prescribed except with the prior consent of the company by a special resolution. The sum prescribed vide sub-rule (2) of Rule 10C of Companies (Central Government) General Rules and Forms is presently Rs. 50,000. The prior approval of the Central Government shall be referred in case the said total monthly remuneration exceeds Rs. 2,50,000 p.m.

The object of Sub-section (1B) is to see that the moneys of the company are not siphoned into the pockets of the relatives of the directors without such persons being otherwise competent to fill the office or without rendering real services to the company [*Dalmia Cement (Bharat) Ltd. v. Union of India* (1980) 50 Comp Cas 18 (Del)].

In Ravinder Kumar Sangal v. Auto Lamps Ltd., (1984) 1 Comp. L.J. 59 (Delhi), the auditors of the Company raised an objection that since the petitioner was the son-in-law of the Managing Director and had been receiving total remuneration in excess of Rs. 36,000 per annum without the prior sanction of the Central Government, he was liable for consequence under Section 314(2B) or (2C) of the Companies Act, 1956. The petitioner contended that his 'remuneration' was not more than Rs. 3,000 per month and Section 314(1B) was attracted only when the monthly remuneration was more than Rs. 3,000 (Now Rs. 20,000). The Delhi High Court held that the wide definition of the term remuneration though extended to a number of sections of the Companies Act, 1956 has not been made applicable by the legislature to Section 314. It held that Section 314 not only postulates remuneration, it also speaks of total monthly remuneration. The word 'monthly' connotes anything taking place once a month having duration of one month, occurring, appearing or being made, done or acted upon every month. Hence, reference in the case to the total yearly earning exceeding Rs. 36,000 is misplaced. Thus emphasis should be not on what a person gets for a whole year but on his/her monthly remuneration.

Further, section 314 does not prohibit the holding of an office or place of profit under a company; it only regulates the holding of such office. Certain persons cannot hold an office or place of profit in a company unless the requirements of the regulatory provisions laid down in this section are fulfilled.

Directors' Relatives (Office or Place of Profit) Rules, 2011

In exercise of the powers conferred by Clause (b) of Sub-section (1) of Section 642, read with Sub-section (1B) of Section 314 of the Companies Act, 1956, the Central Government has promulgated the Directors' Relatives (Office or Place of Profit) Rules, 2011 vide Notification No. GSR 357(E) dated 02.05.2011.

These Rules provide for the requirements of the approval of Central Government in case of appointment of relatives etc. of the directors of the company.

The rules are issued in suppression of the Directors' Relatives (Office or Place of Profit) Rules, 2003 notified vide GSR 89(E) dated 5.2.2003.

The salient provisions of these rules are as under:

1. **Applicability:** These rules shall be applicable to all the companies which are registered under the Companies Act, 1956.
2. **Approval of the Central Government:** No appointment for an office or place of profit in a company shall take effect, unless approved by the Central Government on an application (Form not specified – i.e. on the letter head of the company), in respect of the following persons:
 - (i) partner or relative of director or manager; or
 - (ii) firm in which such director or manager, or relative of either is a partner; or
 - (iii) private company of which such director or manager or relative of either is a director or member.
 - (iv) An individual who is a relative of a director or manager and is appointed as an advisor or consultant and paid remuneration including commission on periodical basis.
3. **Amount of Remuneration:** These rules shall be applicable if the remuneration proposed to be paid to the appointee is exceeding 2,50,000/- per month.
4. **Selection Procedure:** The selection and appointment of a relative of a director for holding office or place of profit in the company with a salary exceeding Rs. 2,50,000 per month shall be approved by adopting the same procedure applicable to non-relatives and approved by a Selection Committee.

Selection Committee: In the case of Listed Public Companies, the "Selection Committee" mean a committee, consisting of at least three members, majority of which shall consist of independent directors and an expert in the respective field from outside the company.

However, in case of unlisted public companies, independent directors are not necessary but outside experts should be there in the selection committee.

Further, in the case of private companies, selection committee is not necessary.

5. **Examination of Applications:** The applications submitted by the companies under these rules shall be examined by the Central Government in respect of the following, which shall be in addition to all other requirements as prescribed under various provisions of the Companies Act, 1956:
 - (i) Undertaking by the individual appointee that he/she will be in the exclusive employment of the company and will not hold a place of profit in any other company.
 - (ii) The monetary value of monthly/annual remuneration inclusive of all allowances and perquisites, proposed to be paid to the appointee,

alongwith details of his services to be rendered by him to the company.

- (iii) Details of Shareholding pattern of the company showing separately the holdings of Directors and their relatives, public holdings, each institution's holdings individually and the quantum of dividend paid by the company during the last three preceding financial years..
- (iv) Educational qualification/experience, pay scale, allowances and other benefits of similarly placed executives.
- (v) If a relative, is being appointed, then an undertaking from the director or the company secretary of the company that the similarly placed employees are getting the comparable salary.
- (vi) List and particulars of the employees who are in receipt of remuneration of Rs. 2,50,000/- or more per month.
- (vii) Total number of relatives of all directors appointed as managerial personnel or in any other position in the company. The total remuneration paid to all of them altogether as a percentage of profits as calculated for the purpose of Section 198 of the Act.

Meaning of office or place of profit

Sub-section (3) of Section 314 defines the term 'office or place of profit'. As per this sub-section an office or place of profit shall be deemed to be an office or place of profit in the company:

- (a) in case the office or place is held by a director, if the director holding it obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director, whether as salary, fees, commission, perquisites, the right to occupy free of rent any premises as a place of residence, or otherwise;
- (b) in case the office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it obtains from the company anything by way of remuneration whether as salary, fees, commission, perquisites, the right to occupy free of rent any premises as place of residence or otherwise.

Thus, an office or place held by a director is deemed to be an office or place of profit, only if such director obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director.

The Department of Company Affairs has clarified that the remuneration paid to the Managing Director or Whole-time Director is a remuneration to which a person becomes entitled as a director and, therefore unless the remuneration paid to a director is over and above the remuneration to which he would be entitled as Managing or Whole-time Director, his holding of office would not be deemed to be an office or place of profit under the Act. In such cases, the provisions of Section 314(1B) of the Act will not apply. The appointment of Managing Director of a company as sole selling agent by the company could be regarded as holding an office of a profit under the company within the meaning of Section 314 and

consequently a special resolution according the consent of the company to such appointment is required to be passed [Circular No. 12(9) CL. VI 68 dated 19.11.68].

Nothing contained in Section 314 applies to a person who being the holder of any office of profit in the company is appointed by the Central Government, under Section 408, as a director of the company.

It is seen from the provisions of Sub-section (3) of Section 314 that the basic criteria/principle to determine whether “an office or place of profit” is an office or place of profit is ‘remuneration’ paid to the person holding the office.

It was held by the Calcutta High Court, in the context of Section 204 of the Act that the phrase ‘office or place of profit’ has to be given its ordinary meaning namely that by virtue of the office any profit is derived [*Shalagram Jhajharia v. National Co. Ltd.* (1976) 1 Comp LJ 29 (Cal)]. Merely because a person holds any position in or under the company he cannot be said to be holding an office or place of profit. For payment of interest on loans obtained from a director of a company, no special resolution under Section 314 is necessary. This is not a case of office or place of profit within the meaning of the section.

It was, however, held by the Bombay High Court that a private company which was appointed as a sole-selling agent of a public company and persons were directors in both the companies, the private company appointed to an office or place of profit under the public company and therefore Section 314 was attracted [*Firestone Tyre & Rubber Co. Ltd. v. Synthetics & Chemicals Ltd.* (1971) 41 Comp Cas 377 (Bom) : (1970) 2 Comp LJ 200] See also *Shalagram Jhajharia v. National Co. Ltd. (Supra)*.

Contravention of the provisions of Section 314

Where an office or place of profit is held in contravention of Section 314, the director, partner, relatives etc. shall be deemed to have vacated his or its office as such, on and from the date of the general meeting of the company or the date of expiry of the period of three months as the case may be and shall also be liable to refund to the company any remuneration received or the monetary equivalent of any perquisite or advantages enjoyed by him or it, for the period immediately preceding the date aforesaid in respect of such office or place of profit.

Renewal of appointment

The explanation to Sub-section (1) of Section 314 says that a special resolution is necessary for every appointment in the first instance and that a special resolution will be necessary on a subsequent appointment on a higher remuneration not covered by the earlier resolution except where an appointment on a time scale has already been approved by the special resolution. It has been held by the *Bombay High Court in Firestone & Rubber Co. v. Synthetic & Chemical Ltd.*, (1971) 41 Com Cases 377 (Bom) that ‘higher remuneration’ would include the situation of a possible higher remuneration and that a reappointment which is not made immediately after the expiry of first appointment and is renewed after a gap of time, would not be a “subsequent appointment” and further that where in the original appointment there is no term for renewal, a reappointment would operate as a new appointment, requiring a special resolution.

The company cannot waive the recovery of any sum refundable to it unless permitted by the Central Government.

Every individual, firm or private company or any other body corporate proposed to be appointed to any office or place of profit to which Section 314 applies, is required to declare in writing before or at the time of appointment, whether he or it is or is not connected with any director of the company in any of the ways mentioned above.

17. IMPORTANT CLARIFICATIONS

(1) Partnership firm working for a place of profit and relative of director becoming partner

A partnership firm is appointed by a company to an office of profit and at the time of appointment none of the directors is related to any partner of the said firm. Hence, Section 314, would not apply to such appointment. But if the firm is reconstituted by appointment of a relative of a director as one of the partners of the firm without the knowledge or consent of either of the director concerned or the company, would Section 314 be applicable and will the following consequences follow?

- (a) Will the director have to vacate his office?
- (b) Will the firm cease to hold office from the date of its reconstitution?
- (c) Will the company be considered to have made any default?

The Department of Company Affairs (Now Ministry of Company Affairs) viewed that in a case like the one cited above it is permissible, for the company to regularise the matter by complying with the requirements of Section 314 within three months from the date of appointment.

In default thereof –

- (a) the director will have to vacate his office after three months of the reconstitution of the firm.
- (b) the firm will cease to hold office after three months from the date of its reconstitution; and
- (c) the company will not be considered to have defaulted. Attention in this connection is invited to the provisions of proviso to Sub-section (1) and of Sub-section (2) of Section 314 of the Act. [Extract from the queries raised by the Company Law Association of India in memorandum submitted to the Dept. of Co. Law Administration on 31-7-1962 and the Department's views thereon (Company News & Notes dated July 1, 1963)].

(2) Director as technical advisor

On the question whether appointment of a director as 'technical adviser' requires special resolution under Section 314, the Department has expressed the following view:

"A large number of cases continued to come to the notice of the Department where directors were appointed as "Technical advisors" sometimes on very nominal remuneration. It was contended by the companies that since technical advice was given in a capacity other than that of a director, a special resolution under Section 314 of the Act was not required for their appointment and the remuneration paid to them was outside the limit laid down for the total managerial remuneration. All such cases were closely examined against the background of the management pattern of the company in the past, the technical qualification of the persons concerned, then

powers and duties and whether such persons were rendering any managerial services to other concerns also. In most of the cases, it was found that in fact the persons concerned were performing managerial services. The companies were therefore advised by the Department to get their appointment and remuneration regularised in the manner laid down in the Act. In almost all cases the suggestions of the Department were accepted by the companies concerned. [7th Annual Report of the Department for the year end 31st March, 1963].

(3) Employee becoming relative of director subsequently

The following query was raised to Department :

Query – Section 314 does not make it clear if a special resolution is required to be passed if an employee of a company becomes related to a Director of the company, during the course of his employment –

- (a) in case he had been appointed before the Director became a director of the company; and
- (b) in case he had been appointed after the Director became a director-which contingency is not provided for under the newly inserted Sub-section (1A).

Answer:

The Department expressed following views :

Only the cases of employee-relatives, already of office, before the relative becomes a Director, are covered by Sub-section (1A) of the amended Section 314 of the Act. As such, where an employee is appointed to his office before the Director becomes a Director but the employee becomes related to the Director afterwards, as well as the cases falling under category (b) in the query, will require special resolutions to be passed under Section 314(1) of the Act (Letter No 8/16(1)61-PR, dated 23-1-1961).

(4) Sale or purchase of materials by director or his relative, associate, etc.

The provisions of Section 314(1) of the Companies Act do not apply to the sale or purchase of material by a company to or from its director or his relative, a firm in which such director or relative is a partners any other partner in such a firm, or a private company of which the director is a member or director. It would be enough in such cases if the consent of the Board of directors of the company is obtained as laid down in Section 297(1) of the Act (Letter No 8/38(314)/61-PR, dated 10-5-1961).

(5) Payment of guarantee commission and interest on loans

Department's view – Section 314 is not applicable to the payment of guarantee commission payable to a director for guaranteeing the company's loans and to receive interest on loans advanced by the directors to his company (Letter No 8/26, dated 9-1-1978).

(6) Clarifications on Section 314

The Department of Company Affairs (Now Ministry of Company Affairs) vide Circular No. 14/75 dated 5th June, 1975, has issued the following clarifications regarding Section 314.

Some doubts have been raised regarding the scope of Sub-section (1B) of

Section 314 inserted in the Companies Act, 1956 by Clause 29 of the Companies (Amendment) Act, 1974. These points have been examined and the Department's views thereon are given below.

Section 314 of the Companies Act, 1956 applies to public as well as private companies. Sub-section (1) of this section provides that no director of a company and no partner or relative of such director...shall hold any office or place of profit, except that of managing director or manager, banker or trustee for the holders of debentures of the company, carrying a total monthly remuneration of such as may be prescribed under the company unless a special resolution according the consent of the company is passed at the general meeting of the company held for the first time after the holding of such office or place of profit.

The new Sub-section (1B) says that notwithstanding anything contained in the aforesaid Sub-section (1), no such office or place of profit carrying a monthly remuneration of not less than Rs. 20,000* shall be held except with the prior consent of the company by a special resolution and the approval of the Central Government.

A question has been raised whether a special resolution under Section 314(1B) is necessary for the appointment of managerial person who may be relatives of director and whose appointment are already regulated by Section 269 of the Act. This query arises with reference to public companies to which the said Section 269 applies and strictly, will have to be answered in the affirmative. But for administrative convenience, it has been decided that the approval of the Central Government once again under Section 314(1B) will not be necessary in the cases where the Central Government's approval has already been secured under Sections 198, 269, 309, 310 and 311, as the case may be. Irrespective of the question of Central Government's approval, the special resolution required under Section 314(1B) will have to be passed whether by a public company or a private company.

Further, with reference to the special resolution in the main part of Sub-section (1B) it is necessary to understand the reference in the proviso of the Sub-section to the approval of the company in general meeting as meaning the approval by a special resolution of such meeting. But in a case where the special resolution was passed in terms of Sub-section (1), it will not be necessary to have another resolution, ordinary or special, once again and only the approval of the Central Government in terms of the proviso to Sub-section (1B) will be necessary.

Another question raised is whether approval of the general meeting and of the Central Government is necessary for an employee drawing salary exceeding Rs.20,000* per month who is a relative of an existing Director but the appointment of such employee was made before his relative became a Director, i.e., whether the exemption under Section 314(1A) ensures under Section 314(1B) as well. It is considered that Sub-section (1) and Sub-section (1A) should be read together before applying Sub-section (1B) and in as much as there is nothing in Sub-section (1B) to affect the operation of the principle underlying Sub-section (1A). The exemption under Sub-section (1A) continues to apply even with reference to a case concurrently falling under Sub-section (1B).

In the case of a private company (not governed by Section 269 etc. of the

* Present limit under Section 314(1B).

Companies Act, 1956), a question has arisen whether the appointment of a person as a managing director who is related to a director of the company will attract the provisions of Section 314(1B) where the remuneration payable to such managing director is in excess of the limit envisaged in the Sub-section (1B). This question is answered in the affirmative. The circumstances that for the purpose of Sub-section (1), which deals with appointment to an office of profit carrying not less than a total monthly remuneration of Rs. 10,000 an exception made in respect of an appointment of managing director or manager is not considered relevant because Sub-section (1B) expressly overrides Sub-section (1) and calls for the exercise of a greater vigilance against the likelihood of the abuse of patronage in a case where the remuneration proposed is of the order of Rs. 20,000 per month and more.

A question has also been raised whether provisions of Section 314(1B) are applicable where a company proposes to appoint a firm of solicitors and advocates, etc. to help the company in its work. It is considered that an advocate or solicitor appears in a Court of Law as an Officer of the Court in pleading the cause of justice and hence, such appearance and receiving fee on that account cannot lead to an inference of an office or place of profit in or under the company under Section 314 of the Act. However, if such a solicitor/advocate, etc. is appointed on a regular retainer basis for rendering legal advice other than appearance in Court, the provisions of Section 314 will be applicable.

Some doubts had been raised regarding the application of Sub-section (1B) of Section 314 to an individual who is a partner or relative of a manager or director of a private company appointed as managing or whole-time director of such company at a monthly remuneration of not less than Rs. 20,000. The position has since been re-examined and it has now been decided to clarify the ambit of Section 314(1B) as follows:

Sub-section (3) of Section 314 refers to what is treated for the purposes of Section 314 an office or place of profit. The said Sub-section (3) provides that if the office or place is held by a director it will be treated as holding an office or place of profit if the director obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director.

Section 309 of the Act refers to remuneration of directors. Section 309 in turn provides that the remuneration payable to a director of a company, including any managing or whole-time director, shall be determined in accordance with and subject to the provisions of Section 198 and that section, namely, Section 309. It therefore, follows that the remuneration paid to the managing or whole-time director is remuneration to which he becomes entitled as a director to which he would be entitled to as a managing or whole-time director, his holding of office would not be deemed to be an office or place of profit under the company. In such a case the question of application of the provisions of Section 314(1B) does not arise [Vide circular No. 4 of 1976 dated the 11th February, 1976 on Files No. 8/12 (314-1B/75-CL.V)].

(7) Appointment at general meeting – Directors appointed by articles – Whether the section is attracted when it is proposed to elect such directors at annual general meeting.

Query: In terms of Section 257 read with Section 256 directors appointed by the

articles of a newly registered company not having been appointed by the company in general meeting could not be deemed to be directors retiring by rotation. Will the provisions of Section 257 apply to such directors?

Answer: In the opinion of the Department, Section 257 will be attracted when it is proposed to elect such directors at the annual general meeting. (Company News & Notes July 1, 1963 issue.)

(8) Appointment at general meeting – Additional director and director appointed to fill casual vacancy – Whether required to comply with Sub-section (1)

Query:

1. Whether an additional director who ceases to hold office under Section 260 and a director appointed to fill a casual vacancy who vacates office under Section 262 are required to give notice under Section 257 when they seek re-appointment at the annual general meeting, or a notice from a member under Section 257 would be necessary?
2. Whether they should file a fresh consent to act as director with the company under section 264 before the general meeting, as also file a consent with the Registrar of Companies under that section when re-appointed?

Answer:

1. In the view of the Department, additional directors appointed under Section 260 and directors appointed to fill casual vacancies under Section 262 are not “retiring directors” within the meaning of the Explanation below Sub-section (5) of Section 256. Accordingly in their case, the provisions of Section 257(1) will be attracted and will have to be complied with.
2. In view of the clarification given above, the aforesaid directors should comply with the provisions of Section 264(1) and (2) also.

(Company News & Notes, July 1, 1963 issue)

(9) Directors – Appointment at general meeting – Whether requirement of giving notice to shareholders regarding candidature for directorship of a person other than retiring director applies to private companies also

Query: According to new Sub-section (1A) of Section 257, a notice should be given to all the shareholders regarding the candidature for directorship of a person other than the retiring director 7 days before the meeting of the company in which they are proposed to be elected. Sub-section (2) exempts private companies from the operation of Sub-section (1). It is not clear whether Sub-section (1A) will apply to private companies or not.

Answer: Sub-section (1A) applies only where Sub-section (1) applies. As Sub-section (2) specifies that Sub-section (1) shall not apply to a private company, unless it is a subsidiary of a public company, Sub-section (1A) will also not apply in such a case.

(10) Filing of consent of candidate for directorship with company – Whether it is obligatory for nominated director to file consent with company

In view of the fact that the Government would not nominate an unwilling person to the office of a director, and no useful purpose would be served by such a person filling his written consent with the company in addition to the consent that would be filed by him with the Registrar Pursuant to Section 264(2), it is not obligatory for such nominated directors to file written consent with the company under Sub-section (1). (Letter : No. 8/21/(264)/61-PR, dated 22-2-1962)

(11) Filing of consent to act as director with registrar – Whether provisions of Sub-section (2) of Section 264 applies in a case where all directors at annual general meeting are re-appointed

Query: There appears to be a divergence of interpretation of the scope of Section 264(2) which says that person, other than a director, re-appointed after retirement by rotation, shall not act as a director of a company unless he has, within thirty days of his appointment, signed and filed with the Registrar his consent in writing to act as such director. In the case of a company where all directors retire simultaneously at an annual general meeting and all of them are re-elected, the directors need not file their consent under Section 264(2). But there appears to be a view that *en bloc* retirement is not the same as retirement by rotation and whenever there is *en bloc* retirement, the directors concerned should file their consent on re-election. The *en bloc* retirement and retirement by rotation should, therefore, be treated alike.

Answer: The Department is of the opinion that under Section 264(2), only a director who retires by *rotation* at an annual general meeting of a company and is re-appointed thereat is not required to file with the Registrar his consent to act as a director within the time-limit laid down therein. In a case where all the directors retire at the general meeting and are re-appointed thereat, there is not retirement by rotation within the meaning of the *Explanation* below Sub-section (5) of Section 256 or Sub-section (2) of Section 264. Accordingly, a director who retire *en bloc* at a general meeting are required to comply with the requirement in Sub-section (2) of Section 264. (Source : *Company News & Notes*, July 1, 1963 issue.)

(12) Filing of consent to act as director with registrar – Effect of non-filing, Whether penalty under Section 629A would be attracted if director continues to act as such without filing his consent

The Department has now been advised that the prohibition contained under Section 264(2) *operates only in respect of a person acting as director without his consent being filed within the specified period*. This prohibition, however, does not extend to his appointment as such as in the cases falling under Section 261, nor does it serve as disqualification as in the cases falling under Sections 266 and 274, nor does the office of director become automatically vacant as in cases falling under section 283. *The consequence of a director continuing to act as such without filing his consent within the period specified in Section 264(2) would be that the penalty under section 629A would be attracted in the matter*. Such consent may, however, be filed after the expiry of the said period on payment of additional fee contemplated by Section 611(2). It is further, open to the Central Government under Section 637B to condone the delay in filing the consent within the period specified in Section 264(2)

and thereby remove the prohibition contained in the latter-mentioned section of the Act. [Letter : No. 5/6/68-CL-V, dated 21-10-1970 (in modification of earlier letter of even number, dated 21-2-1970)].

(13) Filing of consent to act as director with registrar – Whether additional director, elected as director at general meeting in which he vacated his office of additional director, is required to file fresh consent.

Query: Whether a person, who had been holding the office of an additional director under Section 260, should file a fresh letter of consent under Section 264(2), and also a fresh declaration of share qualification under Section 271, with the Registrar, if he were elected as a director of the company at the annual general meeting of the company in which he vacated his office of additional director that he was holding?

Answer: While such a person is not required to file, on his election, a fresh declaration of share qualification with the Registrar under Section 271, he is to file a fresh letter of consent with the Registrar under Section 264(2), since the exception that had been made in the latter section was only in respect of a director who retired by rotation. (Source: Clarification issue by Department of Company Law Administration).

ANNEXURE I

FORM 'DD-A'

Companies (Disqualification of Directors under Section 274(1)(g) of the Companies Act, 1956) Rules, 2003

INTIMATION BY DIRECTOR

[Pursuant to Section 274(1)(g)]

Registration No. of Company.....

Nominal Capital ₹.....

Paid-up Capital ₹.....

Name of Company.....

Address of its Registered Office.....

To

The Board of Directors

of.....

I..... son/daughter/wife of..... resident of.....
director (managing director) manager in the company hereby give notice that I
am/was a director in the following companies during the last 3 years:

No.	Name of the Company	Date of Appointment	Date of Cessation
1.		
2.		

I further confirm that I have not incurred disqualification under Section 274(1)(g) of the Companies Act, 1956 in any of the above companies, in the previous financial year, and that I, at present stand free from any disqualification from being a director.

or

I further confirm that I have incurred disqualifications under Section 274(1)(g) of the Companies Act, 1956 in the following company(s) in the previous financial year, and that I, at present stand disqualified from being a director.

No.	Name of the Company	Date of Appointment	Date of Cessation
1.		
2.		

Signature
(Full Name)

Dated this..... day of.....

FORM 'DD-B'

Report by a public company

[Pursuant to Section 274(1)(g) and Rule 5 of the Companies (Disqualification of Directors under Section 274(1)(g) of the Companies Act, 1956) Rules, 2003]

NOTE: All fields marked in *are to be mandatorily filled.

1. (a) *Corporate identity number (CIN) of company _____ Pre-fill
(b) Global location number (GLN) of company _____
2. (a) Name of the company _____
(b) Address of the registered Office of the company _____
3. Paid-up capital (in Rs.) _____

*It is hereby reported under Section 274(1)(g) of the Companies Act, 1956, that M/s. _____ have failed to

___ file the annual accounts and annual return for the last three financial years ending as on _____(DD/MM/YYYY)

and/or ___ others

___ Repay deposits or interest thereon on due date being _____(DD/MM/YYYY)

___ Redeem its debentures on due date being _____(DD/MM/YYYY)

___ Pay dividend declared by the company since _____(DD/MM/YYYY)

The period of one year has expired on _____(DD/MM/YYYY)

The particulars of directors at the relevant period are as under :

- 1.* (a) Director identification number (DIN) _____

- (b) Name of the director _____
- 2.* (a) DIN _____
- (b) Name of the director _____
- 3.* (a) DIN _____
- (b) Name of the director _____
- 4. (a) DIN _____
- (b) Name of the director _____
- 5. (a) DIN _____
- (b) Name of the director _____
- 6. (a) DIN _____
- (b) Name of the director _____
- 7. (a) DIN _____
- (b) Name of the director _____
- 8. (a) DIN _____
- (b) Name of the director _____
- 9. (a) DIN _____
- (b) Name of the director _____
- 10. (a) DIN _____
- (b) Name of the director _____
- 11. (a) DIN _____
- (b) Name of the director _____
- 12. (a) DIN _____
- (b) Name of the director _____

Attachments

Optional attachment (s) – if any

Attach

List of attachments

Remove attachment

Declaration

To the best of my knowledge and belief, the information given in this form and its attachments is correct and complete. I have been authorised by the board of directors' resolution dated* _____ (DD/MM/YYYY) to sign and submit this form.

To be digitally signed by:

Managing director or director or manager or secretary of the company_____

Modify

Check Form

Pre-scrutiny

Submit

For office use only

This e-Form is hereby registered

Digital signature of the authorising officer_____

Submit to BO_____

FORM 'DD-C'

Form of application for removal of disqualification of directors

*[Pursuant to Section 274 of the Companies Act, 1956 and Companies
(Disqualification of directors under Section 274(1)(g) of
the Companies Act, 1956) Rules, 2003]*

*NOTE: All fields marked in *are to be mandatorily filled.*

1. (a) *Corporate identity number (CIN) of company_____ Pre-fill
(b) Global location number (GLN) of company_____
2. (a) Name of the company_____
- (b) Address of the registered
Office of the company_____
3. *Grounds under which director(s) are disqualified _____
4. *Date of disqualification_____ (DD/MM/YYYY)
5. *Details of the application_____

Attachments

1. *Board resolution Attach
2. Optional attachment (s) – if any Attach

List of attachments

Remove attachment

Declaration

To the best of my knowledge and belief, the information given in this application and its attachments is correct and complete. I have been authorised by the board of directors' resolution dated* _____(DD/MM/YYYY) to sign and submit this application.

To be digitally signed by:

Managing director or director or manager or secretary of the company_____

Modify

Check Form

Prescrutiny

Submit

For office use only**Digital signature of the authorising officer**

This e-Form is hereby approved_____

This e-Form is hereby rejected_____

Submit to BO_____

ANNEXURE II

**COMPANIES (APPOINTMENT OF SMALL SHAREHOLDERS'
DIRECTOR) RULES, 2001**

NOTIFICATION

[GSR 168(E) dated 9.3.2001]

In exercise of the powers conferred by Section 642 read with Section 252 of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules, namely:

1. Short title and Commencement

- (1) These rules may be called the Companies (Appointment of the Small Shareholders' Director) Rules, 2001.
- (2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions

- (a) "Act" means the Companies Act, 1956 (1 of 1956);
- (b) "Small Shareholder" means a shareholder holding shares of nominal value of twenty thousand rupees or less in a public company to which Section 252 of the Act applies.

3. Applications

These rules shall apply to public companies having—

- (a) paid-up capital of five crore rupees or more;
- (b) one thousand or more small shareholders.

4. Manner of election of small shareholders' director

- (1) A company may act *suo-moto* to elect a small shareholders' director from

amongst small shareholders or upon the notice of small shareholders, who are not less than 1/10th of total small shareholders and have proposed name of a person who shall also be a small shareholder of the company.

- (2) Small shareholders intending to propose a person shall leave a notice of their intention with the company at least 14 days before the meeting under the signature of at least 100 small shareholders specifying name, address, shares held and folio number and particulars of share with differential rights as to dividend and voting, if any, of the person whose name is being proposed for the post of director and of other small shareholders proposing such person as a candidate for the post of director of small shareholders.
- (3) A person whose name has been proposed for the post of small shareholders' director shall sign, and file with the company, his consent in writing to act as a director.
- (4) The listed public company shall elect small shareholders' nominee subject to sub-rules (1), (2) and (3) above through the postal ballot.
- (5) The unlisted company may appoint such small shareholders' nominee subject to above conditions if majority of small shareholders recommend his candidature for the post of director in their meeting.
- (6) Tenure of such small shareholders' director shall be for a maximum period of three years subject to meeting the requirement of provisions of Companies Act except that he need not have to retire by rotation.
- (7) On expiry of his tenure, the same person if so desired by small shareholders, may be elected for an another period of 3 years.
- (8) Such director shall be treated as director for all other purposes except for appointment as whole time director or managing director.

5. Disqualification

A person shall not be capable of being appointed as small shareholders' director of company, if—

- (i) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- (ii) he is an undischarged 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 in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence;
- (v) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last fixed for the payment of the call; or
- (vi) an order disqualifying him for appointment as director has been passed by a Court in pursuance of Section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section.

6. Vacation of office

A person appointed as small shareholders' director shall have to vacate the office if—

- (i) such person so elected, as director of small shareholders ceases to be a small shareholders' director on and from such date on which he ceased to be a small shareholder;
- (ii) he has been rendered disqualified by virtue of Sub-rule (1) of Rule (5).
- (iii) he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call;
- (iv) he absents himself from three consecutive meetings of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;
- (v) he is partner of any private company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the company in contravention of Section 295;
- (vi) he acts in contravention of Section 299;
- (vii) he becomes disqualified by an order of Court under Section 203;
- (viii) he is removed in pursuance of Section 284.

7. Restriction on number of directorship

No person shall hold office at the same time as small shareholders' director in more than two companies.

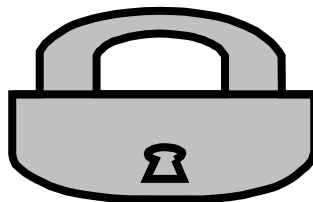
LESSON ROUND-UP



- Acting collectively as a Board of directors, directors can exercise all the powers of the company except those, which are prescribed by the Act to be specially exercised by the company in General Meeting.
- Every public company shall have at least three directors and every other company shall have at least two directors u/s 252 of the Act.
- Directors are trustees for the company i.e. the directors are persons selected to manage the affairs of the company for the benefit of the shareholders.
- Section 274 lays down disqualifications of directors. Also individuals only can be a director u/s 253 of the Act.
- Disqualified directors and companies are required to file returns in form DD-A and DD-B respectively to the Registrar of Companies through MCA portal.

- Holding of qualification shares in a company in which one is director is not statutorily required.
- Central Government's approval is required for increasing the number of directors in certain circumstances specified u/s 259 of the Act.
- Directors may be appointed by becoming subscribers to the Memorandum (S.254); by members in general meeting (S.255-257, 265); by Board of directors (S.260, 262 & 313); by Central Government (S.408 and 409); by third parties and small shareholders if the articles provide.
- Two or more directors should not be elected *en bloc* or by a single resolution.
- A director may be removed from the office before the expiry of his term by shareholders of the company under Section 284 of the Act, Central Government (Section 388 B to 388 E) and by CLB (u/s 397 and 398 of the Act).
- A director may resign his office in the manner provided by the articles.
- Any officer or employee of a company shall be punishable with fine on the complaint of company or any creditor or contributory thereof, if he wrongfully obtains possession or withholds any property of the company u/s 630 of the Act.
- Disqualifications leading to the vacation of the office of a directors as mentioned in Section 283 are the statutory disqualifications and no director and no company is immune from them.
- Directors are not entitled to payment in the absence of express provisions. The remuneration paid to directors is subject to the provisions of Section 198, 309 and Schedule XIII of the Companies Act.
- The remuneration payable to managing director, whole time director and manager who are in the whole time employment of the company shall not exceed five per cent of the net profits for one such director, and if there is more than one such director, ten per cent for all of them together.
- Provisions related to managerial remuneration shall not apply to private company unless it is a subsidiary of a public company.
- Section 314 regarding office or place of profit applies to public as well as private companies.
- Section 314 does not prohibit the holding of an office or place of profit under a company; it only regulates the holding of such office. Certain persons cannot hold an office or place of profit in a company unless the requirements of the regulatory provisions laid down in this section are fulfilled.

SELF-TEST QUESTIONS



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

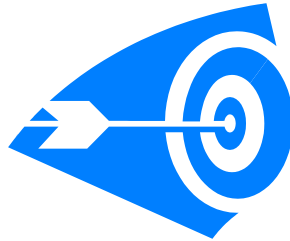
1. Explain the concept and the evolution of the institution of directors.
2. What are the qualifications of a director? When is a person disqualified for

appointment as a director of the company? What are the rules as regards disqualification of Directors?

3. Explain the law relating to number of directors.
 4. Who may be appointed as director of a company?
 5. How can the directors be removed from the office before the expiry of their term?
 6. Under what circumstances is a director deemed to have vacated the office of directorship?
 7. State the provisions of the Companies Act regarding the remuneration of directors.
 8. Discuss in detail the provisions relating to holding of office or place of profit by a director, relative etc. in a company.
 9. How can the small shareholder's director be appointed?
-

STUDY XV
MANAGEMENT AND CONTROL OF COMPANIES-II
POWERS AND DUTIES OF DIRECTORS

LEARNING OBJECTIVES



In the previous chapter, we had learnt about the concept of directors, their appointment, removal, remuneration etc. Now let us learn about the powers and duties of directors.

Directors acting collectively i.e. Board of Directors are authorized to do what the company is authorized to do unless barred by restrictions on their powers by the provisions of the Companies Act, 1956, the Memorandum or Articles of the company.

After going through this chapter, students will learn the following:-

- Distribution of powers of a Company
- Exercise of Powers
- Loans to Directors
- Board's sanction for contracts in which Directors are interested.
- Disclosure of Interest by Directors
- Duties of Directors
- Liabilities of Directors
- Court's power to grant relief in certain cases
- Compounding of certain offences – Section 621A
- Monitoring and Management

1. DISTRIBUTION OF POWERS OF A COMPANY

Except where express provisions are made that the powers of a company in respect of any matter are to be exercised by the company in general meeting, in all other cases the Board is entitled to exercise all its powers. The directors acting together are the authority for conducting the affairs of the company. They are authorised to do what the company is authorised to do, unless barred by restrictions on their powers by the provisions of the Companies Act, 1956 (the Act), the memorandum or articles of the company (Section 291).

The directors shall exercise their powers bona fide and in interest of the company. The directors while exercising their powers do not act as agents for the

majority or even all the members and so the members cannot by resolution passed by a majority or even unanimously supercede the director's powers, or instruct them how they shall exercise their powers. This sovereignty of the directors within the limits of the powers conferred on them by the articles, and within limit laid down by the Act was clearly expressed by Greer L.J. in *John Shaw & Sons (Salford) Ltd. v. Shaw* (1935) 2 K.B. 113 in the following words:

“A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. The powers of management are vested in the directors. They and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in the directors, is by altering the articles, or if opportunity arises under the articles, by refusing to re-elect the directors whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders”.

In *Milan Sen v. Guardian Plastics Ltd.* (1998) 2 Comp L J 320, the directors passed a resolution for rights issue which was questioned by certain shareholders. The Calcutta High Court held that the question whether the company needed additional capital was a question which should primarily be decided by the directors of the company and if they were of the view that further capital in the form of rights issue was required the Court would be slow to disturb the same unless there were extreme circumstances of malafides or breach of trust.

Thus, from the provisions of Section 291 and the exposition of the law stated above, it is clear that subject to the restrictions contained in the Act, Memorandum and articles, the powers of directors are co-extensive with those of the company itself.

The relationship of the Board of directors with the shareholders is more of federation than one of subordinates and superior. Some powers are specially reserved for the Board e.g. appointing directors in casual vacancies, the power to issue debentures, etc. On the other hand, some powers are exclusively reserved for the members in general meeting e.g. borrowing in excess of the paid-up capital and free reserves, selling or disposing off the whole or substantially the whole of the undertaking etc.

However, in the following exceptional cases, the general body of shareholders is competent to act even in matters delegated to the Board:

(a) Directors Acting Mala Fide: The general body of shareholders can intervene when it is proved that the directors have acted for improper motive or arbitrarily or capriciously. In *Satya Charan Lal v. Romeshwar Prasad Bajoria* (1950) SCR 394, it was stated that ordinarily the directors of a company are the only persons who can conduct litigation in the name of company, but when they are themselves the wrong doers, and have acted malafide and their personal interest is in conflict with their duty in such a way that they cannot or will not take steps to seek redress for the wrong done to the company, the majority of the shareholders may take steps for redressal of the wrong.

In *Marshal's Valve Gear Co. Ltd. v. Manning Wardle & Co. Ltd.* (1909) 1 Ch. 267, A and three other persons were four directors of M. Co. and they held almost the whole of the subscribed capital of the company. A was the majority shareholder, but held less than three-fourth of the share capital. Another company, known as N. Co. was committing infringement of M. Co.'s trademark and other three directors were interested in that company. The result was that at a meeting of the Board they declined to sanction any proceeding against N. Co. A, at a general meeting of the shareholders, resolved and commenced an action to restrain the alleged infringement.

(b) Incompetent Board: The general body of shareholders may exercise the powers vested in the Board when the Board is incompetent to act, for instance, where all the directors are interested in the transaction or the Board is unwilling to act, or when there are no validly appointed directors functioning.

In *Vishwanathan v. Tiffins B.A. and P. Ltd.*, AIR 1953 Mad. 520, a clause in the articles of the company authorised the directors to fill casual vacancies and also to increase the number of directors within the maximum number fixed in the articles. Some casual vacancies occurred, and they were promptly filled at a general meeting of the shareholders. This was challenged on the ground that once the power to appoint was delegated to the Board, it could not have been exercised at a general meeting. The Court upheld the appointments by the company in the general meeting, as it found that at the time of the general meeting there was no director in office and, therefore, the members had the right to elect. Venkatarma Iyer, J. observed: "A company has inherent power to take all steps to ensure its proper working and that, of course, included the power to appoint directors. It can delegate these powers to the Board and such delegation will be binding upon it, but if there is no legally constituted Board which could function or if there is a Board that is unable or unwilling to function then the authority delegated to the Board lapses and the members can exercise the right inherent in them of appointing directors."

(c) Deadlock in the Board: If the directors are unable or unwilling to act, on account of deadlock, the shareholders have the inherent power to act.

For instance, in the *Barron v. Potter* (1914) 1 Ch. 895, there were only two directors on the Board of the Company and one refused to act with the other. There was no provision in the articles enabling the general meeting of the shareholders to increase or reduce the number of directors. Held, that as there was a deadlock in the administration resulting from the fact that the power to take necessary steps to ensure the working of the company and to appoint additional director for the purpose.

From the above, it is clear that the residuary powers can be pressed into service by the shareholders in general meeting.

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

The powers of directors are co-extensive with those of the company itself.

- True
- False

Correct answer: True

2. EXERCISE OF POWERS

The powers of the Board may be grouped under the following heads:

- (1) Powers exercisable only at Board meetings;
- (2) Powers exercisable only with the consent of the company in general meeting; and
- (3) All other powers which, subject to the provisions of the Act, the company is authorised to exercise.

2.1 Powers to be exercised only at Board Meetings

Section 292(1) of the Act, provides that the Board of directors of a company shall exercise the following powers on behalf of the company, and it shall do so only by means of resolution passed at a meeting of the Board:

- (a) powers to make calls on shareholders in respect of money unpaid on their shares;
- (b) power to authorise the buy-back as per the provisions of Section 77A;
- (c) power to issue debentures;
- (d) power to borrow moneys otherwise than on debentures;
- (e) power to invest the funds of the company; and
- (f) power to make loans.

The Board, may, however, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, a principal officer of the branch office, the powers specified in clauses (c), (d) and (e), to the extent specified below on such conditions as the Board may prescribe.

The directors can also exercise the power to print share certificates as per the provisions of the Companies (Issue of Share Certificate) Rules, 1960, in their Board meetings.

It is further provided that the acceptance by a banking company in the ordinary course of its business of deposits of money from the public payable on demand or otherwise, or the placing of money on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of money or, as the case may be, a making of loans by a banking company within the meaning of this section.

Every resolution of the Board delegating the powers must specify:

- (a) the total amount outstanding any one time up to which the money may be borrowed by the delegate under clause (c); [Section 292(2)].
- (b) the total amount up to which the funds of the company may be invested and the nature of the investment which may be made by the delegate under clause (d); [Section 292(3)].
- (c) the total amount up to which loans may be made by the delegate, the purpose for which the loans may be made, and the maximum amount of loans which may be made for each such purpose in individual cases under clause (e) [Section 292(4)].

In spite of the fact that the directors can delegate upto certain extent they cannot delegate the whole of their responsibilities, and must continue to exercise control over the Committee which consists of one or more members of the Board. [*Fire Proof Doors, Re*, (1916) 2 Ch 142 : (1916-17) All ER Rep 931]. Where the committee has more than one member, every member must be present to enable the committee to function unless the Board resolution fixes a quorum for committee meetings.

The Board of Directors is competent by resolution to enhance the rates of interest in exercise of the powers under Sub-sections (1)(b) and (1)(c) of Section 292. The exercise of that power is not controlled by Section 293.

Power to borrow money [Sub-section (1)(c)]

The company's power of borrowing may also be exercised by delegating to agents other than directors unless prohibited by the Articles of Association of the company. The expression 'borrowing money' is not confined to the taking of money on the promise to return it, with or without interest; it will also include the entering into any arrangement for deferred payment of the price of machinery, raw materials, etc.

Strangers dealing with a company are entitled to assume that a director or manager was authorised to borrow, even if in fact not so authorised. *Shri Krishna Rathi v. Mondal Bros & Co. (P) Ltd.*, (1967) 1 Comp LJ 10: (1967) 37 Com Cases 256. He has a right to assume, as against the company, that all requirements of internal management have been duly complied with.

In *T.R. Pratt v. E.D. Sasoon & Co.*, AIR 1936 Bom 62 : (1936) 6 Com Cases 90, money was borrowed and used for the benefit of the principal in paying debts of the company, the company could not escape repayment of the debt on the ground that the agents had no authority from the company to borrow.

Power to give security (Implied Power)

The power to borrow implies a power to secure the borrowings by mortgage or a charge on the company's assets. Unpaid calls can be charged under the general powers to borrow but a company cannot give by way of security books and registers which it is bound to keep under the Companies Act.

Borrowing for ultra vires purposes

Borrowing beyond the powers of the company, or the directors, is an *ultra vires* borrowing and does not have the effect, legal or equitable. Any instrument executed or security given therefor is void and no action lies to recover the money. [*Deonarayan Prasad Bhadani v. Bank of Baroda Ltd.*, (1957) 27 Com Cases 223 (Bom)].

In one case, Board of directors passed a resolution for borrowing of money for an *ultra vires* purpose. The same being beyond the powers of the directors and the company, it did not bind the company. [*National Provincial Bank v. Introduction Ltd.*, (1969) 1 All ER 887 : (1969) LJ 28, affirming (1968) 2 All ER 1221 (CA)]. Where the borrowing is *ultra vires* the memorandum or contrary to the law, even the shareholders cannot ratify the act.

But, where the directors have borrowed beyond their own powers, the lender

may take advantage of the rule in *Royal British Bank v. Turquand*, (1856) 6 E & B 327 viz., that all matters relating to internal management of the company have been done regularly and the directors have acted within their powers.

Section 58A - restrictions on borrowing powers

The Board of directors and others who exercise borrowing powers for or on behalf of any non-banking company have to take particular care to see that the directions of Reserve Bank as well as the provisions of Section 58A are complied with. Whenever any company receives any money in the form of deposit it must be noted that the Reserve Bank directions under Section 45-L of the Reserve Bank of India Act have effect notwithstanding anything otherwise provided in the Companies Act or any other law, as it is so expressly provided by Section 45-Q of that Act.

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

The board of directors of a company can issue debentures on behalf of the company without passing a resolution at the meeting of the Board.

- True
- False

Correct answer: False

Other Powers to be exercised at Board Meetings

Besides the above powers, there are certain other powers which the Board of directors can exercise **only at its meeting**. These powers are—

- (a) the power to form opinion about solvency of the Company in respect of buy-back of shares (Section 77A).
- (b) the power to fill up casual vacancies in the office of directors (Section 262);
- (c) the power to constitute Audit Committee and specify terms of reference thereof (Section 292A).
- (d) the power to make donation to political parties [proviso to Sub-section (2) of Section 293A];
- (e) the power to accord sanction for specified contracts in which one or more directors are interested [Section 297(4)];
- (f) disclosure of interest by a director [Section 299(1)];
- (g) the power to receive notice of disclosure of directors' interest [Section 299(3)(c)];
- (h) the power to receive notice of disclosure of directors' shareholding [Section 308(2)];
- (i) the power to appoint or employ a person as managing director if he is the managing director or manager of one and not more than one other company [Section 316(2)];
- (j) the power to invest in shares or debentures of any other body corporate under Section 372A;
- (k) the power to appoint or employ a person as its manager if he is the manager

or managing director of other company [Section 386(2)];

- (l) the power to make a declaration of solvency where it is proposed to wind up the company voluntarily [Section 488(1)];
- (m) approval of text of advertisement for inviting public deposits [Section 58A read with rule 4(4) of the Companies (Acceptance of Deposits) Rules, 1975].

In *Maharashtra State Mining Corpn. v. Sunil* [(2006) 70 SCL 351 (SC)], decided on 24.04.2006, the appellant corporation's managing director terminated respondent's services on 25-11-1991 for various misconducts. The respondent filed a writ petition challenging the said dismissal order on the ground that the Managing Director had no authority to do so since the same was vested in the appellant's board of directors. While the said petition was pending, the Board of Directors passed a resolution ratifying the managing director's impugned action. The High Court, however, while setting aside the impugned termination order, allowed respondent's writ petition. Appellant appealed to the Supreme Court.

Appeal was allowed. According to the Learned Judge of the Supreme Court, the High Court was right when it held that an act by a legally incompetent authority was invalid. But it was entirely wrong in holding that such an invalid act cannot be subsequently 'rectified' by ratification of the competent authority. Ratification, by definition, means making valid an act already done. The principle was derived from the Latin maxim '*rati habitio mandato aequiparature*', namely, 'a subsequent ratification of an act was equivalent to a prior authority to perform such act. Therefore, ratification assumed an invalid act, which was retrospectively validated.

In the instant case, the managing director's order dismissing the respondent from the service was admittedly ratified by the board of directors on 20.2.1991 and the board of directors unquestionably had the power to terminate the services of the respondent. Since the order of the managing director had been ratified by the board of directors, such ratification related back to the date of the order and validated it. Therefore, the instant appeal was allowed, the impugned judgment and order of the High Court was quashed, and the dismissal order dated 25.1.1991 was upheld.

Powers which must be exercised by unanimous vote

The following powers of the Board must be exercised by resolutions passed at meeting with the consent of all the directors present at the meeting—

- (a) the power to appoint or employ a person as its managing director under Section 316 or manager under Section 386 if he is managing director or manager of one and not more than one other company.
- (b) the power to invest in shares or debentures of any other body corporate under Section 372A.

2.2 Powers of the Board exercisable with the approval of the company in general meeting

Section 293(1) provides that the Board of directors of a public company, or of a private company which is subsidiary of a public company shall not, except with the consent of such public company as the case may be, in general meeting—

- (a) sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking;
- (b) remit, or give time for the repayment of, any debt due by a director except in the case of renewal or continuance of an advance made by a banking company to its director in the ordinary course of business;
- (c) invest, otherwise than in trust securities, the amount of compensation received by the company in respect of the compulsory acquisition, after the commencement of this Act, of any such undertaking as is referred to in clause (a), or of any premises or properties used for any such undertaking and without which it cannot be carried on or can be carried on only with difficulty or only after a considerable time;
- (d) borrow money, where the moneys to be borrowed, together with the moneys already borrowed by the company (apart from temporary loans obtained from the company's bankers in the ordinary course of business), will exceed the aggregate of the paid-up capital of the company and its free reserves, that is to say, reserves not set apart for any specific purpose; or
- (e) contribute to charitable and other funds not directly relating to the business of the company or the welfare of its employees any amounts the aggregate of which will, in any financial year, exceed fifty thousand rupees, or five percent of its average net profits as determined in accordance with the provisions of Sections 349 and 350 during the three financial years immediately preceding, whichever is greater.

The resolution of the general meeting in relation to the exercise of the power referred to in clause (d) or in clause (e) above should specify the total amount up to which moneys may be borrowed by the directors or the total amount which may be contributed to charitable or other funds in any financial year, as the case may be [Explanation I].

The expression 'temporary loans' occurring in clause (d) means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short term loans of a seasonal character, but does not include loans raised for the purpose of financing expenditure of a capital nature.

Sub-section (2) of Section 293 provides that nothing contained in clause (a) of Sub-section (1) shall effect—

- (i) the title of a buyer or other person who buys or takes a lease of any such undertaking as is referred to in that clause, in good faith, and after exercising due care and caution; or
- (ii) the selling or leasing of any property of the company where the ordinary business of the company consists of or comprises, such selling or leasing.

Any resolution for any transaction such as is referred to Section 293 (1) (a) may attach such conditions as may be specified in the resolution including conditions regarding the use, disposal or investment of the sale proceeds. However, this shall not

be deemed to authorize the company to effect any reduction in its capital except in accordance with the provisions contained in that behalf in the Companies Act, 1956.

Sub-section (5) of Section 293 provides that no debt incurred by the company in excess of the limit imposed by clause (d) of Sub-section (1) shall be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

The acceptance by a banking company in the ordinary course of its business, or deposits of money from the public, repayable on demand or otherwise, withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of money by the banking company within the meaning of clause (d) of Sub-section (1).

In, *Yellamma Cotton Woollen and Silk Mills Co. Ltd.*, (1970) 40 Com Cases 466 : AIR 1969 Mys 280, movable assets were hypothecated with the condition that on default the lender would take possession of the assets. This will not amount to sale of assets. Transfer of all equity shares in a wholly owned subsidiary company by the holding company may not attract the provision of this section.

The object of the section is to restrict the Board to dispose off the company's assets whatever they may like. It is the shareholders who are the owners of the company and they have the right to dispose off the company's assets according to their wishes and if the directors do not collaborate with them they can either replace directors or get a Court order in the matter [*Kriparam v. Shreyanprasad*, AIR 1951 Punj 79]. In another case, the directors disposed off the assets for the payment of the debts of the company. This was held to be beyond the directors' powers.

A decision was taken by the Board of directors to sell the immovable property of the company. They also obtained sanction of the general body of shareholders. An individual shareholder was not allowed to question the wisdom of the decision. The Court cannot at the instance of a single shareholder upset the decision taken by the Board of directors and sanctioned by the general body. The Court cannot substitute its decision for the commercial wisdom of the Board of directors. [*Cochin Malabar Estates & Industries Ltd. v. P.V. Abdul Khader* (2003) 114 Com. Cases 777 (Ker.)].

A closed unit of a company is not "an undertaking" within the meaning of this sub-section and the provisions of section 293(1) do not apply to a proposed sale of the unit. [*Pramod Kumar Mittal v. Andhra Steel Corporation Ltd.*, (1982) 2 Comp LJ 629 : (1985) 58 Com Cases 772 (Cal)].

Exemption of equitable mortgage/pledging from applicability of Section 293(1)

Meaning of Equitable Mortgage

It is a mortgage that does not meet the requirements of a legal mortgage but comes into effect by an agreement to create a legal mortgage or by the creation of an equitable charge such as for the repayment of a loan. It gives the mortgagee the right to foreclose on the property, sell it, or appoint a receiver in case of non payment

Meaning of Pledging

It means offering assets to a lender as collateral for a loan. Though the asset will be pledged to the lender, it still owned by the borrower unless he/she defaults on the loan.

The Execution of an equitable mortgage and pledging by a company is not a disposition of the whole or substantially the whole of the undertaking of the company under Sub-section (1)(a) of Section 293 of the Act. [*Sheth Mohanlal Ganpatram v. Sayaji Jubilee Cotton & Jute Mills Co.*, (1964) 34 Com Cases 777 (Guj)].

Execution of an usufructuary mortgage

Department's view - If a company mortgages the whole or substantially the whole of its undertaking for obtaining loans or other financial assistance, it need not comply with the provisions of Section 293(1)(a) of the Act, but if it is an usufructuary mortgage the said section would be attracted. (Letter No. 8/19(293)/64-PR, dated 21.7.1964).

Usufructuary mortgage

Where the mortgagor delivers possession, or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee and authorises him to retain such possession until payment of the mortgage money, and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same in lieu of interest or partly in payment of the mortgage money, partly in lieu of interest and partly in payment of the mortgage money, the transaction is called a usufructuary mortgage and the mortgagee a usufructuary mortgagee.

Leasing of the right to use the facilities of a company, was held to be not a lease or disposal of the Company's undertaking, because undertaking means substantial part of the assets. An agreement of sale etc. means a complete and exclusive transfer whereby the transferee gets the right to hold, possess and control the undertaking in question [*Allana Cold Storage Ltd. v. Goa Meat Complex Ltd.*, (1997) 90 Com. Cases 50 at 64].

Where a company's business was neither to invest in shares, nor even to engage in the business of investing in shares, but even so the company carried on some investment in shares, the sale of such shares by the company was held to be not the sale of the undertaking or even a substantial part of the undertaking. The Company Law Board, while examining the validity of such a transfer of shares, propounded this test as to whether the sale of undertaking was involved or not, that whether the business of the company would be carried on effectively even after the disposal of the assets in question or whether a mere husk of the undertaking would remain after the disposal of the assets. [*Tracstar Investments Ltd. v. Gordon Woodroffe Ltd.* (1996) 87 Com. Cases 941 (Mad.-CLB)]. Affirmed in *Shoe Specialities Ltd. v. Tracstar investments Ltd.*, (1997) 99 Com. Cases 471 (Mad-DB).

Borrowings

The provisions of Sub-section (5) of Section 293 clearly lays down that the debts incurred in excess of the limit specified shall not be valid unless the lender proves that he lent his money in good faith and without knowledge of the limit imposed by Sub-section (1) being exceeded. He cannot assume that the consent of the company in general meeting has been given. Neither the rule in *Royal British Bank v. Turquand*, (1856) 6 E & B 327 nor the series of decisions relating to ratification by

shareholders will apply. If the condition in Sub-section (5) is not satisfied, the debt in excess of the limit is not valid or effectual.

In case of an ultra vires borrowing, the directors may, because of an implied warranty given by the lender be personally liable to damages to the lender [*Firbank's Executors v. Humphreys*, (1886) 18 QBD 54; *Garrad v. James*, 1925 Ch 616]. The money may come in the hands of the company, and if paid to the company's creditors, the lender may be subrogated to the rights of the creditors [*Blackburn Building Society v. Cunliffe Brooks & Co.* (1882) 22 ChD 61 : (1881-5) All ER Rep Ext. 1280]. If it is proved that money had gone into the company's coffers, the company will be liable to repay, even if the borrowing is unauthorised.

In case of a borrowing in excess of the limits, the excess borrowing would be ultra vires and not the whole transaction. But if all the shareholders ratify the excess loans by directors, such a ratification will validate such excess debts.

The consent of the company in general meeting may be in the form of a formal ordinary resolution [*Bamford v. Bamford* (1970) Ch. 212: (1969) 1 All ER 969 (CA)] or it may be at an informal meeting of all the shareholders [Re, *Express Engineering Works Ltd.*, (1920) 1 Ch 466: (1920) All ER Rep Ext 850 (CA)] or by the acquiescence of all the shareholders without a meeting [*Parker Ltd v. Reading*, (1926) Ch. 975 : (1926) All ER Rep 323].

Hire purchase and leasing transactions: Hire purchase and leasing transactions are not covered by clause (d) of Section 293(1), as they do not amount to "borrowing".

Whether Contingent Liabilities is a Borrowing or not

Contingent liabilities like amounts outstanding on deferred payment agreement or under guarantee issued by the bankers for such deferred payment instalments or in respect of letters of credit established by the company's bankers cannot be termed borrowings by the company and are not covered by the provisions of sections 293. This view has also been clarified by the Company Law Board, stating that in the view of the Department, the term borrowing under section 293(1)(d) does not include debts on account of purchase of machinery and deferred payments [Letter No. 8/16(1)61-PR dated 9-5-1961].

Prohibitions and Restrictions Regarding Political Contributions

Section 293A(2) permits Non-Government Companies which are in existence for not less than three financial years, to make contributions, directly or indirectly, in any financial year, to any political party or for any political purpose to any person, amounts not exceeding five percent of their average net profits determined in accordance with provisions of Sections 349 and 350 during the three immediately preceding financial years.

Government Companies and Companies which have been in existence for less than three financial years cannot make any contribution to political party or for any political purpose to any person.

It is further provided that no such contribution shall be made by a company unless a resolution authorising the making of such contribution is passed at a meeting of the Board of directors and such resolution shall, subject to other

provisions of this section, be deemed to be justification in law for the making and the acceptance of the contribution authorised by it.

A donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given or made can reasonably be regarded as likely to effect public support for a political party shall also be deemed to be contribution of the amount of such donation, subscription or payment to such person for a political purpose [Section 293A (3) (a)].

The amount of expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for the advantage shall also be deemed—

- (i) where such publication is by or on behalf of a political party, to be contribution of such amount to such political party, and
- (ii) where such publication is not by or on behalf of but for the advantage of a political party, to be a contribution for political purpose to the person publishing it [Section 293A (3) (b)].

Such contributions are required to be disclosed by every company in its profit and loss account, giving particulars of the total amount contributed and the name of the party or the person to which or to whom such amount has been contributed [Section 293A (4)].

A company which contravenes the provisions of Section 293A is punishable with fine which may extend to three times the amount so contributed. Further, every officer of the company, who is in default is also punishable with imprisonment which may extend to three years and is also liable to fine [Section 293A (5)].

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

Government companies which have been in existence for less than three financial years can make contributions to political parties, or for any political purpose, to any person.

- True
- False

Correct answer: False

Government companies and companies, which have been in existence for less than three financial years, cannot make any contribution to a political party, or for any political purpose, to any person.

Power of Board and other persons to make contributions to the National Defence Fund, etc.

By virtue of Section 293B, the Board of directors of any company or any person or authority exercising the powers of the Board of directors of a company or of the company in general meeting, may, notwithstanding anything contained in Section

293 and 293A or any other provisions of this Act or in the memorandum, articles or any other instrument relating to the company, contribute such amount as it thinks fit to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence. The amount of contributions made for this purpose are required to be disclosed by the company in its profit and loss account of the financial year during which such contributions are made.

3. LOANS TO DIRECTORS

According to Section 295 (1) of the Companies Act, 1956, no company, (hereinafter known as the lending company), shall without obtaining the previous approval of the Central Government in that behalf, directly or indirectly, make any loan to or give any guarantee or provide any security in connection with the loan made by any person to or to any other person by:

- (a) any director of the lending company or of a company which is its holding company or any partner or relative of any such director;
- (b) any firm in which any such director or relative is a partner;
- (c) any private company of which any such director is a director or member;
- (d) any body corporate at a general meeting of which not less than twenty five per cent of the total voting power may be exercised or controlled by any such director, or by two or more directors together; or
- (e) any body corporate, the Board of directors, managing director, or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

Meaning of “making of a loan” – The making or giving of a loan means an act of giving or something else by one person to another. There ought to be a positive act with an understanding that the money or something else so given will be returned by the borrower, with or without interest within an agreed period in any agreed manner.

Meaning of ‘indirect loan’ – Section 295 applies to the loans, etc. given by a company ‘directly or indirectly’. Indirect loan means that the company shall not give a loan through the agency of one or more intermediaries. The word ‘indirectly’ in the section cannot be read as converting what is not a loan into a loan. As such, a debt which is not in the nature of loan cannot be said to be the case of an indirect loan. [Fredie Ardeshir Mehta (Dr.) v Union of India (1989) 2 CLA 244 (Bom): (1991) 1 Comp LJ 437 (Bom)]. Financial accommodation given to a director by the company directly or indirectly by way of payment towards his personal expenses will attract the provisions of this section.

The provisions of sub-section (1) do not apply to:

- (a) any loan made, guarantee given or security provided:- (i) by a private company unless it is subsidiary of a public company, or (ii) by a banking company;
- (b) any loan made by a holding company to its subsidiary company;

- (c) any guarantee given or security provided by a holding company in respect of any loan made to its subsidiary company.

This does not apply to a private company which is not subsidiary to a public company.

Section 283 lays down that the office of the director shall become vacant for contravention of Section 295.

In the case of *M.R. Electronics Components Limited and Others v. Assistant Registrar of Companies* (1986) 3 Comp. L.J. 28 (Mad.), the directors of a company had given an advance of Rs. 5,000 to the Managing Director's wife who was employed by the Company on monthly salary. On the ground that the provisions of Section 295 of the Companies Act, 1956 were violated, prosecution was launched against the company and its directors and the trial court held that the advance paid to the employee amounted to a loan and consequently convicted the accused for an offence punishable under Section 295(4). In the revision which was filed in the Madras High Court against the said conviction it was held that as far as the ingredients are concerned, salary advance and loan are in all respects similar. Therefore, for the transaction to be characterized as a loan or salary advance it is the capacity of the person receiving the amount that counts. Merely because the beneficiary of a salary advance is the wife of the Managing Director of a company, it cannot be said merely on the sole reason that as she is the wife of one of the directors, an offence has been committed. The court had to find out in each case whether the salary advance was a genuine salary or a loan disguised as salary advance. For that purpose, it would be necessary to consider whether beneficiary is a bona-fide employee, whether advance falls within the general scheme of advances given by the company to other employees, whether the amount given is disproportionate to the salary of the employees, whether conditions of repayment or other conditions of the loan like the rate of interest are exorbitant, whether there was laxity in the recovery of the advance, etc. It is in taking into consideration the circumstances that surround the operation that the court can reach the correct conclusion.

The Bombay High Court in *Fredie Ardeshir Mehta (Dr.) v. Union of India* (1991) 70 Comp. Cas. 210 (1991) 1 Comp. LJ 437 (Bom.) held that the company selling one of its flats to one of its directors on receiving half the price in cash and agreeing to accept the balance in instalments does not amount to giving of loan to the director.

Non applicability of Section 295(1) On House Building Loan to Directors

Ministry of the Corporate Affairs had allowed companies to make house building loans to their Managing Directors and Whole-time Directors without obtaining prior approval of the Central Government under Section 295 of the Companies Act, 1956 on such terms and conditions as are applicable to its officers/employees. The approval of the Government will however, be necessary in the case of companies having no such scheme or where the house building loan proposed to be made is not covered by the terms and conditions as are applicable to its officers/employees.

Exemption to Government Companies from applicability of Section 295

Sub-Section (1) of Section 295 is not applicable to a Government company provided such a company has obtained the approval of the Administrative Ministry,

Department of the concerned State Government. [Notification No. GSR 581(E) dated 16.7.1985].

Contravention of Section 295

Any contravention of the provisions of Section 295 shall be punishable either with fine, which may extend to Rs. 50,000/- or with simple imprisonment for a term which may extend to six months. However, where any such loan or any loan in connection with which any other guarantee or security has been given or provided by the lending company has been repaid in full, no punishment by way of imprisonment shall be imposed under this sub-section and where the loan has been repaid in part, the maximum punishment by way of imprisonment shall be proportionately reduced.

All persons who are knowingly parties to any contravention of Sub-section (1) of Section 295 shall be liable jointly and severally to the lending company for the repayment of the loan or for making good the sum which the lending company may have been called upon to pay in virtue of the guarantee given or the security provided by such company.

Application for Approval — Information to be Stated Therein

Application for giving loan, providing security or guarantee in connection with a loan shall be made to the Central Government in e-Form 24AB.

Every applicant is required to furnish the under mentioned information and documents to the Ministry of Company Affairs while filing the e-form:

- (i) Working results of the company for the last three financial years.
- (ii) Amount of loan or security or guarantee.
- (iii) Details and justification of the proposal mentioned in the application.
- (iv) Details of the borrowing Company.
- (v) Controlling and common interest in shareholding pattern of the borrowing Company.
- (vi) Details of loan given or corporate guarantee or security provided to any Company or person or firm etc. so far under Section 295 along with details thereof and proof of compliance of Section 372A wherever applicable.

The following attachments are required to be filed along with the e-form:

- (i) Copy of the board of directors resolution in this regard.
- (ii) Copy of member's resolution containing specific approval of required members along with explanatory statement.
- (iii) A declaration that Company has not defaulted in making repayments to the investors as and when they become due to them.
- (iv) List of directors of board of both the Companies and disclosing inter se interest, if any.
- (v) Copy of draft loan agreement.
- (vi) Declaration to the effect that funds proposed to be loaned are not required for its working capital requirements at least for a year.

- (vii) Copy of loan scheme for the employees of the Company, if any.
- (viii) A no objection certificate or prior approval of public financial institutions or banks in case any term loan is subsisting.
- (ix) A declaration from the statutory auditor or a Company Secretary in whole time practice that:
 - (a) The Company has not defaulted in:
 - (i) The repayment of any fixed deposits or part thereof or interest thereon.
 - (ii) Payment of dividend.
 - (iii) Redemption or repayment of debenture and timely payment of interest thereon.
 - (iv) Redemption of Preference Shares, and
 - (b) The Company is regular in filing all forms or returns as required to be filed under the Companies Act, 1956.
 - (c) The proposal is in conformity within the provisions of the Section 372A of the Companies Act, 1956.
 - (d) That the Company is not in any default on account of undisputed dues of the Central Government e.g. income-tax, central excise etc.
- (x) Copy of letter from bank or financial institutions wherein the Company has been asked to furnish Corporate Guarantee or security for the loan sanctioned to the borrower Company.
- (x) Shareholding pattern of applicant and borrowing Company.

4. BOARD'S SANCTION FOR CONTRACTS IN WHICH DIRECTORS ARE INTERESTED

Section 297 of the Companies Act, 1956 provides that the consent of the Board of directors is required for certain contracts in which particular directors are interested. It provides that a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company except with the consent of the Board of directors:

- (i) for the sale, purchase or supply of any goods, materials or services; or
- (ii) for underwriting the subscription of any shares in or debentures of the company.

In the case of company having a paid-up share capital of not less than rupees one crore, previous approval of the Central Government would be required [proviso to Section 297(1)]. For the previous approval of the Central Government, application shall be made in e-form 24A [form for filing application to Central Government (Regional Director)] of General Rules and Forms.

The power has been delegated to Regional Director.

Sub-section (2) of Section 297 provides that nothing contained in (i) above shall apply to:

- (a) the purchase of goods and materials from the company or the sale of goods

and materials to the company, by any director, relative, firm, partner or private company as aforesaid for cash at prevailing market prices; or

- (b) any contract or contracts between the company on one side and any such director, relative, firm, partner or private company on the other for sale, purchase or supply of any goods, materials and services in which either the company or the director, relative, firm, partner or private company, as the case may be regularly trades or does business. However, the value of contract or contracts should not relate to goods and materials the value of which, or services the cost of which, exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract or contracts; or
- (c) in the case of a banking or insurance company any transaction in the ordinary course of business of such company with any director, relative, firm, partner or private company as aforesaid.

In circumstances of urgent necessity, the director, relative, firm, partner or private company as aforesaid may enter, without obtaining the consent of the Board, into any contracts with the company for the sale, purchase or supply of any goods, materials, or services even if the value of such goods or cost of such services exceeds five thousand rupees in the aggregate in any year comprised in the period of contract, but then the consent of the Board must be obtained at a meeting within three months of the date on which the contract was entered into.

The consent of the directors must be accorded by a resolution passed at a meeting of the Board. It is not enough to obtain the consent by means of a resolution passed by circulation.

The consent contemplated here cannot be a general consent but consent to each specific contract. If consent of the Board is not accorded to any contract under this section, anything done in pursuance of the contract shall be voidable at the option of the Board.

This section does not apply to contracts between two public companies and also is not attracted to a transaction of loan made by a director to the company because it is not a sale or purchase of goods or a contract to render services. It has been observed by the Calcutta High Court that the section does not seem to recognise any public policy prohibiting a contract between a private and a public company with some common shareholders or directors [*Albert Judah v. Ramapada Gupta*, (1960) 30 Com Cases 582: AIR 1959 Cal 715].

If 'X' is a director of A Ltd. and also a director/member of B Private Ltd., then Section 297(1) will apply to contracts between these two companies, subject to the exceptions provided therein. However, if only the relatives of X are directors/members of B Private Ltd. (and not 'X' himself) the section will not apply. The same rule will also apply to Section 295.

Section 297 not applicable to lease of immovable property

Lease of immovable property is outside the scope of Section 297 as the reference to "goods" in the section means every kind of movable property under the Sale of Goods Act.

The provisions of this section are not violated if, without obtaining the sanction of the Board, a director owning premises enters into a contract of tenancy with the company or gives on hire to the company any plant or machinery owned by him.

Department's Clarification. Sona Steering Systems Ltd., a joint venture of Maruti Udyog Ltd., made an application to the Department of Company Affairs for approval under Section 297(1) of the Companies Act, 1956, for taking on rent office premises for the company from a firm in which directors of the company were interested. It was clarified that the proposal of the company, being a transaction in immovable properties, is not covered by the provisions of Section 297. (The letter No. 9/4/90 – CL X dated 27-3-1990).

Service contracts

It may be noted that all contracts including service contracts whatever their value, with the directors and other persons mentioned in the section require the previous approval of the Central Government. If so, appointment of such persons coming under Section 314 will also be covered. It is to be noted that even a director can enter into a contract to serve the company and prior approval of the Central Government would have to be sought.

Oral contracts

Under the Indian Contract Act, a contract need not be in writing, and an oral contract is also valid in law. The provisions of Section 297 will accordingly also apply in respect of an oral contract.

Contracts for supply of services

Contracts for supply of services are also covered under Section 297. Services like banking, finance, insurance, transport, advertising, warehousing, purveying of news or information, etc. are also included but not for personal services, such as a contract of employment as the same is covered under Section 314. Further, the reference to the market value of the services in clause (a) of Sub-section (2) also seems to exclude personal service contracts.

A cheque may be treated as equivalent of a cash payment for the purpose of this provision [Letter No. 8/2 (Misc.)/75-CL.V, dated 6-6-1975].

Delegation of powers to Regional Directors under Section 297(1) (Proviso)

Central Government has delegated to the Regional Directors the powers and functions under the proviso to sub-section (1) vide Notification No. GSR 563 (E), dated 19-8-1993.

Simplified procedure for obtaining online approval of Central Government under Section 297 of the Companies Act, 1956

Vide General Circular No. 52/2011 dated 25.07.11, the Ministry has decided to simplify the procedures and to give approval online, if the proposed contract has been approved by the shareholders by way of special resolutions in a general meeting.

According to new procedure—

1. Application will be made in a new e-form with the prescribed fee. The relevant information like terms of contract and details of Board resolutions and special resolutions shall be captured in the e-form. The e-form shall also be certified by the practicing professional who shall specifically certify the correctness of the information and declarations given by the company in the e-form.
2. The company while seeking approval of the directors and shareholders in their meeting shall specifically take approval to the effect that—
 - (i) Proposed contract is competitive, at an arm's length, without conflict of interest and is not less advantageous to it as compared to similar contracts with other parties.
 - (ii) The company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon and has filed its upto date Balance Sheets and Annual Returns with the Registrar of Companies.
 - (iii) The proposed contract is falling within the provisions of section 297 of the Act and provisions of Sections 198, 269, 309, 314 and 295 are not applicable in the proposed contract.
 - (iv) The company and its Directors have complied with the provisions of sections 173, 287, 299, 300, 301 and other applicable provisions of the Companies Act, 1956 with regard to the proposed contract.
3. The application will be processed online and approval of Central Government shall also be made available to the applicant company online on the basis of declarations made by the company and certifications by the professionals given in the e-form.
4. If any of the information or declaration given by the company or certificate given by the professional in the e-form is found to be wrong, then the applicant company, its Directors and professional shall be liable for penal action under section 297 and 628 of the Companies Act, 1956 in addition to penal action prescribed in regulations of the respective professional institutes.

The process of online approval of Central Government under section 297 of the Companies Act, 1956 has been implemented with effect from 24th September, 2011.

Non-applicability of the provisions of Section 297 to certain transactions :

- (1) ***Professional services of solicitors/advocates.*** Services of the nature of a legal practitioner are not obtained on the basis of say, lowest tender but on account of their professional expertise irrespective of the cost involved. Such services cannot be bracketed with a contract for supply of goods or materials. The Department's view is that these services fall outside the scope of Section 297 of the Act and the scope of the section does not extend to supply of professional services of the nature given by firms of solicitors and advocates, etc. (Circular No. 13/75, dated 5-6-1975).
- (2) ***Appointment of additional director.*** The appointment as an additional director of a person who is related to a director has been held not to violate the requirement of Section 300 (1) because such appointment does not

constitute any “contract or arrangement” of the company with the sitting director [*Shailesh Harilal Shah v. Matushree Textiles Ltd.*, (1994) 2 Comp LJ 291 at 301 : AIR 1994 Bom 20]. The director in question was not accordingly disentitled from participation and voting at a meeting of the Board.

- (3) **Appointment as managing or whole-time director.** A question has also been raised whether proviso to Section 297(1) applies to a contract of employment of a director as managing or whole-time director. In this connection, it is pointed out that it is a basic principle of Company Law that directors are agents or trustees and they stand in fiduciary position not only to the company but also members and creditors. This position is not changed merely by entrusting them with additional responsibilities for managing the affairs or rendering of services of a professional nature though they are remunerated for those services in accordance with the Articles of Association of the Company subject to the provisions of the Companies Act. ‘Supply of Service’ is not the same as ‘rendering of personal service’ as a director or managing or whole-time director. Furthermore, there are specific provisions in the Companies Act, for regulating such appointments. Therefore, the Department’s view is that proviso to Section 297(1) does not apply to the contract of employment of a director as a managing or whole-time director (Circular No. 13/75, dated 5-6-1975).

Consequences of non-compliance with section

Section 297 does not provide any penalty for non-compliance. The penalty, therefore, will be as per the provisions of Section 629A. Default or non-compliance with the section in cases where approval of the Central Government is necessary would render the transaction void but it would be only voidable where the consent of the Board of directors’ was necessary and was not accorded.

Where the accounts and affairs of the company were inspected and a violation of the section was detected, it was held that the period of limitation began from the date on which the directors submitted their explanation and not from the date of the report. The Court however agreed that the prima facie limitation begins on the date on which a document is filed with ROC. The court said that the limitation is a mixed question of law and fact. [*First Leasing Company of India Ltd. v. Addl. ROC* (1997) 89 Com. Cases 635 (Mad)].

As the proviso to Sub-section (1) of Section 297 forbids the entry into contracts with a director, or his relative, or firm or partner or private company specified in the Sub-section (1), except with the previous approval of the Central Government, failure to obtain such previous approval will make the contract illegal and void, the provisions of Sub-section (5) making such contract voidable being confined only to cases where the consent of the Board of directors has not been accorded to the contract [*Globe Motors Ltd. v. Mehta Teja Singh & Co.*, (1984) 55 Com. Cases 445 (Del) (DB)].

5. DISCLOSURE OF INTEREST BY DIRECTORS

Section 299 of the Companies Act provides, that every director of a company who is in any way, whether directly or indirectly concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered

into by or on behalf of the company shall disclose the nature of his concern or his interest at a meeting of the Board of directors [Section 299(1)].

A director occupies a fiduciary position in relation to a company and he must act bonafide in the interests of the company. If a director makes a contract with the company and does not disclose his interest, he will be committing breach of trust [*Yashovardhan Saboo v. Groz-Beckert Saboo Ltd.*, (1995) 83 Com Cases 371 at p.413 (CLB)].

Section 299 is wider in scope and deals with contracts between companies in which a director is interested directly or indirectly. Here there is a conflict of duties as contrasted to the conflict of personal interest contemplated under Section 297.

In case of a proposed contract or arrangement such disclosure shall be made at the meeting of the Board, where it is first taken into consideration. At the date of that meeting if the director was not concerned or interested in the proposed contract or arrangement, he should disclose his interest or concern at the first meeting of the Board held after he becomes so concerned or interested.

In the case of any other contract or arrangement, the required disclosure shall be made at the first meeting of the Board held after the director becomes concerned or interested in it [Section 299(8)].

Such disclosure may be made by a general notice given to the Board by a director stating that he is a director or member of a specified body corporate or partner of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may be entered into after date of the notice, shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made. Such notice shall expire at the end of the financial year for which it is given. However, it may be renewed for further periods of one financial year at a time, by a fresh notice given in the last month of the financial year in which it would otherwise expire. The general notice given to the Board is not effective unless it is given and it is brought up and read at the first meeting of the Board after it is given. The notice required to be given under Section 299 of the Act should be in Form No. 24AA which is prescribed by the Companies (Central Government's) General Rules and Forms, 1956.

Every director who fails to comply with the provisions of Sub-section (1) and (2) shall be punishable with fine which may extend to fifty thousand rupees. The provisions of Section 299 do not apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than two per cent of the paid-up share capital in the other company.

The Department of Company Affairs vide letter No. 8/9/(299)63 - PR dated 20.9.1963, clarified that the provisions of Section 299 are applicable to directors nominated by the Government on the Board of directors of any company.

Section 299 applies to any contract or arrangement to which a company is a party and in which a director is interested. The section is wider in scope than section 297 which refers to certain direct contracts only. The contracts falling within the purview of section 297 necessarily attract section 299 although the converse may not

be true. Unlike section 297, however, section 299 does not confine to any specified contracts. Besides contracts, it also applies to arrangements.

Position of Interested Director

Section 300 prohibits an interested director from participating in the discussion of or voting on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company in which his presence shall not be counted for the purpose of forming a quorum at the time of any such discussion or vote and if he does vote, his vote shall be void. Interest here means personal interest and not official or any other interest. It may be financial interest and includes interest arising out of fiduciary duties or closeness or relationship such as that of husband and wife, father and son [Firestone Tyre & Rubber Co. v. *Synthetics & Chemicals Ltd.*, (1970) Comp. L.J. 200].

However, the above provisions do not apply to:

- (i) a private company which is neither a subsidiary nor a holding company of a public company;
- (ii) a private company which is a subsidiary of a public company in respect of any contract entered into, or to be entered into, by the private company with the holding company thereof;
- (iii) any contract of indemnity against any loss which the directors, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company;
- (iv) any contract with another company in which the director is a nominee director of the first company and holding not more than the qualification shares or is a member of the other company holding not more than two per cent of the paid-up share capital;
- (v) a public company or a private company which is a subsidiary of a public company, which has been exempted by the Central Government by notification.

Any director who knowingly contravened the above provisions is punishable with fine which may extend to fifty thousand rupees.

6. DUTIES OF DIRECTORS

The duties of directors are multifarious and they vary from company to company depending upon the type and size of its activities.

The duties of directors may be divided under two heads:

1. Statutory duties and
2. Fiduciary and general duties

Statutory duties – Statutory duties are the duties and obligations imposed by the Companies Act. Important amongst them are:

- (A) **Duty to attend Board meetings** – Section 283(1)(g) imposes a statutory duty on the directors to attend Board Meeting. Although a director may not

be able to attend all the meetings but if he fails to attend three consecutive meetings or all meetings for a period of three months whichever is longer, without obtaining leave of absence from the Board, his office shall automatically fall vacant.

- (B) ***Duty not to contract without Board's consent*** — The directors should not enter into contracts with company in violation of the provisions of Section 297 of the Act.
- (C) ***Duty to disclose interest (Sections 299-300)*** — Section 299 imposes an obligation on a director to disclose the nature of his concern or interest whether (direct or indirect) if any, at a meeting of the Board of directors. A director is in a fiduciary position. A person in fiduciary position is not permitted to obtain profit from his position except with the consent of his beneficiaries or other persons to whom he owes the duty. In terms of Section 300 an interested director shall not participate or vote in Board's proceedings.
- (D) ***Duty of Director etc. to make disclosure*** — Section 305 imposes an obligation on every director managing director, manager or secretary of a company who is appointed to or relinquishes the office or director, managing director, manager or secretary or any other body corporate (including foreign company) shall within twenty days of such change, disclose to the company. If he fails to do so, he shall be punishable with fine which may extend to five thousand rupees.
- (E) ***Duty of Directors to make disclosure of Shareholding*** — Section 308 imposes an obligation that every director and every person deemed to be a director by virtue of Sub-section (10) of Section 307 shall give notice, in writing, of the matters relating to himself/herself as required under Section 307 of the Act. The Directors and deemed director(s) giving the notice shall take all reasonable steps to secure that it is brought up and read at the meeting of the Board next after it is given. Any person who fails to comply with the provisions, shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to fifty thousand rupees or with both.
- (F) ***Duty in connection with the general meeting*** — the directors have to convene statutory meeting, annual general meetings (AGMs) and also extraordinary general meetings [Sections 165, 166 & 169]. The Companies Act confers the duty of the preparation and placing at the annual general meeting along with the balance sheet and profit and loss account, a report on the company's affairs. The Board's report must also include a Directors' Responsibility Statement as provided under sub-section (2AA) of Section 217. Closely related thereto is the duty of authenticating and approving annual financial statement under Section 215 of the Companies Act.
- (G) ***To disclose receipt from transfer of property*** — Section 319 of the Companies Act provides that any money received by the directors from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company or the amount shall be held by the directors in trust for the company. This money may be in the nature of compensation for loss of office but in essence may

be on account of transfer of control of the company. But, if it is bona fide payment of damages of the breach of contract, then it is protected by Section 321(3). Even no director other than the managing director or whole time director can receive any such payment from the company itself.

- (H) **To disclose receipt of compensation from transferee of shares —** Section 320 provides that if the loss of office results from the transfer (under certain conditions) of all or any of the shares of the company, its directors would not receive any compensation from the transferee unless the same has been approved by the company in general meeting before the transfer takes place. If the approval is not sought or the proposal is not approved, any money received by the directors shall be held in trust for the shareholders who have sold their shares.

Section 320 also provides that in pursuance of any agreement relating to any of the above transfers, if the director receives any payment from the transferee within one year before or within two years after the transfer, it shall be accounted for to the company unless the director proves that it is not by way of compensation for loss of office.

Section 321 further provides that if the price paid to a retiring director for his shares in the company is in excess of the price paid to other shareholders or any other valuable consideration has been given to him, it shall also be regarded as compensation and should be disclosed to the shareholders. No director can receive any such payment from the company itself.

- (I) **Duty to file declaration of Solvency —** Section 77A imposes an obligation on the directors of the company in connection with passing special resolution for buy-back of its own shares/securities to enquire into the affairs of the company and form opinion about solvency of the company and to file declaration of solvency in the prescribed form with affidavit.
- (J) **To make a declaration of solvency in the case of a Members' voluntary winding up (Section 488) —**
- (1) Maintenance of books of account, audit, auditors report, directors' report.
 - (2) Restriction on loans to directors and their associates.
 - (3) Certain powers to be exercised only at Board Meetings and certain powers to be exercised with shareholders' consent.
 - (4) Inspection and investigation into the affairs of the company.
- (K) **To file return of allotments —** Section 75 of the Companies Act, 1956 requires a company to file with the Registrar, within a period of 30 days, a return of the allotments stating the specified particulars. Failure to file such return shall make the directors liable as 'officer in default'. A fine up to Rs. 500 per day till the default continues may be levied.
- (L) **Duty to intimate disqualification —** Every director in a public company registered under the Companies Act, 1956 shall file form 'DD-A', intimating his disqualification to the company under section 274(1)(g) of the Companies Act, 1956, before he is appointed or re-appointed by the company. Form DD-A is prescribed under the Companies (Disqualification of Directors under section 274 (1) (g) of the Companies Act, 1956) Rules, 2003.

Besides the above, the Companies Act contains several provisions that are aimed at directing the conduct and behaviour of the directors in relation to the companies towards ethical standards, transparency and accountability. These are-

- (1) Disclosure of shareholding dealings in the company's shares.
- (2) Restrictions on remuneration and other benefits from the company.
- (3) Restriction on holding of office or place of profit in the company by themselves or their relatives and disclosure of information in connection therewith.

Fiduciary and General duties:

The directors have several duties to discharge under the common law some of which have been evolved by courts from time to time, having regard to the position of directors in the company. Some of these duties are:

- (1) Duty not to be negligent and not to commit or let others to commit tortuous acts.
- (2) Duty not to exceed powers.
- (3) Duty to have regard to and act in the best interests of the company and its stakeholders.
- (4) Duty to creditors if business is conducted with intent to defraud them.
- (5) Duty of confidentiality.
- (6) Duty not to exercise powers for a collateral purpose.
- (7) Duty not to misapply company assets.
- (8) Duty not to compete with the company.

Some of the duties are discussed below at length.

1. ***Duty of good faith*** – The directors must act in the best interest of the company. Interest of the company implies the interest of present and future members of the company on the footing that the company would be continued as a going concern.
2. ***Duty not to make secret profits*** – A director should not make any secret profits even while selling his own property to the company as it would amount to a breach of faith. He should also not exploit to his own use the corporate opportunity. In *Cook v. Deeks* [1916] AC 554, it was observed that “men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interest which they are bound to protect and while ostensibly acting for the company direct in their own favour business which should properly belong to the company they represent”.

If a property is acquired by the director in such capacity and he makes a profit on re-sale of the same. Such profit would belong to the company and he should account for such profit.

3. **Duty to take care** — Justice Romer in *Re City Equitable Fire Insurance Company's* case observed:

“His (director’s) duties will depend upon the nature of the company’s business, the manner in which the work of the company is distributed between the directors and other officials of the company. In discharging these duties a director must exercise some degree of skill and diligence. But he does not owe to his company the duty to take all possible care to act with best care. Indeed, he need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. It is, therefore, perhaps another way of stating the same proposition that directors are not liable for mere errors of judgement.”

Similar view was expressed in *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate* [1899] 2 Ch. 392, in the following words:

“If directors act within their powers, if they act with such care is to be reasonably expected of them having regard to their knowledge and experience and if they act honestly for the benefit of the company they discharge both their equitable as well as legal duty to the company.”

Reference can be made hereto Sections 201 and 633 of the Companies Act which provides that any provision in the company’s Articles or in any agreement that excludes the liability of the directors for negligence, default, misfeasance, breach of duty or breach of trust, is void. Where a director may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust but if he has acted honestly and reasonably and having regard to all the circumstances of the case, he ought fairly to be excused, the court may relieve him wholly or partly from his liability on such terms as it may think fit.

4. **Duty not to delegate** - Director is an agent of the company and therefore is bound by the maxim *‘delegatus non potest delegare’* which means a delegatee cannot further delegate. Of course, there are exceptions and a director may, however, delegate in the following cases:
- (a) Where permitted by the Companies Act (that is to say Section 297 permits such delegation depending on the circumstances).
 - (b) Certain functions may be delegated to other officials of the company.
 - (c) Where authorised by the Articles of Association of the company.
 - (d) Where a director is authorized to delegate specific powers by a Board resolution or a resolution passed in general meeting or by a Power of Attorney executed under the common seal of the company.
5. A director of a company shall not assign his office and any assignment so made shall be void.

7. LIABILITIES OF DIRECTORS

Under the Companies Act, 1956, the liabilities of company directors are

numerous. The directors have always to be on guard lest they should incur any liability for any default or violation of any provision. Their civil and criminal liabilities may be grouped under certain heads for convenience of consideration and discussion. They are:

1. Liability to outsiders;
2. Liability to the company;
3. Liability to the shareholders;
4. Liability for statutory defaults and violations.

1. Liability to outsiders

Directors of a company may personally become liable to outside parties in the following cases:

(a) When they enter into contracts on behalf of the company:

- (i) if the contracts are *ultra vires* the company;
- (ii) if they act outside the scope of their own authority;
- (iii) if they act in their own name and not 'for and on behalf of the company';

Directors will be personally liable firstly if they contract in their own names without disclosing that they are acting on behalf of the company. Where a contract was being entered into by the company and not by the director himself, the director should clearly state so that he is doing so only as an agent or else the contract would be personal one and the directors would be personally liable. But where all the contracts for services were made in the name of the companies trading under their trade names and the director sought to be made liable merely appended his name to authenticate the contracts on behalf of the companies, he could not be held personally liable. Further to make signatory director liable there should have been a clear intention on the part of the parties that the director should be a party to the contracts. In a particular case there was no such indication. The company which he represented was insolvent and, therefore, he was personally liable for breach of contract [*Cottrell v. Badgerhill Properties Ltd.*, (1991) BCL 805 (CA)].

Secondly, if the directors act beyond their powers, they will be personally liable for damages, say, if he negotiates a loan which exceeds the limits of the borrowing powers as laid down by the Memorandum of Association or misrepresent to the bank that a resolution was passed authorising him to sign cheques where in fact, he was not so authorised.

(b) When they issue a prospectus:

- (i) in violation of the provisions of the Companies Act, 1956 and the SEBI (ICDR) Regulations;
- (ii) which contains mis-statements(s);
- (c) When they are found guilty of fraud;
- (d) When they allot shares in an irregular manner;

- (e) When their liability has been made unlimited under Sections 322 and 323 of the Act. Section 322 provides that the memorandum of a company may make the liability of any or all directors, or manager unlimited. In such cases, the directors, manager and the member who propose person for appointment to the office of director or manager, shall add to that proposal a statement that the liability of the person holding that office will be unlimited, and before the person accepts the office or acts therein, notice in writing that his liability will be unlimited, shall be given to him by the following or one of the following persons, namely, the promoters of the company, its directors, manager, if any, and its officers.

A limited company may, if so authorised by its articles, by special resolution, alter its memorandum so as to render unlimited the liability of its directors or of any director. However, if the concerned director(s) is already holding office on the date of alteration, the alteration making his liability unlimited shall not have any effect till his term expires unless he accords his consent thereto (Section 323).

- (f) When the Court orders that the directors are personally liable for all or any of the debts or liabilities of the company for fraudulent trading on the part of the company.

2. Liability to the Company

The directors are liable to the company in the following cases:

- (a) When they are negligent in the performance of their duty as directors and the company suffers loss, etc. There are no set standards of skills and care but only general principles which may be applied to determine whether a director has been negligent depending on the facts of each case. It is not possible or practical to take every possible care. [*Lagunas Nitrate Co. v. Lagunas Syndicate*, (1899) 2 Ch 392: (1895-9) All ER Rep Ext 1349 (CA)]. It is not negligence for a director to fail to attend the Board meetings and thereafter not to ascertain the proceeding thereof [*City Equitable Fire Insurance Co. Ltd. Re*, (*Supra*)]. Where in one case the directors delegated their power to manage the company to a properly appointed managing director who was able to dispose of the company's investments for his own requirements, it did not amount to negligence [*Re, City Equitable Fire Insurance Co. Ltd.*, (1925) Ch 407 : (1924) All ER Rep 485 (CA)].
- (b) When they commit an act which is *ultra vires* their powers or *ultra vires* the company. [*Re. Sharpe* 1892 1 Ch. 154].
- (c) When any illegal act or breach of trust is committed by them.

Liability under guarantee for company's debts

Where a director guaranteed his company's debts and his company became liable as a guarantor of its subsidiary company's debts, it was held that the director's guarantee would cover that debt also. The terms of the guarantee also covered the contingent liability of the holding company for the debts of its subsidiary as these liabilities crystallised [*Bank of Scotland v. Wright*, (1991) BCLC 244 (QBD)].

Where certain directors who had guaranteed the company's debts retired and new directors were appointed in their place who also signed the guarantee bond and

there was no agreement to show that the earlier guarantee had ceased to be operative it was held that all the directors including retired directors were liable jointly and severally under guarantee. [*Bank of Baroda v. Official Liquidator*, (1992) 73 Com Cases 688 (MP)].

A bank granted a temporary overdraft accommodation to a company for the purpose of meeting its working capital requirements. The advance was granted on the strength of a specific undertaking or promise made by the respondents, who were the managing director and a director to liquidate within one month, the entire outstanding in the account including costs and expenses. A decree passed against the director and the managing director personally was held to be justified. They could not get an order that recovery should not be out of personal assets. [*Indian Overseas Bank v. A.B. Senan* (1999) 96 Com Cases 839 (Ker.)].

Liability in respect of company's debts

There is no provision in the Companies Act making the managing director of a company personally liable for the company's debts. For ascertaining such liability, the principles of agency shall apply to the transaction in question [*Kundan Singh v. Moga Transport Co. P. Ltd.*, (1987) 62 Com Cases 600 (P&H)].

Where directors deliberately dispose off their company's assets so as to make them unavailable to pay the company's debts, the creditors affected cannot recover damages from them (i.e. the value of the assets made unavailable) by suing them for the tort of conspiracy, because the director's purpose is to benefit the company by preserving the assets for its benefit, [*Allied Arab Bank Ltd. v. Hajjar* (No.2), (1988) QB 944].

The managing director of a company who executed the documents for obtaining cash credit facility from a bank on behalf of the company would not incur any personal liability for the loan obtained by the company. He is also not a necessary party to suit by the bank against the company [*Bank of Maharashtra v. Racmann Auto Pvt.Ltd.*, (1992) 74 Com Cases 752, 755 (Del)].

Directors are liable for any misapplication of money to any ultra vires purpose [*Kathiawar Trading Co. Ltd. v. Virchand Dipchand*, (1893) ILR 18 Bom 119]. A shareholder can maintain an action against the directors to compel them to restore funds of the company employed in ultra vires transactions, without making the company a party to it [*Jahangir Rustamji Modi v. Shamji Ladha*, (1867) 4 Bom OC 185].

Where certain directors who had guaranteed the company's debts retired and new directors were appointed in their place who also signed the guarantee bond and there was no agreement to show that the earlier guarantee had ceased to be operative, it was held that all directors including retired directors were liable jointly and severally under the guarantee. [*Bank of Baroda v. Official Liquidator* (1992) 73 Com Cases 688 (MP)].

Directors are personally liable if they act beyond the powers delegated to them even though the acts are not *ultra vires* the company [*Re Oxford Benefit Building & Investment Society*, (1886) 35 Ch D 502].

In case of service contracts, directors are liable for damages if they breach the express or implied terms of these contracts. The company can then recover the entire amount of compensation for the loss suffered.

Liability for Personal Profits

The directors are liable to the company for all personal profits or gain made by them taking advantage of their position as directors. A director is also liable in the following circumstances:

- (a) Diversion of the company's clientele to a business carried on by the director himself, [*Cook v. Deeks*, (1916) 1 AC 554, 564: (1916-17) All ER Rep 285: AIR 1916 PC 161].
- (b) A director was held liable when a director patented and exploited in his own name an invention made during the course of his employment with the company [*Cranleigh Precision Engineering Ltd. v. Bryan*, (1964) All ER 289].
- (c) A director is personally liable even after he ceases to be a director. If a director makes an attempt to commit a breach of fiduciary duty while he is a director and commits breach after resigning as a director, he remains liable to the company for any profit he obtains from the transaction as a whole.
- (d) Where a director receives commission from a supplier of goods to the company, he is bound to repay the same to the company.

3. Liability to the Shareholders

The position of the directors in respect of the company's properties and the rights conferred upon them to be exercised as directors is that of a trustee. If they commit any breach of trust or indulge in wrongful uses of their rights and the company suffers loss, they have to make good the loss. Similarly, if shareholders suffer loss due to the negligence of the directors they are personally liable for the loss.

Right of shareholders to take action

When directors have acted mala fide or beyond their powers, the majority of the shareholders must in such a case be held entitled to take steps to redress the wrong. [*Dr. Satya Charan Law v. Rameshwar Prosad Bajoria*, (1950) 20 Com Cases 39, 48 : AIR 1950 FC 133]. Even a single shareholder can proceed in such a case.

Rectification by Shareholders of ultra vires acts of the directors

If an act is ultra virus a company, i.e., beyond the powers laid down in the memorandum, such act cannot be ratified by the general meeting. But where the act is beyond the powers of the directors, but within the powers of the company, the same can be ratified by the shareholders [*Towers v. African Tug Co.*, (1904) 1 Ch 558]. However, ratification of a particular act by directors does not confer excess powers on the directors for the future.

The directors are liable to compensate the company for loss suffered due to transactions entered into beyond the powers of the company and in particular to restore the value of the assets which have been disposed of in connection with the ultra vires transactions [*Land Credit Co. of Ireland v. Lord Fermoy*, (1869) LR 8 Eq 7].

No individual shareholders can institute litigation in the company's name without the consent/sanction of the general meeting. However, shareholders can pass an ordinary resolution and stop proceedings against the company by directors who have acted mala fide. It is a breach of their duties if directors wrongfully use information say by speculating on shares, stating speculation loss/profit in Profit & Loss A/c.

Directors are liable for the profits they make on buying or selling the company's shares by making use of the confidential information available with them as directors. [*Brophy v. City Service Co.*, (1974) 31 Del Ch 241 (USA)].

4. Liability for Statutory Defaults and Violations

Under the Companies Act, 1956, the directors are required to ensure compliance with the several provisions of the Act and penalties have been prescribed for defaults and/or non-compliance. The directors are liable for consequences in the following situations:

- (a) If, they issue a prospectus in contravention of Section 57 or 58 of the Companies Act, 1956, they are liable to be punished with fine, which may extend to fifty thousand rupees (Section 59).
- (b) Pursuant to the provisions of Section 69 (5) of the Act, directors of a company shall be jointly and severally liable to repay share application money with interest at the rate of six per cent per annum from the expiry of one hundred and thirtieth day after the first issue of the prospectus, if the minimum subscription as stated in the prospectus has not been received by the company.
- (c) The directors of a company, according to Section 71 (3) of the Act, who knowingly contravene, or willfully authorise or permit the contravention of any of the provisions of Section 69 or 70 of the Act with respect to the allotment of shares or debentures, shall be liable to compensate the company and the allottee respectively for any loss, damage or costs which the company or the allottee may have sustained or incurred thereby.
- (d) Section 73 (2) and (2A) of the Act lays down that the directors of a company shall be jointly and severally liable to repay the share application money with interest at the rate of 15% presently prescribed, from the expiry of the eighth day from the day the company becomes liable to repay it.
- (e) The directors are liable under Section 207 of the Act to be punished with simple imprisonment for a term which may extend to three years and shall be liable to a fine of one thousand rupees for every day, if they fail to distribute dividend within thirty days of its declaration by the shareholders.
- (f) Directors knowingly contravening the provisions of Section 300 of the Act by participating and/or voting in Board proceedings relating to any contract or arrangement in which they are interested or concerned, shall be liable for punishment which may extend to fifty thousand rupees as per Sub-section (4) of the said Section.
- (g) Sub-section (4) of Section 299 declares that every director who fails to comply with the provisions of Sub-section (1) or (2) of Section 299 with regard to disclosure of their interest at Board meetings, shall be liable to

punishment which may extend to fifty thousand rupees and also he vacates the office of director automatically under Section 283(1)(l).

- (h) The directors of a company, who are knowingly party to any contravention of the provisions of Sub-section (1) or (3) of Section 295 of the Act, which deal with loan to directors without the previous approval of the Central Government, shall be liable to punishment either with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months.

There are numerous other provisions in the Companies Act, for default or violation whereof the directors are liable to varying degrees of punishments and fines or both.

Liability under other Corporate Laws

Apart from the directors' liability for violations of the Companies Act, they are also liable for violation of the provisions of other corporate laws, important among them being: Income-tax Act and the Rules, Sales-Tax Act and Rules, Central Excise and Salt Act and the Rules, Customs Act and the Rules, Foreign Exchange Management Act, Negotiable Instruments Act, 1881 and the Rules, Provident Fund Laws, Employees State Insurance Laws and various industrial and labour laws. The managing director and the members of the Board of directors can be prosecuted under environmental laws like the Water (Prevention and Control of Pollution) Act, 1974.

A managing director is a 'principal officer' and is liable under the Income-tax Act for false verification of an income tax return [*M.R. Pratap v. V.M. Muthukrishnan, I.T.O. Central Circle III, Madras*, (1992) 74 Com Cases 400, 406]. Where there was a false statement in verification under the Income-tax Act, it was held that the complaint against a nominee directors was justified [*J. Sethuraman v. IAC of IT*, (1992) 74 Com Cases 815 (Mad)].

Section 18 of the Central Sales Tax Act provides that the directors of a private company which is being wound up are liable for the sales tax dues of the company if the same cannot be recovered from the company itself. [*P. Chockalingam v. Deputy Commercial Tax Officer*, (1990) 68 Com Cases 707, 710 (Mad)].

Director's Liability for Acts of Co-directors

A director is an agent of the company and not of other members of the Board. Anything done by the Board cannot make a director liable who did not know that action and did not participate in it, even if he attends the subsequent meeting at which the minutes recording the wrongful action of the earlier meeting are confirmed.

A director could not be liable for the misconduct of another director unless he has joined with him in the perpetration of the wrong or has omitted to thwart the wrong due to his negligence [*Life Insurance Corporation v. Haridas Mundra* (1966) 26 Com. Cases 371 (D.B.) (All)]. In the absence of reasonable grounds for suspicion, a director cannot be held liable for the fraudulent acts of co-director on the ground that he ought to have discovered the fraud [*Dovey v. Cory* (1901) A.C. 477]. Thus, a director was not held liable for payment of dividends on false accounts declared at a

meeting where the director to be made liable was absent. [*Negendra Prabhu v. the Popular Bank* ZLR (1961) 1 Ker. 340].

However, the position of managing director or the chairman of the Board is different. He cannot say that he signed the accounts without understanding the implications of its entries [*Official Liquidator v. Shri Krishna Prasad Singh* (1969) Comp. L.J. 327].

The Managing Director of the company has no authority to use the funds of the company for illegal purposes like giving bribes. Even if the company has benefited from the contract, he has no right to change the company for his illegal activities. The company can recover the money [*Hannibal (E) & Co. v. Frost* 1988 4 BCC 3 (CA)].

Criminal Liability

Finally, directors may incur criminal liability either at common law, or under any statute, notably the Companies Act or the Indian Penal Code. Under the Companies Act, criminal proceedings against directors may be instituted in pursuance of the following sections, among others, resulting in imprisonment :

- (a) Section 44(4) — Filing of prospectus containing untrue statements — two years imprisonment and/or fine upto Rs. 50,000.
- (b) Section 58A(6)(b) — Inviting deposits in contravention of the Rules, or manner or conditions — five years imprisonment and fine.
- (c) Section 58A(10) — Failure to repay deposits as ordered by the CLB — Three years imprisonment and fine.
- (d) Section 63 — Criminal liability for mis-statement in prospectus — imprisonment upto two years or fine upto Rs. 50,000 or both.
- (e) Section 68 — Fraudulently inducing persons to invest money — imprisonment upto five years, or fine Rs. 1,00,000 or both.
- (f) Section 73 — Failure to repay excess application money — imprisonment upto one year and fine upto Rs. 50,000.
- (g) Section 105 — Concealing name of creditor — imprisonment upto one year or fine or both.
- (h) Section 202(1) — Undischarged insolvent acting as director — imprisonment upto two years or fine upto Rs. 50,000 or both.
- (i) Section 207 — Default in distributing dividends — imprisonment upto 3 years and fine upto Rs. 1,000 for every day.
- (j) Section 209A — Failure to assist Registrar or any officer so authorised by the Central Government in inspection of books of account, etc. — imprisonment upto one year and fine not less than Rs. 50,000.
- (k) Section 210(5) — Failure to lay balance sheet etc. at annual general meeting

— imprisonment upto six months or fine upto Rs. 10,000 or both.

- (l) Section 211(8) — Failure to comply Section 211 regarding form of balance sheet and matters to be stated — imprisonment upto six months or fine upto 10,000.
- (m) Section 217(5) — Failure to attach to balance sheet a report of the Board imprisonment upto six months for each offence or fine upto Rs. 20,000 or both.
- (n) Section 221(4) — Failure to supply information to auditor — imprisonment upto six months, or fine upto Rs. 50,000 or both.
- (o) Section 250(9) — Improper issue of shares — imprisonment upto six months or fine upto Rs. 50,000 or both.
- (p) Section 293A(5) — Contribution to political parties in contravention of Section 293A — three years imprisonment and fine.
- (q) Section 295 (4) — Grant of loan to directors — Simple imprisonment upto six months or fine upto Rs. 50,000.
- (r) Section 308(3) — Failure to disclose shareholdings — imprisonment upto two years or fine upto Rs. 50,000 or both.
- (s) Section 372A — Giving loans to other bodies corporate in excess of the limits prescribed under Section 372A — imprisonment upto two years or fine upto Rs. 50,000.
- (t) Section 407(2) — Acting as director after removal by Court — imprisonment upto one year, or fine upto Rs. 50,000 or both.
- (u) Section 488(3) — False declaration of company's solvency — imprisonment upto six months or fine upto Rs. 50,000 or both.

Offences under the Indian Penal Code generally relate to frauds, prejury, misappropriation or embezzlement of funds, conspiracy to defraud, etc. Most of these offences are now covered by the Companies Act.

It may be noted that any provision in the articles, agreement or any other instrument indemnifying a director against any liability is void except as provided in proviso to Section 201.

In some of the sections stated above, for example Section 58A(6)(b), 73 etc. a director may become liable only if he is an 'officer in default'.

Liability as an Officer in Default

The Companies Act, 1956, in a number of sections uses the term "officer in default" when affixing a person with liability for offences, i.e., if default is made in complying with a section, the company and every officer of the company who is in default shall be guilty of an offence under that section. This is followed by the specified penalty consisting of fine or fine and imprisonment in certain cases. It is in the context of prosecution that determination of officer who is in default becomes very important and essential. Under Section 5 of Companies Act which provides the definition of an officer in default, apart from a managing director, whole time director,

an ordinary director will also many a times come within the net of an officer in default. The section provides that:

For the purpose of any provisions in the Companies Act which enacts that an officer of the company who is in default shall be liable to any punishment or penalty, whether by way of imprisonment, fine or otherwise, the expression 'officer who is in default' means the following officers of the company namely:

- (a) the managing director or managing directors;
- (b) the whole-time director or whole-time directors;
- (c) the manager;
- (d) the secretary;
- (e) any persons in accordance with whose directions or instructions the Board of directors of the company is accustomed to act;
- (f) any person who is charged by the board with the responsibility of complying with that provision.

Provided that the person so charged has given his consent in this behalf to the Board—[(Consent to be filed in Form 1AB provided under the Companies (Central Government) General Rules & Forms, 1956];

- (g) Where any company does not have any of the officers specified in clauses (a) to (c), any director or directors who may be specified by the Board in this behalf or where no director is specified all the directors.

Provided that where the Board exercises any powers under clause (f) or clause (g), it shall, within thirty days of the exercise of such powers, file with the Registrar a return in the prescribed form (form prescribed is e-Form 1AA).

It may be noted that managing director(s) whole-time director(s) and manager have been specified as officers in default in clauses (a), (b) and (c) respectively. In case of companies which do not have any of the officers specified in clauses (a) to (c), any director or director specified by the Board will be held as officer in default. Further, if there is no officers as mentioned in clauses (a) to (c) and also no director(s) is/are specified by the Board, then all the directors (the word 'all is not qualified' it may include employee director, part time director, etc.) will be officers in default.

The effect of this provision is that professional managers like Managing Directors, Managers, Whole-time directors or Secretary will be regarded as officers in default without any further inquiry [*Ravindra Narain v. Registrar of Companies* (1994) 81 Comp Cas 925 Rajasthan]. This category will also include those in accordance with whose directions or instructions the Board of directors is accustomed to act. For the rest it would have to be shown that they were under responsibility. Further, persons who have been designated can be prosecuted only by showing their connection with management and default on their part [*R. Banerjee v. H.D. Dubey*, (1992) 75 Comp Cas 722 SC]. It must be alleged in the complaint that the director proceeded against was a director at the material time and had knowledge of the default [*Registrar of Companies v. Bipin Behari Nayale*, (1995) 83 Comp Cas 95 Orissa].

Section 5 stated above makes it clear that all the seven specified categories of officers of the company would be deemed to be officers who are in default irrespective of whether they were a party to the default or not. In other words, it is enough to show that a statutory provision has not been complied with in order to bring them under the mischief of the section.

It is however pertinent to note that Section 5 applies only to those provisions of the Companies Act which use the expression 'Office who is in default' or the like. In cases where a different expression is used, Section 5 shall have no applicability and the element of mens rea unless specifically prohibited would have to be adhered to.

An analysis of the provisions of Section 5 reveals the following:

1. Under the section, liability as 'officer in default' is fastened on all the officers specified in clause (a) to (g) collectively.
2. Element of mens rea i.e. the guilty mind has been dispensed with by deleting the expressions 'knowingly guilty' and 'who knowingly or wilfully authorises or permits' such default; which had been a strong ground of defence in cases of prosecutions under the Act.
3. If any of the officers specified in clauses (a) to (c) are appointed, the directors will not be held as 'officers in default'. Thus, in the case of a public company or a private company which is a subsidiary of a public company having a paid up share capital of rupees five crore or more, ordinary directors may actually never be liable under Section 5 for as per the amended Section 269 read with relevant notification such companies are statutorily required to appoint a managing director or whole-time director or manager.
4. Though Managing director(s)/Whole-time director(s) and Manager have been specified as officers in default in clause (a), (b) and (c) respectively, it may be highlighted that according to Section 197A of the Companies Act a company cannot at the same time appoint or employ a managing director as well as a manager.
5. The new definition has increased the responsibility of a Secretary [clause (d)] by bracketing him alongwith the managerial personnel. Thus a secretary has to be more vigilant in the matter of compliance of various provisions under the Companies Act where his personal involvement can be presumed or specifically prescribed.
6. In case of companies which do have any of the officers specified in clause (a) to (c), any director or directors specified by the Board will be held as officers in default.
7. Further, if there is no officer as mentioned in clause (a) to (c) and also the director(s) as mentioned in previous para is/are not specified by the Board, then all the directors (the word 'all' is not qualified it may include, employee director, part-time director, nominee director,... etc.) will be officers in default.
8. Clause (e) refers to any person in accordance with whose directions or instructions the Board of the company is accustomed to act. Such a person

is included in the definition of “officer” given in Section 2(30) though professional advisers are excluded by Section 7 from this category of persons. Perhaps the situation envisaged in this clause may arise inter alia when the directors on the Board of a company are infact dummy persons and any of the persons who remain behind the scenes may control the acts of directors. Such a person may perhaps include a company or firm, in which case the directors of the other company or partners of that firm would be treated as persons in accordance with whose directions or instructions the Board of directors of the other company are accustomed to act. Practically, however, it may be difficult to decide who such persons are.

9. The expression ‘any person charged by the Board’ under clause (f) refers to only officers of the company and not to the subordinate staff for according to the opening sentence of Section 5 the expression ‘officer in default’ means all the officers of the company as stated in the various clauses.

Further for a person to be brought within the purview of clause (f) the fulfilment of the following two conditions is essential : (a) the Board should charge a person with the responsibility of complying with any specific provision(s) by passing a resolution and (b) the person so charged is required to give the consent in Form 1AB as prescribed under Rule 4BB of the Companies (Central Government’s) General Rules and Forms 1956. Thus where a company has not obtained the consent of the person as prescribed, he cannot be charged by the Board with the intended responsibilities.

10. The proviso to clause (g) provides for filing of return to the Registrar by the Board if it has exercised its authority under clause (f) and (g) within 30 days of the exercise of such power.
11. Where the board specifies any person to be responsible for observance of particular provision, the consent of such a person should be taken and should be filed with the Registrar within 30 days in Form No.1AA.

8. COURT’S POWER TO GRANT RELIEF IN CERTAIN CASES

Section 633 of the Act gives the Court the power to relieve a director of any liability which he may incur under the law. The object of the section is to provide protection against undue hardship in deserving cases. For getting the relief, the section provides that the Court must be satisfied that the defaulting director acted honestly and reasonably and that having regard to all the circumstances of the case he ought fairly to be excused. This satisfaction however, must be reached after a serious and careful consideration of the whole question that the director did act honestly and reasonably [Coal Marketing Co. of India (P) Ltd., in Re. (1967) Comp. L.J. 237].

In the case of *Hemal A. Kanuga & Ors. v. Registrar of Companies* [(2008) 143 Comp Cas 8 (Guj)], while granting officers relief to the directors of the company, the court was of the view that all due care and caution in complying with the provisions of the Act has been taken and even if there may be minor lapses, those were required to be condoned. For minor lapses and defaults of technical nature, to prosecute the company and its highest ranking officers was not just and proper.

Section 633 (1) of the Companies Act, 1956, provides that if in any proceedings for negligence, default, breach of duty, misfeasance or breach of trust against a director of a company it appears to the Court hearing the case that he is or may be liable in respect of the negligence, default, breach of duty, misfeasance etc. but that he has acted honestly and reasonably the Court may relieve him, wholly or partly from liability, he ought fairly to be excused having regard to all the circumstances of the case including those connected with his appointment. [*Tri-sure India Ltd. in Re.* (1983) 54 Comp. Cas. 197 (Bom.)].

In case of criminal proceedings the Court, has, however, no powers to grant relief from any liability which may attach to the directors in respect of the negligence, default, breach of duty, misfeasance or breach of trust.

The section also provides for seeking anticipatory relief from the High Court where the director has reason to apprehend that any proceedings will or might be brought against him in respect of negligence, default, breach of duty, misfeasance or breach of trust. The High Court on such application shall have the same power to relieve him as it would have had if it had been a Court before which proceedings against the director for negligence, default, breach of duty, misfeasance, breach of trust had been brought under Sub-section (1) above.

The section, thus, operates in two states. The High Court can grant anticipatory relief and if a case is actually initiated, only court before which the complaint or trial is going on can grant relief [*Sri Krishna Prashad v. Registrar of Companies* (1978) 48 Comp. Cas. 397 (Delhi)].

The granting of relief under Section 633 is discretionary. It may be partial or complete, or on certain terms or unconditional [*Ramkrishan Dalmia v. Registrar of Joint Stock Companies, Delhi* (1962) 32 Comp. Cas. 341].

Before granting relief the Court is required to serve notice on the Registrar and on such other person, it may think necessary, to show cause why such relief should not be granted. In *Beejay Engineers (P) Ltd. in Re.* (1983) 53 Comp. Cas. 918 the Delhi High Court held that the Section 633 does not limit, restricts or confine its operation to a liability arising out of negligence, default, breach of duty, misfeasance or breach of trust under this Act alone. Protection under this section will be equally available to an officer of a company against liability to be proceeded against for negligence, etc. even under other Acts so long as it is with regard to the affairs and functioning of the company.

It is worth noting, however, that the same High Court has in a later judgment of *Savannah Prasar Jhalani v. Regional Provident Fund Commissioner* (1987) 62 Comp. Cas. 571, disagreed with the view taken in *Beejay Engineers (P) Ltd.* and held that:

“After examining the various provisions of the Act and some other Acts, it appears to me that perhaps this decision i.e. *Beejay Engineers (P) Ltd.* needs reconsideration. Section 633 cannot be panacea for all the ills, i.e. defaults/offences committed in respect of various other enactments, those already in force and those which will come on the statute book at a subsequent date. An act may not have been an offence when the act was enforced and it is, therefore, difficult to see how the Act

could become applicable in that case and when particularly the other Act defining the offence itself provides punishment for offences/defaults committed by the company. To illustrate, Section 276C was introduced in Chapter XXII relating to offences and prosecutions in the Income-tax Act, 1961 w.e.f. 1st October, 1975”.

This question came up for consideration before the Supreme Court in the case of *Rabindra Chamarla v. Registrar of Companies* C.A. No. 3012 of 1990 decided on 19.11.1991 wherein the Supreme Court discussed the appeal and held that relief under Section 633 cannot be extended in respect of any liability under any Act other than the Companies Act, 1956. The Court further held that the expression and proceeding occurring in Section 633 cannot be read out of context and be treated in isolation of the penal provisions of the Companies Act. If that were so, penal clause under the various other Acts would be rendered ineffective by application of Section 633. If the Parliament intended Section 633 to have a coverage wider than that of the Act, it would have specifically provided for it as it is a sound rule of construction to confine the provisions of a statute to itself. While referring to any proceeding under Sub-section (2) Parliament intended to restrict it only to proceedings arising out of negligence, default, breach of trust, misfeasance or breach of duty in respect of duties prescribed under the provisions of the Companies Act. Section 633(2) cannot apply to proceedings against an officer of the company to enforce liability arising out of violation of other statutes. The fact that notice is required to be given to the Registrar of Companies under Sub-section (3) is an indication that the powers under Sub-section (2) must be restricted in respect of proceedings arising out of violation of the Companies Act, 1956.

In the case of *Farouk Irani v. Registrar of Companies* [(2009) 1 Comp LJ 112 (Mad.)], it was held that the powers vested upon the court under Section 633 of the Companies Act, 1956, to grant the relief is, firstly, discretionary. Secondly, the petitioners have to satisfy the following conditions stipulated under Section 633(1) of the said Act:

- (1) the lapse or offence alleged must be one of the kinds mentioned in Section 633(1);
- (2) the applicant must be shown to have acted honestly and reasonably; and
- (3) the court is in a position to conclude or render the finding with regard to all the circumstances of the case that the officer ought to be excused fairly.

9. COMPOUNDING OF CERTAIN OFFENCES—SECTION 621A

In the context of liabilities of directors, the provision regarding compounding of offences is also of special reference. Section 621A of the Companies Act seeks to compound offences punishable under the Act whether committed by the company or any officer thereof, not being an offence punishable with imprisonment only or with imprisonment and also with fine. In other words, three kinds of offences are permitted to be compounded under this section. The first one relates to an offence which says that an offence is punishable with fine only; the second one relates to offence which states that an offence is punishable with imprisonment or fine; and the third one relates to an offence which is punishable with imprisonment or fine or with both.

Imprisonment is not compulsory. An offence punishable with imprisonment only or with imprisonment and fine is not compoundable under this section. The section empowers the CLB to compound offences without any limit or where a maximum amount of fine which may be imposed by an offence does not exceed Rs. 50,000 it may be compounded by the Regional Director. (The powers of the Regional Directors have been proposed to be withdrawn).

The offences committed by a company or its officer within a period of three years from the date on which the similar offence was committed by it or him was compounded under this section, are not compoundable.

An application for compounding of an offence is required to be made to the Registrar who shall forward the same together with his comments thereon to the CLB or the Regional Director, as the case may be. Where an offence is compounded no prosecution lies. Clause (c) of Sub-section (4) [proposed to be renumbered as (3)] permits the compounding of any offence before the institution of any prosecution.

However, for offences punishable with imprisonment or fine or both, there is no getting away from launching prosecution before the magistrate. According to clause (a) of Sub-section (7) [proposed to be renumbered as (6)] of Section 621A any offence which is punishable with imprisonment or with fine, or with both can be compounded with the permission of the Court.

In the case of *Amadhi Investments Ltd., In re.* [(2009) 149 Comp Cas 617 (CLB)], during inspection of the records of the petitioner company by the officers of the Ministry of Corporate Affairs under Section 209A of the Companies Act, 1956, some contraventions of the Act were identified. By three applications before the Registrar of Companies, the Company and its officers sought compounding of offences for violation of the Act and the applications were listed before the Company Law Board. The applications were opposed by the Registrar of Companies alleging involvement of the company in a demat scam. It was held that the show cause notices issued by the Registrar of Companies contained a sentence to the effect that the offences were compoundable under Section 621A of the Act and the party could compound the offence if it so desired. The Registrar could not change his stand at the time of compounding of the offence by the Board as such power was not given to the Registrar by Parliament. So, the offences of the company were compounded and the Registrar was advised to invite applications from the officers in default for compounding of offences.

Choose the correct answer

Which section of the Companies Act, 1956, provides protection to directors against undue hardship in deserving cases?

- (a) Section 633
- (b) Section 276C
- (c) Section 300
- (d) Section 289

Correct answer: a

10. MONITORING AND MANAGEMENT

The persons concerned with the working of a company may be divided into two groups - (1) the managerial persons who formulate and guide the policies of the company and monitor the administration of its business and (2) the administrative staff which attends to the day to day work of the office and the functions of the company's business in accordance with the decisions of the managerial person(s).

(1) The managerial persons include the following :-

- (a) Directors
- (b) Managing director(s) or/and whole time director(s)
- (c) Manager

They work under the control and supervision of the Board of Directors. They are assisted by company secretary, statutory auditors, (financial and costing), internal auditors, legal advisors and other consultants (technical or otherwise) etc. Under Section 197A of the Act, simultaneous appointment or employment of Managing Director and Manager is prohibited. Under Section 292A of the Act an Audit Committee is required to be constituted by every public company having paid up share capital of rupees 5 crore or more for monitoring financial function thereof. A listed company has to constitute, in addition to Audit Committee, Remuneration Committee, Shareholders' Investors' Grievance Committee and Management Committee.

The appointment of directors, managing/whole time director(s) or manager is to be made in accordance with the provisions of the Act and the company's memorandum and articles. The Board of directors may distribute the executive functions of the company to the qualified and experienced persons as heads of production, purchase, sale, administration legal etc, for monitoring the overall working of the company various committees like Project committee, Capital Expenditure Committee, Works Committee, Finance Committee, Administration Committee may be constituted.

(2) The Administrative staff works under the heads of departments like production, marketing, purchase, accounts, legal, personnel, taxation, secretarial, research and development, advertisements, establishment, labour, etc. in accordance with the decisions of the Board of directors and authority delegated to managing/whole-time director(s) or manager or any other chief executive officer of the company.

In accordance with the inclusive definitions provided by Section 2(30) of the Act, "officer" includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act. However, the Board of directors of the company is collectively responsible for its working. All directors are singly and jointly liable for all acts of commissions and omissions done in managing the affairs of the company, unless any individual director or officer is made responsible for a particular function by

delegation of authority. As such, the managing/whole-time director(s) or manager shall be accountable for the functions delegated to them by the Board of directors and for default, contravention or non-compliance, they are personally liable until they prove their bona fide.

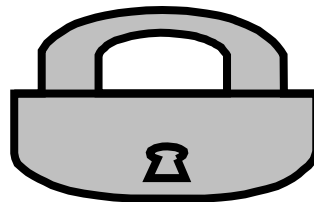
LESSON ROUND-UP



- Subject to the restrictions contained in the Act, Memorandum and Articles, the powers of directors are co-extensive with those of the company itself.
- In some exceptional cases, the general body of shareholders is competent to act even in matters delegated to the Board.
- Certain powers are exercisable only at Board Meetings and certain powers are exercisable with the approval of company in general meeting.
- Without obtaining the previous approval of the Central Government, a company cannot make any loan to or give any guarantee or provide any security in connection with the loan made by or to any person specified u/s 295(1).
- Under Section 297 of the Act, consent of Board of directors is required for certain contracts in which particular directors are interested. However, it is not applicable to certain transactions as specified under the provisions of the Act.
- Every director of a company who is in any way interested in a contract or arrangement shall disclose the nature of his concern at a meeting of the Board of directors u/s 299 of the Act.
- An interested director is prohibited from participating in the discussion of or voting or, any contract or arrangement entered into or to be entered into by or on behalf of the company in which his presence shall not be counted for the purpose of forming of quorum at the time of such discussion u/s 300 of the Act.
- The Companies Act, 1956 has imposed certain duties and obligations on the directors. In addition, directors are bound by some fiduciary and general duties under the common law.
- Some of the statutory duties imposed upon the company directors by the Companies Act, 1956 are as follows:
 - Duty to attend Board meetings.
 - Duty not to contract without Board's consent.
 - Duty to disclose interest. (Sections 299-300)
 - Duty of Director etc. to make disclosure.
 - Duty of Directors to make disclosure of Shareholding.
 - Duty in connection with the general meeting.
 - To disclose receipt from transfer of property.

- To disclose receipt of compensation from transferee of shares.
- Duty to file declaration of Solvency.
- To make a declaration of solvency in the case of a Members' voluntary winding up. (Section 488)
- To file return of allotments.
- Under the Companies Act, 1956, the liabilities of company directors are numerous. The directors have always to be on guard lest they should incur any liability for any default or violation of any provision. Their civil and criminal liabilities may be grouped under certain heads for convenience of consideration and discussion. They are:
 1. Liability to outsiders;
 2. Liability to the company;
 3. Liability to the shareholders;
 4. Liability for statutory defaults and violations.
- Section 633 of the Companies Act, 1956 gives the Court the power to relieve a director of any liability which he may incur under the law. For getting the relief, the section provides that the Court must be satisfied that the defaulting director acted honestly and reasonably and that having regard to all the circumstances of the case he ought fairly to be excused.
- Under Section 621A, Central Government is empowered to compound offences. Section 621A of the Companies Act seeks to compound offences punishable under the Act whether committed by the company or any officer thereof, not being an offence punishable with imprisonment only or with imprisonment and also with fine. In other words, three kinds of offences are permitted to be compounded under this section. The first one relates to an offence which says that an offence is punishable with fine only; the second one relates to offence which states that an offence is punishable with imprisonment or fine; and the third one relates to an offence which is punishable with imprisonment or fine or with both.

SELF-TEST QUESTIONS



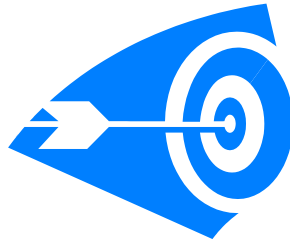
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. State the matters that may be transacted only at Board Meetings?
2. What powers can be exercised by the Board with the consent of members in general meeting?
3. Discuss the liabilities of directors to the company and to outsiders for their acts.

4. "Directors are not only agents but are also in some sense trustee of the company". Discuss.
 5. State the provisions of the Companies Act relating to housing loans and other loans to directors.
 6. Discuss the duty of a director to disclose his interest in contracts to be entered into by the company. What are the consequences of non-disclosure?
 7. Write short note on :
 - (i) *Ultra-vires* borrowings.
 - (ii) Political contribution.
 - (iii) Compounding of offences.
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STUDY XVI
MANAGEMENT AND CONTROL OF COMPANIES-III
MANAGING DIRECTOR, WHOLE-TIME DIRECTOR AND MANAGER

LEARNING OBJECTIVES



This study deals with the definitions, appointment, removal, powers etc. of Managing Director, Whole-time Director and Manager in a company.

The study covers the following topics:-

- Managing director
- His appointment, removal, qualifications, powers and duties
- Executive Directors/Whole-time Director
- His appointment, powers, duties and liabilities
- Manager
- Their appointment, disqualification, etc.
- Remuneration, powers, duties and liabilities of Managing Director
- Chairman, his appointment, removal, duties and responsibilities.

1. MANAGING DIRECTOR

Definition

Section 2(26) of the Companies Act, 1956, defines 'managing director'. It stipulates that a Managing director means a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called. The sub-section further states that a managing director shall exercise his powers subject to the superintendence, control and directions of the Board of directors. The sub-section excludes from the sphere of substantial powers to be exercised by the managing director the administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share.

The managing director of a company filed a suit on behalf of the company against the tenants and the trial court granted decree directing the tenants to vacate and deliver possession of the tenanted premises. The court also directed payment of damages and, in default, to pay interest. The tenants filed an application and contended that in the instant case, the managing director, who had filed suit, had no proper authorization from the board of directors. The Court dismissed the application of the tenants and held that the words 'substantial powers of management' specifically excludes certain acts from its purview. Therefore, except the excluded acts, the managing director has power and privilege of conducting the business of the company in accordance with the memorandum and articles of association of the company. The institution of the suit on behalf of the company by the managing director is deemed to be within the meaning of 'substantial powers of management', since such a power is necessary and incidental to manage the day-to day affairs and business of the company. Therefore, by virtue of provisions of section 2(26), the suit instituted by the managing director is deemed to be within his power and authority. The suit was obviously filed for the benefit of the company. In that view of the matter, the contention that the managing director had no authority to file a suit is untenable and the same is rejected. [*Wasava Tyres v. Printers (Mysore) Ltd.* (2008) 86 SCL 171 (Kar)].

In *G. Subba Rao v. Rasmi Die-Casting Ltd.* [1998] 93 Comp. Cas. 797, the Andhra Pradesh High Court held that from the definition of 'managing director' as per Section 2(26), it is clear that the managing director has to act under the superintendence, control and direction of the Board of directors. Moreover, powers of routine administrative nature like the power to affix the common seal, to draw and endorse any negotiable instrument do not fall within the substantial powers conferred upon the managing director. *What is to be seen is whether the managing director making any representation for and on behalf of a company had in fact, 'actual authority' either in terms of the provisions of the constitution of that company or by virtue of the delegation by the Board of directors.*

A managing director must hold and continue to hold the office of director. A managing director is first a director and then a managing director with certain additional powers [*Shanta Shamsher Jung Bahadur v. Kamani Brothers P. Ltd.* (1959) 29 Comp Cas 501 (Bom)]. A managing director is an ordinary director entrusted with special powers. If a company wants to appoint a person as managing director, who is not a director of the company, he has first to be appointed as an additional director in accordance with the provisions of Section 260 of the Act. He shall also be bound in accordance with provisions of Section 270 of the Act to obtain his qualification shares if any, prescribed by the articles of association of the company, within two months of his appointment as director, the nominal value whereof shall not exceed five thousand rupees or the nominal value of one share, if it exceeds rupees five thousand.

A managing director of a limited company may have a dual capacity. He may both be a director as well as an employee. Where he is so employed, the relationship between him as the managing director and the company may be similar to a person who is employed as a servant or an agent, for the term 'employees' is not large enough to cover any of these relationships. The nature of his employment may be determined by the articles of association of the company and/or the agreement.

A director entrusted with managerial functions will be a managing director even though he may be called as 'technical director' or 'technical advisor' (*Fourth Annual Report - year ended 31st March, 1960*).

A managing director as defined by the Act is a director who is entrusted with substantial powers of management.

Appointment

A managing director is generally appointed by the company's Board of directors, which is, generally authorised by the articles. In *Nelson v. James Nelson & Sons*, (1914) 2 KB 770: (1914-15) All ER Rep 433 CA, Swinfen Eady, LJ. Said: "Unless there is a power given to the directors by the articles to appoint a managing director, it is not competent for them to make such an appointment. The articles may give a power to the directors to appoint one of their members to be managing director. Where the power to appoint a managing director is vested in the Board, the members cannot exercise it. [*Thomas Logan Ltd. v. Davis*, (1911) 104 LT 914, affirmed (1911) 105 LJ 419 (CA)]. If the articles vest the power in the shareholders the appointment of managing director must be made by the shareholders.

The Department of Company Affairs (now Ministry of Corporate Affairs) has clarified that a managing director may be appointed in any one of the five ways, namely,

1. By virtue of an agreement with the company.
2. By virtue of a resolution passed by the company.
3. By virtue of a resolution passed by the Board of directors.
4. By virtue of the memorandum of association.
5. By virtue of the Articles of Association.

With effect from 18.9.1990, it is obligatory for a public company or a private company which is a subsidiary of a public company having a paid-up share capital of rupees five crores or more, to appoint a managing director or whole-time director or manager [Section 269(1) read with Rule 10A of the Companies (Central Government's) General Rules and Forms, 1956].

Sub-Section (2) of Section 269 provides that no appointment of a person as a managing director (or whole-time director or manager) in a public company or a private company which is a subsidiary of a public company shall be made except with the approval of the Central Government. However, approval of the Government is not necessary if the appointment is made in accordance with the conditions specified in Parts I and II of Schedule XIII (the said parts being subject to the provisions of Part III of the said schedule) and a return in the prescribed form viz. e-Form 25C is filed with Registrar within 90 days from the date of such appointment.

Appointment with the Approval of Central Government

In case the provisions of Schedule XIII (Refer Annexure I) cannot be fulfilled by company, an application seeking approval to the appointment of a managing director (Whole-time director or manager) shall be made to the Central Government, in e-Form No. 25-A.

While according its approval, the Central Government should be satisfied that:

- (i) the managing (or whole-time director or manager) is in its opinion a fit and proper person to be appointed, or such appointment is in the public interest; or
- (ii) the term and conditions of the appointment of managing director (or whole-time director or manager) are fair and reasonable [Section 269 (4)].

The powers under Sections 269, 198, 637AA is a quasi-judicial function and not an administrative one [*Cibatul Ltd. v. Union of India*, (1980) 50 Com Cases 437]. The Central Government while performing the duty, has to take into account the objectives and facts and to determine those facts in a quasi-judicial manner. Granting or withholding of approval is the function of the Central Government and it is for the government to come to a conclusion keeping in view the statutory provisions. If such a conclusion has been arrived at by taking into consideration, matters which are relevant, it will be not for the court to upset that conclusion.

The Central Government may also while according its approval, approve appointment of a person for a period lesser than the period for which the appointment is proposed to be made. If the appointment of a person as managing director or whole-time director or manager as the case may be, is not approved by the Central Government, the person appointed shall vacate his office on the date on which the decision of the Central Government is communicated to the company, and if he omits or fails to do so, he will be punishable with a fine which may extend to five thousand rupees for every day during which he omits or fails to vacate such office [Sub-section (6) of Section 269].

Where a person acts as managing director without approval of the Central Government and in contravention of the requirements of Schedule XIII, provisions of Sub-section (7) to Sub-section (11) of Section 269 become attracted.

All acts done by a managing or whole-time director or a manager, as the case may be, purporting to act in such capacity and whose appointment has been found to be in contravention of Schedule XIII, shall, if the acts so done are valid otherwise, be valid notwithstanding any order made by the CLB under Section 269(9) of the Act. [Section 269(12)]

Where the Central Government *suo moto* or on any information received by it is, *prima facie*, of the opinion that any appointment made without the approval of the Central Government has been made in contravention of the requirements of Schedule XIII, it shall be competent for the Central Government to refer the matter to the CLB for decision. The CLB shall on receipt of a reference hereunder, issue a notice to the company, the managing director or whole-time director or manager, as the case may be and the director or other officer responsible for complying with the requirements of Schedule XIII, to show cause as to why such appointment shall not be terminated and the penalties provided in Sub-section (10) should not be imposed.

The CLB shall, if, after giving a reasonable opportunity to the company, the managing director or whole-time director or the manager, the officer who is in default, as the case may be, comes to the conclusion that the appointment has been made in contravention of the requirement of the Schedule XIII, make an order declaring that a contravention of the requirements of Schedule XIII has taken place [Sub-section (9) of Section 269].

On the making of an order by the CLB

- (a) the company shall be liable to a fine which may extend to fifty thousand rupees;
- (b) every officer of the company who is in default shall be liable to a fine of one lakh rupees; and
- (c) The appointment of the managing or whole-time director, as the case may be, shall be deemed to have come to an end and the person so appointed shall in addition to being liable to pay a fine of one lakh rupees, refund to the company the entire amount of salaries, commissions and perquisites received/enjoyed by him between the date of his appointment and passing of such order.

For contravention of this provision or any direction given by the Company Law Board, every officer of the company who is in default and the managing or whole-time director or the manager, as the case may be, shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine which may extend to five hundred rupees for every day of default.

All acts done by a managing director or whole-time director or manager, as the case may be purporting to act in such capacity and whose appointment has been found to be in contravention of Schedule XIII shall, if the acts so done, are valid otherwise, be valid notwithstanding any order made by the Company Law Board under Sub-section (9) of the section.

Section 637A, makes it clear that where the Central Government is required or authorised by any provisions of the Act to accord approval in relation to any matter, then, in the absence of anything to the contrary contained in such or any other provisions of the Act, the Central Government may accord such approval, subject to such conditions, limitations or restrictions as it may think fit to impose. In view of the provisions of Sections 269 and 637A, the Central Government may impose a condition restraining remuneration of the appointee. There is no infirmity in the condition so imposed [*Company Law Board v. Upper Doab Sugar Mills Ltd.* (1977) 47 Comp Cas 173 (SC)].

As per provisions of Section 302 of the Act, where a company enters into a contract for the appointment, *inter alia*, of a managing director or varies such contract already in existence, the company shall within twenty-one days from the date of such contract or variance as the case may be send an extract of every such contract to the members of the company. The same will apply in the case of appointment of whole-time director or manager.

No company can appoint a managing director for a term exceeding five years at a time. He may, however, be re-appointed for another term of five years. The time limit is provided in Section 317 of the Act. Section 316 of the Companies Act lays down that no public company and no private company which is a subsidiary of a public company shall appoint any person as managing director, if he is already either the managing director or manager of any other company except as provided in the section. The section provides that such company may appoint or employ a person as its managing director, if he is the managing director or manager of one and of not more than one other company including a private company which is not a subsidiary

of a public company. The section further says that such an appointment shall be made by a resolution passed at a meeting of the Board of directors of the company with the consent of all the directors present at the meeting and of which meeting and of the resolution to be moved thereat specific notice has been given to all the directors then in India. Sub-section (4) of Section 316 provides that notwithstanding anything contained in the section the Central Government may, by order, permit any person to be appointed as managing director of more than two companies. If the Central Government is satisfied that it is necessary that the company should, for their proper working function as a single unit and have a common managing director.

Reappointment of Managing Director

In terms of explanation to Section 269 of the Companies Act, 1956, appointment includes reappointment. Reappointment of a managing director of a company must be taken for consideration before the expiry of his term of office. If the reappointment of the managing director is approved and if it is not in accordance with the conditions specified in Parts I and II of Schedule XIII then the approval of the Central Government must be obtained for such reappointment. Rest of the provisions for reappointment of a managing director are same as in the case of appointment of a managing director.

Retirement by Rotation of Managing Director

Section 255 of the Act states that unless the articles of association of a company provide for the retirement of all directors at every annual general meeting not less than two-thirds of the total number of directors of a public company or of a private company which is a subsidiary of a public company, shall be liable to retirement by rotation. Articles of most of the public companies provide that a person shall not be liable to retire by rotation so long as he continues to hold the office of the managing or whole-time director.

In terms of Section 268 of the Act, any amendment of any provision in the memorandum or articles of a public company or of a private company which is subsidiary of a public company or any agreement or resolution relating to appointment or re-appointment of a managing or whole-time director or other director not liable to retire by rotation in such a company requires approval of the Central Government. But the approval of the Central Government is not required for making a new provision in this regard, such approval is required only when an existing provision in the Articles of Association etc. is amended. [Clarification of Department of Company Affairs vide its letter No. 1(120) CL-1/65, dated 04/11/65].

No approval of the Central Government under Section 268 is required for appointment or re-appointment of managerial personnel, if made in terms of Section 269 of the Act. (DCA's Circular No. 3 of 1989 dtd. 13.04.89). Provisions of Section 268 of the Act are not applicable to a Government company. (Notification GSR 235 dtd. 31.01.78).

In case the managing director is liable to retire as director by rotation but he is appointed as a managing director for a fixed term, say five years and eventually a situation may arise that, at an annual general meeting he would retire by rotation but would be reappointed at the same meeting. In such a case during the intervening period between his retirement and reappointment he might deem as not occupying the office of director and in consequence it would result in a break in his appointment

as a Managing Director. The views of the Department of Company Affairs (Now, Ministry of Corporate Affairs) on this point are as under:

A managing director's office as managing director does not suffer any break if he retires as a director under Section 255 and is re-elected as a director in the same meeting. Hence, in such a case, the approval of the Government would not be necessary for five years where the terms of appointment of a managing director have already been approved by the Government for that period. [Letter: No. 8/16(1)/61-PR, dated 9-5-1961].

Whether a person initially appointed as additional/alternate director could continue as managing/whole-time director

A clarification has been sought as to whether a person initially appointed as additional/alternate director could continue as managing/whole-time director. The terms "director" and "managing director" are defined in the Act. On the face of it, a managing director has first to be a director. So long as he is a director and is also appointed as managing director, he continues as managing director, subject to the approval of the Central Government.

An additional director can be appointed by the Board of directors of a company under Section 260. Such a person continues to be the additional director till the commencement of the next annual general meeting. As soon as the annual general meeting opens, he ceases to be the additional director of the company. If such a person while he was the additional director of a company had been appointed as managing director ceases to be a director, he also ceases to be the managing director, the latter appointment also ceases simultaneously with his ceasing of directorship at the commencement of the annual general meeting. However, if such a person is re-elected as a full-fledged director at the annual general meeting and thereby he continues as a director of the company, he shall continue as a managing director also for the period for which he is so elected by the annual general meeting and for the period for which his appointment has been approved by the Central Government under Section 269.

An alternate director has no *locus standi*, the moment the principal director returns to the state in which the board meeting of the company is ordinarily held, he ceases to be the director immediately. If such an alternate director has been appointed as a managing director also and the approval of the Central Government had been obtained to such appointment, even then the moment he ceases to be a director of the company, he ceases to be the managing director also.

As to the enquiry whether a person who ceases to be a managing director because he has not been re-elected by the annual general meeting as a director, can be continued as an employee of the company and whether such an approval if made in the articles of the company shall be approved by the Central Government, it may be stated that the appointment of a person in the capacity of an employee is a management function for which no approval of the Central Government is necessary. However, any provision in the articles of the company of the nature of continuing a person, appointed as a managing director, to remain as an employee after his appointment as a managing director ceases, will attract Section 268 and approval of the Central Government will be necessary. Each case has to be examined on its merits. [Letter: No. 8/21/(260)/76-CL-V, dated 17-3-77].

If an advocate is validly appointed as managing director in accordance with the provisions of the Companies Act, there will be no bar simply because he is a practising lawyer, although his appointment as such may be in violation of the Bar Council Act and it appears to be a matter for the Bar Council to take up with the person concerned. [Letter: No. 8/55(269)/63-PR, dated 31-8-1963].

The appointment of whole-time company secretary as part-time director on the Board of directors of the company does not require approval of the Central Government under Section 269(1) so long as substantial powers of management of the affairs of the company are not vested in the incumbent [Letter: No. 16/39-CL-III/85, dated 26-6-1987].

Resignation by Managing Director

It is a general view that a managing director combines two capacities, namely, manager and director. The capacity as managing director cannot be terminated by merely sending two resignations. It becomes effective only when the company accepts the resignation and relieves him from his duties [*Achutha Pai v. Registrar of Companies*, (1966) 36 Com Cases 598: (1966) 1 Comp LJ 104 (Ker)]. On the other hand, it is viewed that a managing director does not hold two offices namely that of manager and of a director. The concept of a 'manager' as defined by the Act is different from that of a managing director. A managing director as defined by the Act is a director who is entrusted with substantial powers of management. It is, however, true that a managing director may resign his office and continue to be an ordinary director. His resignation as managing director becomes effective only when accepted by the Board.

Removal of a Managing Director

No approval of the Central Government is required to remove a person from managing directorship. The articles of association of most companies empower the Board of directors to remove or dismiss a managing director from his office as such. The removal of a managing director in accordance with the provisions in the articles or in pursuance of the terms of the contract; if any, between the company and the managing director would not amount to an amendment within the meaning of Section 268 requiring the approval of the Central Government under that section.

A managing director can be removed as a director pursuant to Section 284 of the Act, which would result in the termination of the office of the managing director. However, this section presumes the right to claim compensation or damages if such removal results in a breach of contract. [Section 284(7)].

Qualifications

Apart from the disqualifications enumerated under Section 274, Section 267 of the Act makes a specific prohibitory provision with regard to the appointment of certain persons as managing directors. The section lays down that no company shall appoint or employ or continue the appointment or employment of any person as its managing director who—

- (a) is an undischarged insolvent or has at anytime been adjudged as insolvent;
- (b) suspends or has at any time suspended payment to his creditors, or makes, or has at any time made, a composition with them; or

- (c) is or has at any time been, convicted by a Court of an offence involving moral turpitude.

Apart from this, Part I of Schedule XIII contains five conditions which must be satisfied by a person to be eligible for appointment as managing director without the approval of the Central Government. These conditions are as below:

- (a) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the following Acts, namely:-
- (i) the Indian Stamp Act, 1899 (2 of 1899),
 - (ii) the Central Excise Act, 1944 (1 of 1944),
 - (iii) the Industries (Development and Regulation) Act, 1951 (65 of 1951),
 - (iv) the Prevention of Food Adulteration Act, 1954 (37 of 1954),
 - (v) the Essential Commodities Act, 1955 (10 of 1955),
 - (vi) the Companies Act, 1956 (1 of 1956),
 - (vii) the Securities Contracts (Regulation) Act, 1956 (42 of 1956),
 - (viii) the Wealth-tax Act, 1957 (27 of 1957),
 - (ix) the Income-tax Act, 1961 (43 of 1961),
 - (x) the Customs Act, 1962 (52 of 1962),
 - (xi) the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969),
 - (xii) the Foreign Exchange Regulation Act, 1973 (46 of 1973), [This Act has been repealed and FEMA, 1999 has been enacted].
 - (xiii) the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986),
 - (xiv) the Securities and Exchange Board of India Act, 1992 (15 of 1992),
 - (xv) the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992);
- (b) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (52 of 1974);

Provided that where the Central Government has given its approval to the appointment of a person convicted or detained under sub-paragraph (a) or sub-paragraph (b), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval;

- (c) he has completed the age of 25 years and has not attained the age of 70 years:

Provided that where—

- (i) he has not completed the age of 25 years, but has attained the age of majority; or
- (ii) he has attained the age of 70 years; and

where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the Central Government shall be necessary for such appointment;

- (d) where he is a managerial person in more than one company he draws remuneration from one or more companies subject to the ceiling provided in Section III of Part II;
- (e) he is resident in India.

Explanation: For the purpose of this Schedule, resident in India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India:

- (i) for taking up employment in India, or
- (ii) for carrying on a business or vocation in India.

But this condition shall not be applicable to the companies in Special Economic Zones, as may be notified by Department of Commerce from time to time.

However, a person, being a non-resident in India, shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, alongwith the visa application form, profile of the company, the principal employer and the terms and conditions of such person's appointment.

Powers of Managing Director

A managing director acts subject to the superintendence, direction and control of the Board of directors of the company and also subject to the provisions of the Act. He derives powers from the company or its Board. Sub-section (26) of Section 2 of the Companies Act, 1956 gives sufficient indication as to the sources of power of a managing director. Generally, the Articles of the company contain provisions regarding the powers of managing director. The managing director shall have general conduct and management of the whole of the business and affairs of the company except in matters which may be specifically required to be done by the Board of directors either by the Act or by the Articles. The agreement or Board resolution appointing the managing director may also confer various powers to the managing director like, buying fixed assets, selling assets, borrowings, investing, entering into contracts, appointment of senior personnels etc.

Representative capacity of managing director

Notwithstanding the fact that the Managing Director does not hold a power of attorney the Court may allow representation by him [*Puri Construction Pvt. Ltd. v. N.L. Mehta*, (1982) 2 Comp LJ 765 (Del)]. But it is established that a managing director is vested with representative capacity and persons dealing with him in the ordinary course of business are entitled to assume that he has the necessary authority [*South African Industrial Friendly Co-op Soc v. Webber*, (1992) TPD 49]. Where a company has borrowing powers, he has the authority to authenticate promissory notes on behalf of the company [*Kumar Krishna Rohatagi v. State Bank of India*, (1980) 50 Com Cases 722 (Pat-DB)].

A managing director, being in charge of the management of the company's affairs, enjoys the power to vary the duties of employees within permissible limits. [*V. Ramaswami v. Madras Times Printing & Publishing Co.*, AIR 1917 Mad 485].

The Civil Court will not interfere where a managing director carrying out the duties of managing director is removed from his office [*Joginder Singh Palta v. Time Travels (Pvt.) Ltd.*, 1983 Tax LR 2487: (1984) 56 Com Cases 103 (Cal)]. Any subsequent act of a managing director who ceases to be so will not be valid, as firstly he has not the authority to act so and further it would amount to an irregular exercise of power.

Relationship with the Board of Directors

The managing director of a company is appointed by its Board of directors and exercises his powers of management subject to the superintendence, control and direction of the Board of directors. He is a link between the directors and executives of the company. By virtue of his position as co-ordinator of activities of the various divisions and departments of the company, he is expected to be thoroughly conversant with the day-to-day working of the company, the problems faced by the various departments of the company and by having a frequent interaction with the company's executives, staff and workers, he is in a better position as compared to other directors of the company to suggest solutions to the problems. He reviews the working of the company at Board meetings and briefs the directors on the business before them and guide the directors and he can render all assistance to them to enable them to contribute their best to the deliberations of the Board so that the decisions of the Board are based on the expert advice of the managing director and knowledge, experience and expertise of the directors.

Position of managing director etc., on private company becoming public

On a private company becoming a public company, the provisions of the Companies Act, which are applicable to public companies, become applicable to the company, including the provisions of all the sections, governing appointment and remuneration of managing director/whole-time director or manager, namely Sections 269, 198, 309, 310, Schedule XIII etc. and therefore such a company must comply with these provisions.

However, a question arises, whether the appointment and remuneration approved and effectuated prior to the company becoming a public company would remain unaffected and need not therefore be altered for the remainder of the term for which the managing director was appointed. The Department of Company Affairs (Now, Ministry of Corporate Affairs) has clarified that the provisions of *Section 269 will not apply to a person who has been holding the office of a managing director or whole-time director in a private company immediately before its conversion into a public company*, as no fresh appointment is involved. It may, however, be added that this view cannot be extended to Sections 198, 255, 309, 310, 311, etc., the restrictions contained in these sections will automatically apply to the company from the date of its conversion into a public company [Letter: No. 8/11/43A/61-PR-dated 25.1.1961].

The Department of Company Affairs (Now, Ministry of Corporate Affairs) has further clarified that the existing appointment of managing director or whole-time director would not require the approval of the Central Government now but it will be necessary at the time of the next appointment. In case the existing appointment is for an indefinite period i.e. until further orders. Then unless the appointment is terminated earlier, the period of appointment will be taken as five years from the date

of the company becoming a public company [Letter: No. 32/13/75-CI - III dated 25-6-75].

From the above, it appears that the appointment of managing and whole-time director made prior to the private company becoming a public company, voluntarily shall remain unaffected for a period for which the appointment was made or five years from the date of the company becoming a public company, whichever is less.

When the office of a director is terminated, his appointment as a managing director would also terminate with it but when he is removed from managing directorship only, his appointment as a director would remain effective and when this happens on the conversion of a private company into a public company he would remain a director till he is rotated out at the next annual general meeting of the company [*Swapan Das Gupta v. Navin Chand Suchanti*, (1988) 64 Com Cases 562, 582: (1988) 3 Comp LJ 76 (Cal) (DB)].

Duties of a Managing Director

The duties and responsibilities of a managing director are set out in detail in the document by which he is appointed, i.e. either in the articles of association of the company or in the Board resolution or company resolution through which he is appointed or by the agreement which he enters into with the company.

The Companies Act lays down that the managing director of a company is entrusted with substantial powers of management. However, he exercises his powers subject to the superintendence, control and directions of the Board of directors of the company. He is fully answerable to, and functions under the overall supervision, guidance and control of the Board of directors. The Board cannot divest itself of the powers it has to exercise under the Act and under the memorandum and articles of association of the company by delegating all its powers to the managing director.

Liabilities

The managing director is liable for breach, whether willful or unintentional, of any of the duties and powers entrusted to him under the terms and conditions of his appointment, or under any provisions of the Companies Act, or by virtue of any provisions of the memorandum and articles of association of the company or under the provisions of any other law which he is bound as managing director to honour and to comply with. He is liable for fraudulent conduct of business of the company, for improper use of the company's funds and properties. He is also liable both in a prospectus issued by the company during his tenure as managing director and which he has signed as managing director before its release. His name is included as an 'officer in default' under Section 5 of the Act and can be made liable accordingly.

2. EXECUTIVE DIRECTOR/WHOLE-TIME DIRECTOR

The terms executive director and the whole-time director have not been defined in the Companies Act except saying that he is in the whole-time employment of the company. An executive director may also be called whole-time director. In many companies, however, the executive directors are not members of the Board of directors of the Company. The Company Law Board has however issued directive to the effect to desist such company practices as to naming their employees as

executive directors but not making them Board members. Hence, for the purpose of our study, we will presume executive directors to be members of the Board of directors of the concerned company. They are essentially directors but unlike ordinary directors, they devote their entire time and attention to the business and affairs of the company. They cannot accept the office of executive director or whole-time director in any other company. They may, however, accept the office of a non-executive director in other companies subject to overall number of companies as prescribed in Section 275 of the Companies Act, 1956 i.e. fifteen public companies.

The office of the whole-time director has, for certain prohibitive sections of the Companies Act for appointment to such an office, been equated with that of the managing director. Section 267 of the Act prohibits the appointment or employment of certain persons as managing or whole-time director in any company. They are: (i) an undischarged insolvent or who has at any time been adjudged insolvent; (ii) a person who suspends or has at any time suspended, payment to his creditors or makes or has made at any time a composition with them; and (iii) a person who is or has at any time been convicted by a Court of an offence involving moral turpitude.

Since a whole-time director and an executive director are also directors and additional responsibility is entrusted to them, their appointment shall be subject to the provisions of Section 274 of the Act, which lays down certain disqualifications of directors.

Further, where the appointment of the whole-time director is as per Schedule XIII the eligibility conditions as contained in Part I of the said Schedule must be satisfied as explained earlier.

Appointment

The substantive provisions with regard to appointment and reappointment of whole-time director are similar to that of managing director which have been discussed earlier.

Period of Appointment

It is a point worth noting here that while in the case of a managing director, Section 317 restricts the period for which he may be appointed at a time upto five years, there is no such restriction on the appointment of a whole-time director, so that he may be appointed for a longer period without the necessity for renewal every five years, provided, however, that his office of director is not one, which is subject to retirement of directors by rotation.

Whole-time director is virtually managing director

A whole-time director for the purpose of Section 269 or 309 is a director rendering his services whole time to the management of the company and, therefore, he is virtually a managing director though not so designated. A 'director-in-charge' also stands in the same position as a managing director, even if he does not give his whole-time to management of the company (Annual Report of DCA year ended March 31, 1957).

Whether a whole-time employee is a whole time director

A, 'whole-time' employee of a company also appointed as a director of the

Company is in the position of a 'whole time' director. The view is equally applicable in the case of an alternate director. Accordingly the appointment of an employee as an alternate director will be governed by the provisions of Sections 314, 269, 309 and 198 of the Companies Act, 1956 (DCA Letter No. 2/19/63 P.R. dated 29-6-1964).

Branch manager if appointed director would be whole-time director

The Department is of the view that when a branch manager who is apparently a whole-time employee, is appointed, as director, he will be in the position of a 'whole-time director' and the appointment would require the approval of the Central Government under Section 269 if it is not in accordance with Schedule XIII. (Company News & Notes, dated July 1, 1963).

Role and Powers of Executive/Whole-time Director

The executive director of a company is duty bound to execute the policies laid down and decision taken by the Board of directors at their various meetings. He has to co-ordinate activities of various divisions and departments of the company and ensures that the short-term and long-term policies and plans of the company are executed and implemented as per the time schedule fixed by the Board. In the event of any delay in the implementation of the policies and plans chalked out by the Board of directors, he is duty bound to bring the fact to the notice of the Board so that causes of the delay may be analysed and remedial action can be taken, if any, and future plans and policies be modified in the light of the experience gained.

The whole-time director is normally entrusted with the responsibility of one particular department or division of the company. If he is appointed for looking after the work of procurement of raw materials, stores, spares, plants and machines, jigs, tools, fixtures, oils lubricants etc, it is his duty to establish proper coordination with the production and marketing departments to ensure procurement of all the inventory in such a way that unwanted inventory is not built up, non-moving items are disposed off and productions not hampered on account of non-availability of necessary inputs. If he is in charge of production, he has to coordinate the activities of his department with the marketing and procurement divisions so that right quality goods are produced in right quantity and in right time to execute the various sale orders in time. He should ensure that no sale orders are allowed to remain in the pipeline for a long time and at the same time unnecessary stock of semi-finished and finished goods are not built up. If he is incharge of marketing the product of the company, he has to keep the marketing team in absolute readiness since the market is very competitive and aggressive salesmanship is required. The sales team must make all possible efforts to keep the order book always full. The whole-time director incharge of marketing has to coordinate the marketing activities with the production and with the Transport incharge/Transport Companies so that the orders booked by the sales team are dispatched in time and the quality and quantity of the goods dispatched remain perfect to avoid all chances of complaints on their account and also sales accounts department for timely realisation of sales proceeds in time. Similarly, if the whole-time director is incharge of finance, he has to make sure that sufficient funds are available to the company to keep all the divisions to their optimum use. Funds should be managed in such a way that they are turned over in the quickest possible time thereby reducing interest burden to the minimum and at the same time the funds should never be in short supply lest the production programme is held up for want of

funds or unnecessarily huge funds are laying in the current accounts of the company without earning any interest, whereas in certain other accounts the company has to pay heavy amounts in the form of interest and service charge because of huge debit balance in cash credit accounts, overdraft and other interest bearing accounts. He should also ensure timely sales realisation as to avoid long debtors position. It is possible by coordination with the marketing head. Such a situation should be avoided by judiciously planning funds management.

Duties of a whole time director

The duties and responsibilities of an executive director or whole-time director are governed by the terms and conditions of their appointment and also by powers and authorities given to them and responsibilities entrusted to them by the Board of directors from time to time or by the shareholders at their general meetings. Unlike the managing director of a company, an executive director or a whole-time director is not entrusted by the company with substantial powers of management of the business and affairs of the company. They are bound to act in strict compliance with duties and powers entrusted to them under the overall direction of the managing director, if any.

Liabilities

An executive director and a whole-time director are not personally liable on the contracts made by them for the company with the third parties. Even where a contract is *ultra-vires* their powers, meaning thereby that where they have no authority to contract, they are not personally liable on the contracts. They may, however, be liable for damages for acting without authority or in excess of authority if they can be deemed to have given out to outsiders that they had authority to act on behalf of the company. However, if they contract in their own names without disclosing that they are acting for the company, they may be personally liable to third parties. They are personally liable to the injured party for any fraudulent act on their part as no contract or agency or other service can impose upon the agent any obligation to commit or procure any fraud or any other wrong. Therefore, where a wrongful act such as libel or trespass, infringement of a patent or trade mark etc. is committed by an executive director or a whole-time director, they are liable along with the company.

3. MANAGER

Definition

As per Sub-section (24) of Section 2 of the Companies Act, "manager" means an individual who, subject to the superintendence, control and direction of the Board of directors, has the management of the whole or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not. Thus, only an individual can be appointed as a manager in a company. There is difference in the mode of appointment of manager and managing director. Besides, in a case where a manager is also appointed a director, if for any reason his office as director is vacated, the office of 'manager' held by him is not affected, whereas in the case of managing director, if he ceases to be director for any reason whatsoever, his office as managing director also will cease along with it, as "managing director" means a director who, by virtue of an agreement with the company or of a resolution

passed by the company in general meeting or by its Board of directors or by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him and includes a *director* occupying the position of a managing director, by whatever name called. Only a director can be appointed as managing director as compared to the manager who may be any individual not necessarily a director.

Number of Managers in a Company

Section 197A of the Companies Act, 1956 provides that notwithstanding anything contained in this Act or any other law or any agreement or instrument no company shall appoint or employ at the same time a managing director and a manager. Thus in terms of Section 197A, a company can at the same time, have two or more managing directors or two or more managers but cannot have both manager and managing director.

Director as Manager

A manager may or may not be director of the company. Where one director of the company is appointed as a Manager, he would, *ipso facto*, become a Managing Director as the Act envisages a distinction between the two. The Department of Company Affairs holds the view that "A person who is a manager within the meaning of Section 2(24) and is also a director of the company would be a managing director and would be subject to all restrictions applicable to a managing director under the Act. In this connection, manager means an individual who has the management of the whole or substantially the whole of the affairs of a company and a director of the company may also be its manager".

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

A manager should always be the director of the company.

- True
- False

Correct answer: False

A manager may or may not be director of the company.

Appointment

A manager may be appointed or reappointed by the Board unless the articles of a company vest that power in the company to be exercised at a general meeting. According to Section 388 of the Act, the provision of Sections 269, 301, 311, 312 and 317 of the Act shall apply in relation to the manager of a company as they apply in relation to managing director thereof, and those of Section 312 shall apply in relation to the manager of a company, as they apply to a director thereof.

Disqualifications

No company shall appoint or employ any firm, body corporate or association as its manager under Section 384. A manager must be an individual. He must not be disqualified under Section 385. If he is a director he must not be disqualified under Section 274 as far as his office of director is concerned.

Term of office

Section 317 permits a company to appoint or re-appoint a manager for a period not exceeding five years at a time. He may, however, be re-appointed for similar terms of five years. The Central Government may also, if it is of the opinion that in the interest of the company it is necessary so to do, accord its approval to the proposed appointment or re-appointment for a period shorter than the period for which the person is proposed to be appointed by the company.

Restriction on the number of companies of which a person may be appointed manager

According to Section 386 no company shall appoint or employ any person as manager, if he is already either the manager or managing director of any other company. However, a company may appoint or employ any person as a manager if he is manager or managing director one and not more than one other company. Such an appointment or employment has to be made or approved by resolution passed at the meeting of the Board with the consent of all the directors present in the meeting, and of which meeting and of the resolution to be moved thereat, specific notice has been given to all the directors then in India. However, the Central Government may, by order, permit any person to be appointed as manager of more than two companies, if the Central Government is satisfied that it is necessary that the companies should, for their proper working function as a single unit and have a common manager.

Restriction on Appointment of Manager

Section 202 prohibits the appointment as managerial personnel of an individual who is an undischarged insolvent. Section 385 also lays down that no individual shall be appointed manager of a company:

- (a) who is an undischarged insolvent, or has at any time, within the preceding five years been adjudged an insolvent; or
- (b) who suspends, or has at any time within preceding five years suspended payment to his creditors, or makes or has at any time within the preceding five years made a composition with them; or
- (c) who is, or has at anytime within the preceding five years been convicted by a Court in India of an offence involving moral turpitude.

Distinction between Manager and Managing Director

The thin line of distinction between a manager and a managing director is not significant as a manager who may also be a director and who is not different from a managing director with regard to his functions. Being a whole-time employee of the company, he is obliged to devote his entire time and attention to the management of the affairs of the company and not to engage himself in any other business. A manager can, however, be director in the other companies within the overall limit prescribed by Section 275 of the Act. Another feature of both the offices is that while a 'manager' by virtue of his office has the management of the whole or substantially the whole of the affairs of a company, a 'managing director' is entrusted with substantial powers of management which would not otherwise be exercisable by him.

Tests to be fulfilled

As held by the Supreme Court, three tests are required to be satisfied:

1. The manager must be an individual, which means that a firm or a body corporate or an association can not be a manager. This fact is made clear in Section 384.
2. He should have the management of the whole or substantially the whole of the affairs of the company.
3. He should be subject to the superintendence, control and directions of the Board of directors in the matter of managing the affairs of the company. A manager has to work or exercise his powers under the control and directions of the Board of directors.

Section 384 in express terms prohibits after the commencement of the Act, the appointment of a firm or a body corporate or an association of persons as a manager as also the continuation of such employment after expiry of six months from such commencement i.e. till 30th September 1956.

Remuneration

Section 387 of the Companies Act deals with the remuneration of a manager. It provides that the manager of a company may, subject to the provisions of Section 198, receive remuneration either by way of a monthly payment, or by way of a specified percentage of the 'net profits' of the company calculated in the manner laid down in Sections 349 and 350, or partly by one way and partly by the other. It further provides that except with the approval of the Central Government such remuneration shall not exceed in aggregate 5% of the net profits.

Section 388 further provides that Sections 269, 301, 311, 312 and 317 as applicable to managing director/whole time director shall also apply to manager. Therefore, the remuneration of a manager has to be fixed by the company within the overall limits as prescribed in Section 198 of the Companies Act and according to the provisions of Section 269 read with Schedule XIII, and Sections 309, 310 and 311 of the Act.

The appointment or re-appointment of the manager, and the fixation of his remuneration is done in the same manner as for managing or whole-time directors of a company.

Powers

The manager of a company may be a director or may only be an employee of the company. If he is a director-manager then he has general conduct and management of the whole of the business and affairs of the company. In such a case he has all the powers of a managing director. However, the manager may exercise these powers subject to the superintendence, control and directions of the Board of directors. Further, in case the manager is only an employee of the company then the terms of agreement appointing him as manager of the company may confer the powers which may be exercised by him. The Board of directors or the Articles of Association of the company may also confer certain powers to a manager.

Duties

The duties and responsibilities of a manager are set out in his contract of service, if any, or in the company/Board resolution or in the articles, by virtue of which he is appointed. The Board of directors of the company is the final authority, subject to whose superintendence, control and direction he has the management of the whole or substantially the whole of the affairs of the company. The Board may increase or contract his duties depending upon the exigencies of work.

Liabilities

A manager is liable for violation, default or breach, whether willful or unintentional, of any of the managerial duties and responsibilities as per his terms of appointment or as enjoined upon him by the Companies Act and any other corporate law or by any provision of the memorandum and articles of association of the company. He is liable for fraudulent conduct of business of the company, for misuse of company's funds and properties. He is also liable both in civil and to criminal prosecution for any wrong statement or misrepresentation in a prospectus issued by the company to which he is a signatory.

Relationship with the Board of Directors

A manager is an important link between the Board of directors on the one hand and the executives of the company, shareholders, suppliers, buyers, various Government agencies and the public at large on the other hand. He co-ordinates the activities of the various divisions and departments of the company and by virtue of his status and position he is expected to be thoroughly conversant with the day-to-day working of the company, the problems and difficulties faced by the various departmental heads. He briefs the directors at periodical Board meetings and at the committees of the directors and reviews the working of the company thereat. He explains to the directors the internal detailed working of various divisions, offers various alternate solutions to the problems facing the company from time to time and thus helps the Board in thoroughly deliberating upon every item of business before it and in taking decisions on short-term plans and long-term policies. He also supplies information to the directors with regard to the implementation of the various Board decisions and policies with comparative figures of targets fixed for various departments, suggests remedial and preventive measures if and when needed and thus helps the directors in their work of directing the business and affairs of the company.

Remuneration of Whole-time/Managing Director/Manager

Section 309 of the Companies Act contains provisions regarding remuneration of directors including any managing or whole-time directors. Sub-section (1) of Section 309 *inter alia*, provides that the remuneration payable to the directors of a company, including any managing director or whole-time director, shall be determined, in accordance with and subject to the provisions of Section 198 and this section, either by the articles of the company, or by a resolution or if the articles so require, by a special resolution passed by the company in general meeting, and the remuneration payable to any such director determined as aforesaid shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity.

The remuneration payable in pursuance of Section 309, including the remuneration payable to the managing or whole-time director, may be determined either by the articles; or by an ordinary resolution of the company. But, if the articles of a company so require, the remuneration shall be determined by a special resolution. It should be noted that where a case falls within the purview of Schedule XIII, the appointment and remuneration payable to the managing or whole-time director referred to in Part I and Part II respectively of the Schedule shall be subject to the approval by an ordinary resolution passed at a general meeting although the appointment and remuneration may have been determined by the Board of directors. This is, however, subject to the provisions of the articles, if any, so far as remuneration is concerned, requiring a special resolution. Every change in the remuneration will require a resolution, ordinary or special, as the case may be as stated above. There is no requirement of prior approval by the shareholders. It can be a *post facto* approval. In the cases falling under Schedule XIII, an ordinary resolution required thereunder can be passed even after the expiry of 90 days from the date of the Board's resolution. [*Circular No. 3/89/3/19/88-CL-V dtd. 13th April, 1989*].

Section 309(3) of the Companies Act provides that a managing director or a whole-time director may be paid remuneration either by way of monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. Except with the approval of Central Government such remuneration should not exceed five per cent of the net profits for one such director and if there is more than one such director, not more than ten per cent for all of them together. The net profits referred to in Sub-section (3) shall be calculated in the manner referred to in Section 198.

Schedule XIII provides guidelines for remuneration of managerial personnel. These guidelines constitute statutory guidelines to the appointment of a person as managing director without the approval of the Central Government. Prior to the enactment of Schedule XIII administrative guidelines on managerial remuneration were issued by the Government from time to time. However, the administrative guidelines issued by the Government are replaced by statutory guidelines contained in the Schedule XIII. (See Annexure 1)

The provisions of Sections 309, 310 and 311 do not apply to a private company unless it is a subsidiary of a public company.

Section 310 provides that any provision relating to the remuneration of any director including a managing or whole-time director, or any amendment thereof, which purports to increase or has the effect of increasing, whether directly or indirectly, the amount thereof, whether the provision be contained in the company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or by its Board of directors, shall not have any effect:

- (i) in case where Schedule XIII is applicable, unless such increase is in accordance with the conditions specified in that Schedule, and
- (ii) in any other case, unless approved by the Central Government, on an application submitted by the company in revised form, e-Form No. 25A.

and that amendment shall be void, if and in so far as it is disapproved by that Government.

However, the approval of the Central Government is not required where any such provision or any amendment thereof, purports to increase, or has the effect of increasing, the amount of such remuneration only by way of a fee for each meeting of the Board, or a committee thereof attended by any such director and the amount of such fee after such increase does not exceed the sum of twenty thousand rupees* [Rule 10B of the Companies (Central Government's) General Rules and Forms as amended dated 24.7.2003].

Section 311 of the Companies Act, 1956 provides that if the terms of any re-appointment of managing or whole-time director made after the commencement of the Act, purport to increase or have the effect of increasing, whether directly or indirectly, the remuneration which the managing or whole-time director or the previous managing or whole-time director, as the case may be was receiving immediately before such re-appointment or appointment, the re-appointment or appointment shall not have any effect:

- (a) In cases where Schedule XIII is applicable, unless such increase is in accordance with the conditions specified in that Schedule; and
- (b) In any other case, unless approved by the Central Government.

and shall be void, if and in so far as it is disapproved by the Government.

As per the Sub-section (3) of Section 309 approval of the Central Government is required in case the remuneration payable to managing or whole time director(s) exceeds 5% of net profits for one such director or 10% of net profits for all of them together. As per Schedule XIII (effective from 1-2-1994); there is no restriction on the quantum of remuneration as long as the remuneration paid during any financial year is within 5% or 10% of net profits, as the case may be (Section I of Part II of Schedule XIII). In the event of loss or inadequacy of profits, a company would have freedom to work out remuneration package for its managerial personnel within the limits specified in paragraph 1 of Section II of Part II of Schedule XIII, without the need of approval of the Central Government under Section 198(4) and 309(3). [See Department's Circular No. 2/94, Dated 10-2-1994 and Notification No. GSR 215(E) dated 2-3-2000].

Any payment by way of remuneration in excess of the limit prescribed by the section or without approval of the Central Government where approval is required, has to be held by the recipient in trust for the company and he shall refund it to the company. The recovery of such sum cannot be waived by the company unless permitted by the Central Government. [*Re Oxford etc. Society*, (1886) 35 Ch D 502; *Leeds Estate etc. Co. v. Shepherd*, (1887) 36 Ch D 787, 809].

Thus, remuneration can be paid either in terms of the company's articles or in accordance with a resolution of the general meeting. A director can sue for remuneration which has been agreed to be paid to him. [*Nell v. Allanta etc., Mines* (1895) 11 TLR 407 (CA)]. But there is no right of action till such resolution passed. He can prove his claim in the winding up like an ordinary creditor. [*Beckwith Exp.* (1898) 1 Ch 324; (1895-9) ALL ER Rep Ext. 1655].

* in case of Companies with paid up share capital and free reserves of Rs. 10 crores and above or turnover of Rs. 50 crore and above and in case of other Companies, sitting fee not exceeding Rs. 10,000.

A remuneration approved by all the shareholders entitled to attend and vote at a general meeting, has the same effect as a resolution duly passed [*Cane v. Jones* (1981) 1 All ER 533: (1980) 1 WLR 1451], Where the remuneration is shown in the accounts which have been approved by the shareholders, this may operate as an authority for payment of remuneration as specified in the accounts [*Felix Hadley & Co. Ltd. v. Hadley*, (1897) 77 LT 131].

Remuneration for Professional Services

The previous sanction of the Central Government under Section 310 is not necessary for paying remuneration to a director for services of a professional nature, since such remuneration is excluded from total remuneration under Section 309(1)(a). In a certain case, it was held that payment can be made for professional services rendered by a director who is a solicitor. The company need not obtain any further approval before making any such payment. [*Ruby Mills Ltd v. Union of India* (1985) 57 Com Cases 193 (Bom)]. Journalist, Editor, Author, Engineer, Solicitor, Operator, Auctioneer, Company Secretaries, Chartered Accountants, Cost Accountants etc. have been taken to be exercising a profession.

Commission upto 1% only when director renders some specific services

Raising of remuneration of a director by way of commission constitutes an increase which would require Central Government approval under Section 310 entitling the Central Government to impose restrictions and conditions in the exercise of its powers under Section 637A and Section 637AA. [*National Engineering Industries Ltd v. Secretary, Ministry of Law Justice and Company Affairs*, (1990-91) 95 CWN 1112 (Cal)].

Department's Clarification - Government has generally never objected to such payments where there are no managing directors but where such managerial officers function and receive remuneration for services rendered by them, commission to the directors to the extent of 1% permitted by the Act is being allowed only where the directors render some specific services for which some remuneration would appear justified. This is a fair and equitable principle based on the wholesome rule of correlation of remuneration to services rendered. It is of course open to the company to satisfy the Board in specific cases that such directors rendered services beyond merely attending Board meetings, and where the board is satisfied about such services, necessary sanction would not be withheld. (Letter No. 2/8/64-PR dated 23.3.1964).

Reimbursement of Medical Expenses

It may also be noted that the Government has vide Circular No. 2/31/CL.VII/95, dated 7.11.1996 clarified that any reimbursement of medical expenses in excess of limits mentioned in total managerial remuneration package requires approval of the Central Government under Section 310 of the Companies Act. An application for this purpose is to be preferred to the Central Government in the prescribed form after complying with the requirement formalities. The circular adds that such proposals are normally considered by the Central Government within the framework of policy as stated below:

- (a) Having regard to the improved medical facilities available in India, the

managerial personnel should obtain specified treatment abroad only in exceptional and deserving cases. All proposals for reimbursement on specialised medical treatment abroad must invariably be accompanied by an essentiality certificate issued and signed by the Director General of Health Services of the concerned State/Union Government.

- (b) The ceiling on reimbursement of medical expenses on specialised medical treatment abroad (inclusive of air fare, boarding/lodging for the patient and the attendant, where the Director General of Health Services considers it necessary that the attendant should accompany the patient) is Rs. 9 lakhs only.
- (c) The proposals for increase in the remuneration by way of reimbursement of medical expenses on specialized treatment abroad is considered in respect of the managerial personnel himself/herself and not his/her family members or dependents.
- (d) It should be noted that any claim for an amount in excess of Rs. 9 lakhs would not be entertained by the Central Government.
- (e) The application under Section 310 of the Companies Act, 1956, in this regard, should be preferred within the currency of the tenure of the managerial personnel concerned.

Expenses on Use of Company's Car and Telephone

Department of Company Affairs has clarified that the expenditure on use of company's car and telephone at residence, which may be borne by the company, are not considered perquisites. The expenditure on personal long distance calls on telephone and use of car for private purpose shall, however, be billed by the company to the appointee; the term "billed" used in this regard in the para on this subject should be taken to mean "to recover".

Payment of Sitting Fee to Managerial Personnel

As regards that payment of sitting fee to managing or whole-time director the Department of Company Affairs (Now Ministry of Company Affairs) has vide letter No. 3/1/90-CI.V dated 18.8.1990 clarified that payment of sitting fee to managerial personnel is part of managerial remuneration and in case of Schedule XIII appointments, no sitting fee is payable in the absence of any proviso made therein.

Expenses incurred on travelling and transportation of personal effects of Managing or Whole-time Director or Manager

Some companies have sought a clarification from the Ministry of Company Affairs whether it would be in order for them to meet the expenses on travel of the managing or whole time director or manager and his family members and on transportation of his personal effects from the place of his duty to his home town or to a place where he intends to settle on expiry of his tenure. In this connection, it is clarified that these expenses are not in the nature of perquisites and are not therefore, covered in Schedule XIII (though Schedule XIII does contain a provision in regard to reimbursement of expenses incurred on joining duty and return to the home country in respect of expatriate managerial personnel). The companies, may

therefore, incur expenses on travel of the managing or whole-time director or manager and his family members and on transportation of his personal effects from his place of duty to his home town or to a place where he intends to settle, on expiry of his tenure, provided the relevant travelling rules of the company provide for incurring such expenditure. No approval of Central Government would be required in such cases. [Circular No. 9/93; F. No 1/4/92-CL. V dated 28-7-1993].

Appointment of managing director without remuneration

Approval of the Central Government is necessary even if the managing director/whole-time director is not paid any remuneration, if the case falls outside Schedule XIII.

Change of designation of managerial personnel

For change of designation of managing or whole time director, fresh approval of the Government is not necessary. It would, however, be advisable to intimate the change to the Government.

'Whole-time director' and 'director in the whole-time employment'

These expressions occurring in Sub-sections (1) and (3) respectively mean the same thing. As the Sub-section (1) provides that the remuneration of such a director payable for services in any capacity whether as director or for other services, the provisions of that sub-section will have to be compiled with, whether the remuneration is for managerial services or other services. When once an employee becomes a director, he will come within the scope of Sections 269, 309 and 310 of the Act.

Compensation for Loss of Office

Sections 318, 319, 320 and 321 of the Act deal with the question of payment of compensation to a director for loss of his office. Section 318 states that no compensation for loss of office or as consideration for retirement from office, or in connection with such loss or retirement shall be paid by a company to any director other than the managing director or a director holding the office of manager, or in the whole-time employment of the company.

Even in the case of a managing director or a whole-time director or a manager no such payment shall be made in the following cases:

- (i) where the director resigns his office on reconstruction or amalgamation of the company and is appointed as the managing director, manager or other officer of the reconstructed company or the body corporate resulting from the amalgamation;
- (ii) where the director resigns his office otherwise than on reconstruction of the company or its amalgamation thereof;
- (iii) where the office is vacated under Section 203 or 283;
- (iv) where the winding up of the company takes place due to his negligence or mismanagement;
- (v) where the director has been guilty of fraud or breach of trust or gross negligence or mismanagement of the conduct of the affairs of the company, or any subsidiary or holding company thereof;

- (vi) where the director has instigated or has taken part in bringing about the termination of his office.

However, the compensation, if payable, must not exceed the remuneration which the director would have earned for the unexpired residue of his term or for three years, whichever is shorter. The amount should be calculated on the basis of the average remuneration actually earned by him during a period of three years before the termination, or where he holds office for lesser period, during such period. But, no such payment shall be made to the director in the event of the commencement of the winding up of the company, whether before, or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital (including the premium, if any) contributed by them.

Sub-section (3) specifies the circumstances in which a managerial personnel entitled to compensation under this section would lose his right to compensation. One of them is when he is guilty of fraud, or a breach of trust, etc.

4. CHAIRMAN

The Chairman is a necessary element of company meeting and is usually appointed by the articles. Section 175 of the Companies Act, 1956 (the Act) provides that unless the articles of company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the chairman thereof on a show of hands.

Election of Chairman

In the absence of any provision in the articles of a company as regards the election of a chairman of its general meetings, the common law rule is that the candidate for the office of chairman should not preside over the election; and where an outgoing chairman seeks re-election, he should vacate the chair pending the election, unless on a show of hands he is re-elected without any controversy. The meeting may appoint a temporary or provisional chairman to run the meeting until the chairman is elected.

Any objection to the appointment of a chairman should be made immediately because otherwise any irregularity in the nomination may become cured by acquiescence. [*Cornwall v. Woods*, (1846) 4 Notes of Cases 555].

Appointment of Chairman

A. Chairman of Board Meeting

Most of the companies name in their articles of association the chairman of the meetings of the Board of directors. Certain other companies incorporate in their articles a provision corresponding to the provision of Regulation 76 of Table A in Schedule I to the Companies Act, 1956, which provides; "(1) The Board may elect a chairman of its meetings and determine the period for which he is to hold office. (2) If no such chairman is elected or if at any meeting the chairman is not present within five minutes after the time appointed for holding the meeting, the director present may choose one of their number to be chairman of the meeting".

B. Chairman of Committee Meeting

With regard to the chairman of the meetings of the various committees of the Board, Regulation 78 of Table A provides: “(1) A committee may elect a chairman of its meetings, (2) if no such chairman is elected or if at any meeting the chairman is not present within five minutes after the time appointed for holding the meeting, the members present may choose one of their number to be chairman of the meeting”.

Pursuant to Section 292A of the Act, an Audit Committee is required to be constituted. Its chairman may be a managing or whole-time director or any other director, whereas in pursuance of the clause 49 of the listing agreement, the Chairman of the Audit Committee shall be an independent director. The chairman of the Audit Committee must have to attend the annual general meeting to provide any clarification on matters relating to audit (Section 292 and Clause 49).

C. Chairman of General Meeting

Usually the chairman of the meetings of the Board of directors, if named in the articles of association or if appointed by the Board of directors of a company for a specific period, presides over all the general meetings of the company. The articles of association of some companies contain provisions corresponding to the ones in Regulations 50, 51 and 52 of Table A about the appointment of chairman of the company's general meetings. Otherwise, if regulations of Table A are not excluded, the said regulations apply. These Regulations are:

Regulation 50: “The chairman, if any, of the Board shall preside as chairman at every general meeting of the company”.

Regulation 51: “If there is no such chairman, or if he is not present within fifteen minutes after the time appointed for holding the meeting or is unwilling to act as chairman of the meeting, the directors present shall elect one of their number to be chairman of the meeting”.

Regulation 52: “If at any meeting no director is willing to act as chairman or if no director is present within fifteen minutes after the time appointed for holding the meeting, the members present shall choose one of their number to be chairman of the meeting”.

Removal of Chairman

In order to remove a chairman, the usual procedure would be for a member to propose a vote of no confidence in the chair and this move should be seconded by another member. The chairman would have the right to make a representation against the removal. The matter should then be put to vote. If he loses the vote, he should relinquish the chair. Thus, a chairman who has been elected by the meeting can be removed by the meeting [*Booth v. Arnold*, (1895) 1QB 571]. But where the company's articles appoint the chairman, the meeting cannot remove him unless it is due to bad faith, impartiality or abuse of authority.

The articles of a company may govern the point and may provide for challenge to be made to a ruling of the chairman. The chairman should vacate the chair while the challenge to his ruling is debated.

Role of Chairman

The chairman has *prima facie* authority to decide all questions which arise at a meeting, and which require decision at the time, but a member by submitting to his ruling and voting upon a resolution which the chairman allows to be put is not precluded from maintaining by litigation that he was wrong [*In Henderson v. Bank of Australasia*, (1890) 45 Ch D 330(A); (1886-90) All ER Rep Ext1190] it was held that the entry in the minute book of the chairman's decision is, however, *prima facie* evidence of the correctness of the decision, and the onus of displacing that evidence is on those who impeach it, and there is delay in commencing proceedings, very strict proof will be required that the entry in the minute book is wrong. [*Indian Zoedone Co.*, (1884) 26 Ch D 70 (CA); *Ayre v. Skelsey Adaman Cement Co.*, (1905) 21 TLR 464 (CA)].

Before proceeding with the business of meeting, the chairman must ascertain that a quorum to constitute the meeting as prescribed under the Act or the Articles of Association of the Company is present. If there is no quorum, he has to adjourn the meeting. Where a meeting has commenced with proper quorum, lack of quorum during the continuance of the meeting will not invalidate the proceedings.

Regulation 53 of Table A gives authority to the chairman to adjourn a meeting where quorum is present. It lays down: "(1) The chairman may, with the consent of any meeting at which a quorum is present, and shall, if so directed by the meeting, adjourn the meeting from time to time and from place to place. (2) No business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place. (3) When a meeting is adjourned for thirty days or more, notice of the adjourned meeting shall be given as in the case of an original meeting. (4) Save as aforesaid, it shall not be necessary to give any notice of an adjournment or of the business to be transacted at an adjourned meeting." The Chairman of the meeting has to keep the above provisions in view while conducting proceedings at such meetings.

The chairman may adjourn meeting at his discretion when he feels that peaceful conduct of the meeting is not possible. While conducting meetings of Board of directors, the chairman has to give a sense of direction to the deliberations ensuring at the same time that he does not curb the freedom of expression of the directors to enable them to put forth their views on the business before the Board. The chairman should not dictate or even try to dictate the directors or check them beyond reasonable limits. He should give opportunity to all the directors present to contribute their best to the deliberations of the Board. The directors must be allowed to feel that they are free to put forward their views before the Board takes decisions. The chairman should allow sufficient time for discussion on all items on the agenda of a meeting. Rushing with the agenda and claiming that the entire business was conducted in a very short time does not give any credit to a chairman. He should give all the directors a sense of participation and should inspire them to do their home work and come prepared for the meeting and contribute their best to the deliberations of the Board. The assent of the directors should not be taken for granted. The chairman must have an extra degree of patience and tact. He should be fair but firm. The chairman must allow the directors to have a fair and full discussion on each business before the meeting but at the same time he must make sure that the discussion must be strictly relevant, brief

and to the point. This will ensure effectiveness of the Board as a decision-making agency of the company.

Whole-time and Part-time Chairman

In India, we have Boards, which are chaired by managing directors, who are known as chairman-cum-managing director (CMD). We have also Boards, which are chaired by directors, who are not whole-time directors. A chairman-cum-managing director (CMD) is sometimes called a whole-time chairman whereas a director, who is not a whole-time director of the company, is called a part-time chairman. Even if a managing director is chairman-cum-managing director of the company, he acts as chairman of the meetings of the Board of directors only when they are held. During the intervals, he occupies the chair of the managing director. Strictly speaking therefore, a chairman is never a whole-time chairman. He is always a part-time chairman. The term whole-time chairman thus seems to be a misnomer.

Where the chief executive, designated either as managing director, executive director or technical director happens to chair the meetings of the Board of directors of a company, he convenes/conducts Board meetings essentially to get certain decisions approved or disapproved as he plans, to feel the pulse of the Board before issues are presented for decisions and to inform the Board on matters and developments to the extent he feels prudent to do so. The effectiveness and success of such a Board, therefore, depends to a great deal, on the clarity of the mind of such chairman-cum-managing director, the home work done by him and the manner in which the Board meetings are conducted and he is expected to take pains to go through all the items on the agenda of a meeting in detail so as to help the participating directors in appreciating the real nature of the problem, matters and issues to be discussed, decisions to be taken and policies to be formulated. Sometimes the Board meetings may not run strictly on the lines expected by the chairman-cum-managing director and in such cases division of votes or differences of opinion on certain matters may take place.

Duties and Responsibilities

The primary duty of the chairman of a Board or company meeting is to ensure the presence of quorum before proceeding with the deliberations of the meeting and then to conduct the meeting in a peaceful atmosphere so that the business on the agenda before the meeting is transacted in an orderly fashion.

In *National Dwellings Society v. Sykes*, (1894) 3 Ch 159, Chitty J said, 'Unquestionably it is the duty of the chairman, and his function, to preserve order, and to take care that the proceedings are conducted in a proper manner, and that the sense of the meeting is properly ascertained with regard to any question which is properly put before the meeting.' But he has no power to stop or adjourn a meeting at his will, [*Second Consolidated Trust Ltd. v. Ceylon Amalgamated Tea and Rubber Estates*, (1943) 2 All ER 567; *Narayan Chettiar S.R.M.S.T. v. Kaleeswarar Mills Ltd.*, (1951) 21 Com Cases 351: AIR 1952 515].

In order to fulfil his duty properly, he must observe strict impartiality, even though he may be personally and strongly opposed to any matter. He must give a reasonable chance to the members present to discuss any proposed resolutions,

as long as discussion is kept within reasonable limits. After it has been reasonably debated he should stop discussion after seeing that the minority is not stifled in any way. He must bow to the majority vote in respect of all matters where he has to take a decision. [*Wall v. London and Northern Assets Corporation*, (1898) 2 Ch 469 (CA)].

But where there is serious disorder, the chairman has an inherent power to adjourn [*John v. Rees* (1969) 2 All ER 274 (Ch D)].

It is his duty to ensure that all the participating directors get an opportunity to express their views on the business before the meeting so that the deliberations and decisions have the benefit of the experience, knowledge and expertise of all the participating directors. He must ensure that the discussions are absolutely relevant and material to the proceedings, not defamatory of any person and not detrimental to the interests of the company. He must take consensus of the meeting on the business before the meeting and voting in Board meetings will be by show of hands. Certain companies provide in their articles that in the event of equality of votes in a meeting on a subject under discussion, the chairman shall have a second or deciding vote, which is also known as casting vote. Regulation 54 of Table A contains this provision. The chairman should take up the routine matters on the agenda first and dispose off them leaving controversial matters to be taken up later on. Although it is advisable that the business on the agenda should be considered in the same order, yet the chairman may, either with the consent of the meeting or at his own discretion take up any item and dispose it of for the sake of convenience and expediency.

At a meeting of Board of directors, the chairman may allow any additional business to be transacted either with the consent of the meeting or at his own discretion but at a general meeting no motion, of which due notice has not been given, can be taken up by the chairman even with the consent of the members present. At the conclusion of a meeting, the chairman should declare the meeting closed.

Where there is some discussion, he should not use the 'closure' to prevent discussion, but if the minority shareholders have had sufficient opportunity of stating their case, he may, with the consent of the meeting, apply the closure and put the question to vote [*Wall v. London and Northern Assets Corporation*, (1898) 2 Ch 469]. The chairman may be called upon to decide tricky questions, and must decide them on a fair basis. His decisions are to be taken as *prima facie* correct [*Indian Zoedone Co.*, (1884) 25 Ch D 70].

The chairman must ensure that minutes of proceedings of all the general meetings and meetings of Board of directors containing a fair and correct summary of the proceedings. The chairman should also make sure that each page of the minutes books is initialed and the last page of each minutes signed with the date of signature in accordance with the provisions of Sub-section (1A) of Section 193 of the Act. According to explanation to Sub-section (5) of Section 193 of the Act, the chairman shall exercise an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in the said sub-section.

Choose the correct answer

The primary duty of the Chairman of a Board or company meeting is to ensure the presence of _____ before proceeding with the deliberations of the meeting.

- (a) All the directors of the Board
- (b) Independent Director
- (c) quorum
- (d) None of the above

Correct Answer: (c)

Chairman's Power under Common Law

The chairman has powers under the common law; such as (1) the power to bring the discussion on any question to a close (2) the power to adjourn a meeting, if it is necessary, in his opinion, under any circumstances. The chairman cannot arbitrarily dissolve or adjourn a meeting, and if he prematurely closes a meeting or adjourns it, his act will be considered irregular and it will be open to the meeting to select another chairman and proceed with the business. Like any other member he has an ordinary vote. But as regards the use of a second or casting vote, he cannot exercise such a right, unless the articles of the company specially confer it to him as per Regulation 74(2) of Table A of Schedule I. [*Nell v. Longbottom* (1894) 1 QB 767].

The decision of chairman of any subject or as to the validity of vote at a meeting are final and binding on the chairman or his successors at later stage. [*Narayanan Chettiar (S.R.M. S.T.) v. Kaleswarar Mills Ltd.*, (1951) 21 Com Cases 351].

Amendments to Resolution

Any amendment to a resolution which is specified and within the scope of the notice may be proposed, seconded and passed at the meeting. Such an amendment cannot be refused by the chairman before the meeting. See *Henderson v. Bank of Australia*. (1890) 45 Ch D 330; (1886-90) All ER Rep 1190 (CA), where the chairman refused to put the amendment, the resolution was set aside.

Adjournment of Meetings

1. The chairman does not have the right to cancel or adjourn a meeting properly convened, except as provided by the articles and in accordance therewith.
2. But the chairman has the right to adjourn a meeting when it is impossible to continue the meeting, by reason of disorder or other like cause [*John v. Rees*, (1969) 2 All ER 274 at 290-291].
3. If the chairman attempts to adjourn improperly, the meeting may elect another chairman and proceed with the business [*National Dwelling Society Ltd. v. Sykes*, (1894) 3 Ch 159].
4. Where the articles provide that the chairman may, with the consent of meeting, adjourn the meeting, he may, in his discretion refuse to adjourn, even though meeting may resolve to do so. (*Salisbury Gold Mining Co. v. Hathorn*, (1897) App Cas 268); but if the articles provide that he shall

adjourn, he has no discretion but must adjourn, if so resolved by the meeting.

5. Of course, Section 174 provides for adjournment or dissolution as the case may require, in case of want of quorum.
6. When in an orderly meeting a poll is demanded on a motion to adjourn and such poll cannot be taken forthwith, the chairman has power to suspend the meeting with a view to its continuance at a later date after the result of the poll is known [*Jackson v. Hamlyn*, (1953) 1 All ER 887: 1953 Ch 577].
7. An adjourned meeting is a continuation of the original meeting, and no new notice need be given except in cases provided by the articles; cited with approval by Delhi High Court in *S.P. Arora v. Roshanara Club*, (1992) 8 Corpt LA 31 at 34 (Del). At an adjourned meeting, only such business as is left incomplete at the original meeting, can be dealt with unless new notice is properly given as required by Sections 171, 172 and 173. Resolutions passed at adjourned meeting are, for all purposes, to be treated as passed on the date on which they were in fact passed.

Chairman's Declaration as to Result to Voting

As mentioned earlier, when voting takes place by show of hands, the Chairman's declaration as to the result of voting is a conclusive evidence of the resolution being passed or not [E.D. *Sasoon United Mills*, Re, AIR 1929 Bom 38; *Gold Co.* (1970) 11 Ch D 701, 719: (1874-80) All ER Rep 957 (CA)]. But there are two exceptions: (a) when a poll is demanded, [*Harben v. Philips*, (1883) 23 Ch D 14, 23] and (b) when the declaration is without taking into account of the numbers or proportion of the votes recorded in favour or against the resolution [*Dhakeshwari Cotton Mills v. Nil Kamal Chakravarthy*, (1937) 7 Com. Cases 117: AIR 1937 Cal. 645]. Further the formalities such as the showing of hands must be complied with even when the motion is unopposed.

Liabilities

The Companies Act fixes no liabilities on the chairman of company and Board meetings. However, the chairman of the meetings of the Board of directors of a company, in whom the administration of the company is vested in accordance with the provisions of its articles of association, company resolution, Board resolution or an agreement, may be liable for ignoring the duties enjoined upon him. He is, however, not liable for monies received and spent by him for and on behalf of the company, if any.

ANNEXURES

ANNEXURE I

SCHEDULE XIII PART I

APPOINTMENTS

No person shall be eligible for appointment as a managing or whole-time director or a manager (hereinafter referred to as managerial person) of a company unless he satisfies the following conditions, namely:

- (a) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any

of the following conditions, namely:

- (i) the Indian Stamp Act, 1899 (2 of 1899),
 - (ii) the Central Excises and Salt Act, 1944 (1 of 1944),
 - (iii) the Industrial (Development and Regulation) Act, 1951 (65 of 1951),
 - (iv) the Prevention of food Adulteration Act, 1954 (37 of 1954),
 - (v) the Essential Commodities Act, 1955 (10 of 1955),
 - (vi) the Companies Act, 1956 (1 of 1956),
 - (vii) the Securities Contracts (Regulation) Act, 1956 (42 of 1956),
 - (viii) the Wealth-tax Act, 1957 (27 of 1957),
 - (ix) the Income-tax Act, 1961 (43 of 1961),
 - (x) the Customs Act, 1962 (52 of 1962),
 - (xi) the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969),
 - (xii) the Foreign Exchange Regulation Act, 1973 (46 of 1973),
 - (xiii) the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986),
 - (xiv) the Securities and Exchange Board of India Act, 1992 (15 of 1992),
 - (xv) the Foreign Trade (Development and Regulation) Act, 1992 (52 of 1992),
- (b) he had not been detained for any period under the Conservation of foreign exchange and Prevention of Smuggling Activities Act, 1974 (52 of 1974):

Provided that where the Central Government has given its approval to the appointment of a person convicted or detained under sub-paragraph (a) or sub-paragraph (b), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval;

- (c) he has completed the age of twenty-five years and has not attained the age of seventy years.

Provided that where:

- (i) he has not completed the age of 25 years, but has attained the age of majority; or
- (ii) he has attained the age of 70 years; and

Where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the central Government shall be necessary for such appointment;

- (d) where he is a managerial person in more than one company he draws remuneration from one or more companies subject to the ceiling provided in Section III of Part II;
- (e) he is resident of India.

Explanation I: For the purpose of this Schedule, resident of India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India —

- (i) for taking up employment in India, or

- (ii) for carrying on a business or vocation in India.

Explanation II: This condition shall not apply to the companies in Special Economic Zones as notified by Department of Commerce from time to time.

Provided that a person, being a non-resident in India shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, alongwith the visa application form, profile of the company, the principal employer and terms and conditions of such person's appointment.

PART II REMUNERATION

Section I — Remuneration payable by companies having profits

Subject to the provision of Section 198 and 309, a company having profits in a financial year may pay any remuneration, by way of salary, dearness allowance, perquisites, commission and other allowances, which shall not exceed five per cent of its net profits for one such managerial person, and if there is more than one such managerial person, ten per cent for all of them together.

Section II — Remuneration payable by companies having no profits or inadequate profits

1. Notwithstanding anything contained in this Part, where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and any other allowances,—

- (A) not exceeding ceiling limit of Rs. 24,00,000 per annum or Rs. 2,00,000 per month calculated on the following scale:

<i>Where the effective capital of the company is</i>	<i>Monthly remuneration payable shall not exceed (Rupees)</i>
(i) less than rupees 1 crore	75,000
(ii) rupees 1 crore or more but less than rupees 5 crores	1,00,000
(iii) rupees 5 crores or more but less than rupees 25 crores	1,25,000
(iv) rupees 25 crores or more but less than rupees 50 crores	1,50,000
(v) rupees 50 crores or more but less than rupees 100 crores	1,75,000
(vi) rupees 100 crores or more	2,00,000

Provided that the ceiling limits specified under this sub-paragraph shall apply, if—

- (i) payment of remuneration is approved by a resolution passed by the Remuneration Committee:

- (ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person.
- (B) not exceeding ceiling limit of Rs. 48,00,000 per annum or Rs. 4,00,000 per month calculated on the following scale:

<i>Where the effective capital of the company is</i>	<i>Monthly remuneration payable shall not exceed (Rupees)</i>
(i) less than rupees 1 crore	1,50,000
(ii) rupees 1 crore or more but less than rupees 5 crores	2,00,000
(iii) rupees 5 crores or more but less than rupees 25 crores	2,50,000
(iv) rupees 25 crores or more but less than rupees 50 crores	3,00,000
(v) rupees 50 crores or more but less than rupees 100 crores	3,50,000
(vi) rupees 100 crores or more	4,00,000

Provided that the ceiling limits specified under this sub-paragraph shall apply, if—

- (i) payment of remuneration is approved by a resolution passed by the Remuneration Committee;
- (ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;
- (iii) a special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding three years;
- (iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely—
 - I. General information:
 - (1) Nature of industry
 - (2) Date or expected date of commencement of commercial production
 - (3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus.
 - (4) Financial performance based on given indicators
 - (5) Export performance and net foreign exchange collaborations
 - (6) Foreign investments or collaborations, if any.
 - II. Information about the appointee:
 - (1) Background details

- (2) Past remuneration
- (3) Recognition or awards
- (4) Job profile and his suitability
- (5) Remuneration proposed
- (6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be w.r.t the country of his origin).
- (7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

- (1) Reasons of loss or inadequate profits
- (2) Steps taken or proposed to be taken for improvement
- (3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures:

- (1) The shareholders of the company shall be informed of the remuneration package of the managerial person.
- (2) The following disclosures shall be mentioned in the Board of Director's Report under the heading "Corporate Governance", if any, attached to the annual report:
 - (i) All elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
 - (ii) Details of fixed components and performance linked incentives along with the performance criteria;
 - (iii) Service contracts, notice period, severance fees;
 - (iv) Stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable;

(C) exceeding the ceiling limit of Rs. 48,00,000 per annum or Rs. 4,00,000 per month calculated on the following scale:

<i>Where the effective capital of Company is</i>	<i>Monthly remuneration payable exceed (Rupees)</i>
(i) less than rupees 1 crore	1,50,000
(ii) rupees 1 crore or more but less than rupees 5 crores	2,00,000
(iii) rupees 5 crores or more but less than rupees 25 crores	2,50,000
(iv) rupees 25 crores or more but less than rupees 50 crores	3,00,000
(v) rupees 50 crores or more but less than rupees 100 crores	3,50,000
(vi) rupees 100 crores or more	4,00,000

Provided that the ceiling limits specified under this sub-paragraph shall apply, if—

- (i) payment of remuneration is approved by a resolution passed by the Remuneration Committee;
- (ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;
- (iii) a special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding three years;
- (iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely—

I. General information:

- (1) Nature of industry
- (2) Date or expected date of commencement of commercial production
- (3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus.
- (4) Financial performance based on given indicators
- (5) Export performance and net foreign exchange collaborations
- (6) Foreign investments or collaborators, if any.

II. Information about the appointee:

- (1) Background details
- (2) Past remuneration
- (3) Recognition or awards
- (4) Job profile and his suitability
- (5) Remuneration proposed
- (6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be w.r.t the country of his origin).
- (7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

- (1) Reasons of loss or inadequate profits
- (2) Steps taken or proposed to be taken for improvement
- (3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures:

- (1) The shareholders of the company shall be informed of the remuneration package of the managerial person.

- (2) The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the annual report:
- (i) All elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
 - (ii) Details of fixed components and performance linked incentives along with the performance criteria;
 - (iii) Service contracts, notice period, severance fees;
 - (iv) Stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable:

Provided further that the conditions specified in sub-paragraph (C) shall apply in the case the effective capital of the company is negative:

Provided also that the prior approval of the Central Government is obtained for payment of remuneration on the above scale if the company is a listed company or a subsidiary of a listed company.

Provided further that approval of Central Government is not required for a subsidiary of a listed company, if:-

- (i) the Remuneration Committee and Board of Directors of the holding company give their consent for the amount of such remuneration of the applicant and for the said amount to be deemed remuneration by the holding company for the purpose of section 198 of the Companies Act, 1956 and;
- (ii) a special resolution has been passed at the general meeting of the company for payment of remuneration of the applicant and;
- (iii) the remuneration of the applicant is deemed to be remuneration paid by holding company and;
- (iv) all members of the subsidiary are bodies corporate:

Provided that a listed company or a subsidiary of a listed company shall not require Central Government approval for the payment of remuneration to its managerial personnel, if the remuneration is fixed by Board of Industrial and Financial Reconstruction"

Provided that no approval of Central Government is required if the managerial person, is not having any interest in the capital of the company or its holding company, directly or indirectly or through any other statutory structures and not having any direct or indirect interest or related to the directors or promoters of the company or its holding company at any time during last two years before or on the date of appointment and is having a graduate level qualification with expert and specialized knowledge in the field of his profession.

- (D) not exceeding Rs. 2,40,00,000 per annum or Rs. 20,00,000 per month in respect of companies in Special Economic Zones as notified by Department of Commerce from time to time:

Provided that these companies have not raised any money by public issue of shares or debentures in India:

Provided further that such companies have not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year.

2. A managerial person shall also be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in paragraph 1 of this Section:

- (a) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961.
- (b) gratuity payable at a rate not exceeding half a month's salary for each completed year of service, and
- (c) encashment of leave at the end of the tenure.

3. In addition to the perquisites specified in paragraph of this Section, an expatriate managerial person (including a non-resident Indian), shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in paragraph 1 of this Section:

- (a) *Children's education allowance:* In case of children studying in or outside India, an allowance limited to a maximum of Rs. 5,000 per month per child or actual expenses incurred, whichever is less. Such allowances is admissible upto a maximum of two children.
- (b) *Holiday passage for children studying outside India/family staying abroad:* Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India with the managerial person.
- (c) *Leave travel concession:* Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Explanation I: For the purposes of Section II of this part, 'effective capital' means the aggregate of the paid-up share capital (excluding share application money or advances against shares): amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in the case of investment by an investment company whose principal business is acquisition of shares, stock debentures or other securities); accumulated losses and preliminary expenses not written of.

Explanation II: (a) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment;

(b) In any other cases, the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Explanation III: For the purposes of Section II of this Part, family means the spouse, dependent children and dependent parents of the managerial person.

Explanation IV: For the purposes of this section, "Remuneration Committee" means:-

- (i) In respect of a listed company, a committee which consists of at least three non-executive independent directors including nominee director or nominee directors, if any; and
- (ii) In respect of any other company, a Remuneration Committee of Directors.

Explanation V: For the purposes of this clause, the Remuneration Committee while approving the remuneration under this section shall,—

- (a) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.
- (b) be in a position to bring about objectivity in the determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation VI: For the purposes of Paragraph 1, "negative effective capital" means the effective capital which is calculated:—

- (a) in accordance with the provisions contained in Explanation I of this Part;
- (b) less than zero.

Explanation VII: For the purpose of section II of this part, "Statutory Structure" means any entity which is entitled to hold shares in any company formed under any statute.

Section III — Remuneration payable to a managerial person in two companies

Subject to the provisions of Section I and II, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

PART III

PROVISIONS APPLICABLE TO PARTS I AND II OF THIS SCHEDULE

1. The appointment and remuneration referred to in Parts I and II of this Schedule be subject to approval by a resolution of the shareholders in general meeting.
2. The auditor or the secretary of the company or where the company has not appointed a secretary, a secretary in whole-time practice shall certify that the requirements of this Schedule have been complied with and such certificate

shall be incorporated in the return filed with the Registrar under Sub-section (2) of Section 269.

CLARIFICATIONS ON SCHEDULE XIII

(A) [Issued by the Ministry of Law, Justice and Company Affairs vide Circular No. 3 of 1989 dated 13.04.89].

(i) Section 269

Approval of the Central Government is not required in the case of appointment of managerial personnel made on or after 15.6.1988 (the date when the amended provision were enforced), in accordance with the conditions specified in Schedule XIII to the Act. A return in the prescribed form (form No. 25C) is to be filed with the concerned Registrar within 90 days from the date of such appointment. While filing the return in Form No. 25C, a copy of the resolution passed by the Board of Directors and/or shareholders in the general meeting is required to be enclosed with the return. In terms of paragraph 1 of Part-I, II of Schedule XIII to the Act, the appointment and remuneration of managerial personnel shall be subject to approval by a resolution of the shareholders in the general meeting. The said resolution in the general meeting can be passed even after the expiry of ninety days period from the date of appointment by the Board of Directors, and is not required to be filed with the Registrar, so long as the resolution passed by the Board of Directors has already been enclosed with the said return.

(ii) Section 268

No approval of the Central Government under Section 268 is required for appointment or re-appointment of managerial personnel, if made in terms of Section 269 of the Act.

(iii) Schedule XIII — Part I

The conditions specified therein are required to be satisfied only at the time of appointment. In case the appointee, after appointment, does not satisfy any of the said conditions, it will not debar the person concerned from continuing in office for the full tenure of his appointment. For example, as per clause (c), an appointee must not have attained the age of 65 years at the time of his appointment. If, for example, the appointment is made at the age of 65 years and thereafter, the appointee crosses the age of 64 years during the tenure of his appointment, no approval of the Central Government is required under Section 268 for the latter part of his appointment which may fall outside the upper age limit.

(B) [Issued by the Ministry of Law, Justice and Company Affairs, Circular No. 295, dated 10.02.1994].

- (i) With effect from 1.2.1994, remuneration payable by a company having adequate net profit to its managerial personnel shall be governed by Section I of Part II of Schedule XIII. In other words, there would be no restriction on the nature of quantum of remuneration paid by a company to its managerial personnel as long as the remuneration paid during any financial years is within 5 per cent or 10 per cent of the net profits, as the

case may be, of that financial year.

- (ii) Remuneration payable by a company to a managerial person in the event of absence or inadequacy of net profits during any financial year shall be governed by the provisions of Section II of Part II of Schedule XIII. A company would have full freedom to work out a suitable remuneration package for its managerial personnel within the limit on remuneration as specified in Para 1 of Section II of Part II. However, certain perquisites as specified in paragraphs 2 and 3 of Section II of Part II shall not be taken into account for computing the ceiling on remuneration.
- (iii) The remuneration specified in Section II of Part II of Schedule XIII is "minimum remuneration" for the purpose of Section 198 of the Companies Act which would be admissible in the event of absence or inadequacy of net profit in any financial year, without the approval of the Central Government in individual cases. In other words, no separate approval of the Central Government would be required under Sections 198(4) and 309(3) of the Companies Act provided the remuneration paid to a managerial person in the event of absence or inadequacy of net profits in any financial year is in accordance with the provisions of Section II of Part II of Schedule XIII.
- (iv) Regardless of the fact that remuneration of a managerial person may have initially been fixed in accordance with the provisions of Section I of Part II of Schedule XIII in view of availability of adequate net profits at the relevant time, the provisions of Section II of Part II shall become automatically applicable to him in any financial year in which the company has no profit or its profits are inadequate. As a consequence thereof, his remuneration during such a financial year will have to be refixed so as to conform the provisions of Section II of Part II Schedule XIII unless, of course, it is already within the specified ceiling. Excess remuneration, if already paid, will have to be recovered from the managerial person in such cases of the approval of the Central Government will have to be obtained for payment of remuneration in excess of the provisions of Section II of Part II of Schedule XIII notwithstanding anything in any agreement entered into with the concerned managerial person or in any resolution of the company or its Board.
- (v) In a case where Section II of Part II of Schedule XIII is applicable, if the effective capital of a company is reduced in any financial year subsequent to the year of appointment (due to repayment of long-term loans, further accumulation of losses or for any other reason) with the result that the remuneration payable in that financial year no longer corresponds to the effective capital, the remuneration will have to be scaled down appropriately unless approval of the Central Government is obtained to payment of remuneration in excess of the limits specified in Section II of Part II of Schedule XIII.
- (vi) Where a company intends to increase or otherwise vary remuneration of its managerial person already in position on the date of notification, it may do so, from a date not earlier than the date of the notification, subject, to the provisions of the revised Schedule read with the provisions of Sections 198,

309, 310, 311, 387 and 388 of the Companies Act, without the approval of the Central Government even where the earlier appointment/remuneration had been approved by the Central Government except in those cases where Central Government had accorded conditional approval to the appointment. For example, in some cases the Central Government approves appointment of a person subject to the conditions that the company would not increase or vary his remuneration without obtaining approval of the Central Government or that the remuneration of a managerial person shall not exceed a specified ceiling if he has been permitted to work as managerial person in more than one company and draw remuneration from both the companies. Where such specific or special conditions have been imposed by the Central Government while approving appointment/remuneration, these conditions would still have to be complied with unless varied by the Central Government.

- (vii) The provision for 10 per cent reduction in salary of a managerial person had been deleted from the revised Schedule XIII effective 14.7.1993. In fact the remuneration specified in Part II of the Schedule as amended on 14.7.1993 and in Section II of Part II of the Schedule as further amended on 1.2.1994 is itself the "minimum remuneration". Hence, where a managerial person had been appointed (with or without Central Government approval) on a specified salary with a provision for 10 per cent reduction in salary in the event of loss or inadequacy of net profits in any financial year, the company may, if it so wishes, delete the said condition without obtaining Central Government's approval, in accordance with the provision of Section 310.
- (viii) It has been observed that resolution have been adopted in shareholder's meeting of some companies authorising respective Board of Directors to revise remuneration of managerial personnel in accordance with such amendments as have made or may be made in Schedule XIII, and such resolutions of shareholders are being treated as compliance of the provisions of Part III of the Schedule XIII. It is emphasized that the provision of Sub-section (i) of Section 309 and Part III of Schedule XIII do not contemplate any blanket approval of the shareholders and the same must be specific as to the terms and conditions of appointment and remuneration. Incidentally Part III of the schedule does not envisage prior approval or approval within 90 days. All that is required is an approval of the shareholders in a general meeting. It would, therefore, be appropriate if such approval is obtained in the first general meeting held immediately after fixation of remuneration.

DCA's clarification on managerial pay

Companies that have appointed managerial personnel before January 16, 2002, can continue to pay them the desired remunerations without worrying about bureaucratic clearances. DCA, while upwardly revising the ceiling of remuneration payable to managerial personnel to Rs. 4,00,000 per month from Rs. 2,00,000 per month, in a notification dated January 16, 2002, had stated that the payment of remuneration should be approved by a resolution of the 'Remuneration Committee'. The amendment has a 'prospective effect' and that remuneration pertaining to the period falling after date of notification would be covered by this amendment. It has further stated that, if part of the period falls prior to the amendment and part of it after the amendment, then the provisions of the amendment would apply if a major part of the period falls after the amendment.

STATEMENT OF REMUNERATION PROPOSED

In Rupees/Rupees equivalent per month

A. SALARY

Basic Salary

Bonus

Gratuity (Non-taxable)

Contribution to Provident fund (Non taxable)

Contribution to Superannuation fund/Annuity fund (Non taxable)

B. ALLOWANCES

Entertainment allowance

Special allowance

C. PERQUISITES

Accommodation

Gas/Electricity/Water expenses

Children education

Transport and driver

Leave Travel concession (Non taxable)

Medical reimbursement (Non taxable)

Insurance (a) Personal effect

(b) Medical (Non taxable)

Servant, mail, cook

Security

Telephone

Club fee

Total

Note 1 Any other item(s), which the company wants to indicate, may be added in the appropriate group above.

Note 2 As per explanation given under Section 198 of the Companies Act, 1956, the salary and perquisites included in the total remuneration should be valued as per actual cost.

Note 3 Income tax liability be indicated on a separate sheet to be attached.

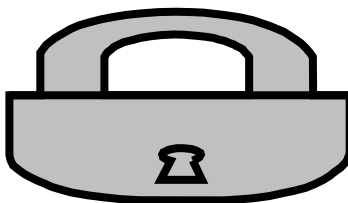
LESSON ROUND-UP



- A managing director means a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its board of directors or by virtue of its memorandum or articles of association is entrusted with substantial powers of management which would not otherwise be exercisable by him and includes a director occupying the position of a managing director, by whatever name called.

- On appointment of a person as a managing director or whole-time director or manager, a return in e-form 25C within 90 days from the date of such appointment is required to be filed with ROC.
- In case, the provisions of Schedule XIII cannot be fulfilled by a company, an application seeking approval to the appointment of a managing director/wholetime director/manager shall be made to Central Government in e-form 25A.
- To remove a person from managing directorship, approval of the Central Government is not required.
- The substantive provisions with regard to appointment and reappointment of whole time director are similar to that of managing director.
- Unlike the managing director of a company, an executive director or a whole time director is not entrusted by the company with substantial powers of management of the business and affairs of the company.
- Manager means an individual who subject to the superintendence, control and direction of the Board of Directors has the management of the whole or substantially the whole of the affairs of a company and includes a director or any other person occupying the position of a manager by whatever name called and whether under a contract of service or not.
- A company can at the same time, have two or more managing directors or two or more managers but cannot have both manager and managing director.
- Section 309 of the Companies Act contains provisions regarding remuneration of directors including any managing or whole time directors.
- The chairman is a necessary element of company meeting and is usually appointed by the articles.
- Primary duty of the chairman of a Board or company meeting is to ensure the presence of quorum before proceeding with the deliberations of the meeting and then to conduct the meeting in a peaceful atmosphere so that all items of the agenda are conducted in an orderly fashion.

SELF-TEST QUESTIONS



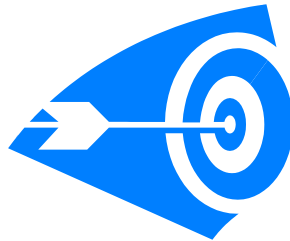
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Discuss the role of Chairman-cum-Managing Director of an average sized company in India.
2. Write a note on the appointment, role and responsibility of a whole-time director.
3. Distinguish between Managing Director and Manager.

4. Define Director-Manager. State his duties and responsibilities.
 5. Can a Managing Director be paid compensation for loss of office?
 6. State the provisions of the Companies Act, 1956, relating to remuneration of Managerial Personnel.
 7. Define 'Managing Director'. State detailed provisions relating to appointment of a managing director.
 8. Can we provide for some perquisites payable to managerial personnel? If yes, then which perquisites shall be included in the definition of 'remuneration' paid or payable to them and which perquisites paid or payable shall not be included in the said term.
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STUDY XVII
MANAGEMENT AND CONTROL OF COMPANIES-IV
COMPANY SECRETARY

LEARNING OBJECTIVES



Every company having a paid up share capital of Rs. 5 crores (at present) shall have a company secretary. Company secretary holds key position in a company. He is entrusted with the responsibility for due compliance with all such legal formalities. After going through this study, you will be able to learn the following:

- Who is company secretary
- Importance and position of a Company Secretary
- Qualities and Qualifications of a Company Secretary
- Appointment of a Company Secretary.
- Dismissal of a Company Secretary
- Powers of a Company Secretary
- Duties, rights and liabilities of a Company Secretary
- Role of Company Secretary
- Company Secretary in practice
- Areas of practice for a Company Secretary
- Code of Conduct for a Company Secretary
- Quality Review Board and Peer Review.

1. WHO IS A “SECRETARY”?

In order to understand the meaning, importance and also position of a secretary, it would be desirable to examine the definition of the term ‘secretary’. *The Chamber’s 20th Century Dictionary* defines ‘secretary’ as ‘a person employed to write or transact business for another or for a society, company, etc.’ The word ‘secretary’ is derived from the word ‘secret’ implying that there is something confidential and secretive about his job though there is another view that the word ‘secretary’ has been derived from the Latin word ‘*secretarius*’ which means a ‘notary or scribe’.

Who is a Company Secretary?

According to Section 2(45) of the Companies Act, 1956, a secretary means a

company secretary within the meaning of Clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, 1980 and includes any other individual possessing the *prescribed qualifications* and appointed to perform the duties which may be performed by a secretary under this Act or any other ministerial or administrative duties. This definition brought the earlier definition of the secretary in line with a definition of company secretary contained in Company Secretaries Act, 1980. Clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, defines a company secretary as a person who is a member of the Institute of Company Secretaries of India.

Thus, secretary, as per this definition, should either be a member of the Institute of Company Secretaries of India (ICSI) or be an individual possessing qualifications as may be prescribed by the Government.

Statutory Requirement

Section 383A of the Companies Act, 1956 as amended by the Companies (Amendment) Act, 1988 introduced the statutory requirement for certain companies to have a company secretary. Sub-section (1) of the section provides that every company having a paid-up share capital of such sum as may be prescribed shall have a whole-time secretary and where the Board of directors of any such company comprises of only two directors, neither of them shall be the secretary of the company. The Government has in exercise of its powers under this section and Section 2(45), framed the Companies (Appointment and Qualifications of Secretary) Rules, 1988 and provided that every company having a paid-up share capital of not less than the prescribed amount (presently rupees 5 crores) must have a whole-time secretary who should be a member of the Institute. Further, the rules provide that in the case of a company with a lesser paid-up share capital, where the paid-up share capital of such company is increased to rupees 5 crores or more, the company shall within a period of one year from the date of such increase appoint a person as a whole-time secretary who should be member of the Institute.

Proviso to Sub-section (1) of Section 383A provides that every company, which is not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more, shall file with the Registrar a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions, as may be prescribed as to whether the company has complied with all the provisions of the Act and a copy of such certificate shall be attached with Board's report referred to in Section 217 of the Act. The Government has since prescribed the rules called the Companies (Compliance Certificate) Rules, 2001 which have come into force vide GSR 52(E) dated 31.1.2001. The Compliance Certificate is required to be in the prescribed form or as near thereto as circumstances admit in respect of each financial year. This certificate is to be filed within thirty days from the date on which annual general meeting was held or the latest day on which the annual general meeting should have been held in accordance with the provisions of the Act.

In accordance with Rule 3A of the Companies (Appointment & Qualifications of Secretary) Rules, 1988, a company having a paid up share capital of two crore rupees or more but less than five crore rupees may also appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of

India constituted under the Company Secretaries Act, 1980, as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956. In that case, such a company is not required to obtain a certificate from a secretary in whole-time practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Where a company fails to comply with the above provisions the company and every officer of the company, who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues. However, in any proceedings against a person in respect of an offence thereunder it shall be a defence to prove that (i) all reasonable efforts to comply with the provisions of Sub-section (1) were taken (ii) that the financial position of the company was such that it was beyond its capacity to engage a whole-time secretary. [Sub-section (1A) Section 383A].

Secretary in Section 25 Companies

The provisions of Section 383A of the Act are applicable to Section 25 Companies also. Hence, these companies are required to appoint a full time secretary in their employment. However, Notification No. SO 1578 (1.7.61), SO 2767 (5.8.64), GSR 73 (30.12.65) and SO 35(E) (9.1.76) have partly exempted the Section 25 Companies from the applicability of Section 2(45) which defines a Secretary. Thus, the secretary of a Section 25 Company need not be a person who is a member of ICSI.

2. IMPORTANCE OF SECRETARY

In ancient times, the term 'secretary' applied solely to the officer who conducted correspondence for the king, but in modern times the duties and functions of a secretary have become wide and varied and he no longer resembles his ancient counterpart. Not only are there company secretaries, but secretaries are also appointed by institutions like clubs, trade and professional associations, cooperative societies, local bodies, etc. His duties range from conducting all correspondence, keeping all records and accounts, writing of minutes to acting as public relations officer of the employer.

In modern times, the secretary has become almost an indispensable person in trade, industry and other social institutions. Any organisation from a sports club right upto the State cannot think of managing its affairs without appointing a secretary. However, the importance and nature of the functions of a secretary differ from organisation to organisation.

The importance of a secretary is specially felt in the business world since the business organisations have to abide by certain legal requirements. The secretary is entrusted with the responsibility for due compliance with all such legal formalities. The Secretary also acts as the company's spokesperson between the management and the staff as well as the outsiders and the shareholders.

3. POSITION OF THE COMPANY SECRETARY

In order to understand the position of a secretary in any company today, it would be useful to make a short historical reassessment of the position of a secretary. The

office of a secretary is as old as the concept of the corporate sector which goes beyond the trading companies of the 17th Century like the East India Company, etc. The role of a secretary from the position of almost a clerk to that of an important figure in the corporate set-up has been acknowledged by judicial decisions over a period of time. The traditional view as propounded by Lord Esher in his judgement in *Newlands v. National Employer's Accident Association Ltd.* and reiterated by a Court of appeal in the cases of *Barnett Hoares & Co. v. The South London Tramways Company C.A.* (1887) 18 Q.B.D. 815 and *George White Church Ltd. v. Caranagh*, 1902 AC 117 was:

“A Secretary is a mere servant, his position is that he is to do what he is told and no person can assume that he has any authority to represent anything at all nor can any one assume that statements made by him are necessarily to be accepted as trustworthy without further enquiry any more than in the case of a merchant it can be assumed that one who is only a clerk has authority to make representation to induce persons to enter into contracts.”

Accordingly, in the past it had been held that a company is not liable for the act of its secretary in fraudulently making representations to induce persons to take shares in the company, or in issuing a forged share certificate. The secretary is, however, the proper official to issue share certificates, and so the company is estopped or barred from denying the truth of genuine share certificates issued by him without the authority of the company”.

It has also been held that:

- (a) He cannot participate in the management of the company's affairs; *Barnett v. The South London Tramways Co.* (ibid).
- (b) He cannot negotiate contracts on behalf of the company [*Barnett (ibid) v. The South London Tramways Co.*, other than the contracts necessary for carrying on the administration of the company's organisation such as, contracts for the employment of staff, the acquisition of office equipment or the hiring of transport for customers visiting company's factory, *Panorama Development (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd.* (1971) 3 All ER 16 C.A.
- (c) He cannot borrow money in the company's name; *Cleadon Trust Ltd.*, Re. (1938) 4 All ER 518.
- (d) He cannot register transfers of shares without the Board's authority; *Chida Mines Ltd. v. Anderson* (1905) 22 TLR 27.
- (e) He cannot call meetings of members. An act done by the secretary after mentioning the matter to some of the directors, but without any express approval of the directors and without a board meeting being held to consider the question will not be considered the act of directors. *Haycraft Gold Reduction & Mining Co.*, Re. (1900) 2 Ch 230; *State of Wyoming Syndicate*, Re. (1901) 2 Ch. 431.
- (f) He has no power to strike a name off the Register of Members, without authority by the Board of directors, *Wheatcroft's case, Re. Matlock Old Bath Hydropathic Co.* (1873) 29 L.T. 324.

- (g) He has no independent authority to bind the company by contract; *Houghton (J.C.) & Co. v. Nothard, Lowe and Wills* (1928) A.C. I.H.C.

A striking departure however was made in *Panorama Development (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd.* In the judgement delivered by Lord Denning in the Court of Appeal on 26th May, 1971, he overruled the 19th Century judgement and said:

“But times have changed. A company secretary is a much more important person now-a-days than he was in 1887. He is an Officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Act but also by the role which he plays in the day-to-day business of the company. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company’s business. So much so that he may be regarded as having been held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company’s affairs, such as employing staff and ordering cars and so forth. All such matters now come within the ostensible authority of a company secretary.”

The changing role and importance of a company secretary has also been incorporated in the statutes over the years. Whilst the Companies Act, 1956 provides for the appointment of a company secretary in companies having a paid-up capital of Rs. 5 crores or more, under the English Companies Act, it is obligatory for every company to appoint a company secretary. The importance of the role of a secretary is also recognised in other statutes like the Income Tax Act, 1961 the MRTP Act, 1969 etc., where the secretary is considered as the principal officer.

The general qualities expected of a good company secretary are: sound education, knowledge of business, law and procedures, finance, good personality, integrity, time management, capacity to manage and leadership qualities, high sense of justice, a balanced mind and a good grasp of things.

In the words, of Sir Edwin Stockton at the Secretaries Conference held at Buxton in 1927:

“The secretary must have sound education and be well informed. He should have specialised knowledge of the profession or business in which he is engaged and be piercing enough to master the technique of his business and its know-how. He should be in a position to adapt himself to situations and changing conditions and keep himself abreast of all legislations and judge made law that may affect or is to affect the industry.

He must have the drive to make quick decisions and be in a position to secure the willing co-operation of all who run the race of administration of the company along with him.

Being a liaison officer, he should have the sense of justice, self control and sympathy in his dealings with others with whom he might come into contact in the course of his administrative activities.

He should at once be a quasi-lawyer, a quasi-economist and particularly he should seek to master the intricacies of modern finance and its bearings upon the activities of his company.

His personality should be, in the minds and eyes of his associates and others in the higher hierarchy, such that he may slowly but steadily improve his image and instil confidence in others who put him in office.”

4. COMPANIES (APPOINTMENT AND QUALIFICATIONS OF SECRETARY) RULES, 1988

According to the **Report of the Committee on the Financial Aspects of Corporate Governance in December, 1992 headed by Mr. Adrian Cadbury**, the company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognize that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board. It should be standard practice for the company secretary to administer, attend and prepare minutes of board proceedings.

Under the Companies Act the directors have a duty to appoint as secretary someone who is capable of carrying out the duties which the post entails. The responsibility for ensuring that the secretary remains capable, and any question of the secretary's removal, should be a matter for the board as a whole.

The Committee expects that the company secretary will be a source of advice to the chairman and to the board on the implementation of the Code of Best Practice.

The Department of Company Affairs, has vide Notification F.No. 1/29/87-CL.V dated 29.11.1988, framed the Companies (Appointment and Qualifications of Secretary) Rules, 1988. The text of these rules is reproduced below:

In exercise of the powers conferred by clauses (a) and (b) of Section 642 read with clause (45) of Section 2 and Section 383A of the Companies Act, 1956 (1 of 1956), and in *supersession of the Companies (Secretary's Qualifications) Rules 1975*, the Central Government hereby makes the following rules namely:

1. Short Title and Commencement

- (1) These rules may be called the Companies (Appointment and Qualifications of Secretary) Rules, 1988.
- (2) It shall come into force on the First day of December 1988.

2. Appointment etc. of whole-time secretary

- (1) Every company having a paid-up share capital of not less than rupees five crores shall have a whole-time secretary.

(2) No person shall be appointed as whole-time secretary under Sub-rule (1) unless he is a member of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980).

(3) A company having a paid-up share capital of less than rupees two crores may appoint any individual as its whole-time secretary to perform the duties of a secretary under the Companies Act, 1956 and any other ministerial or administrative duties:

Provided that no individual shall be eligible to be so appointed unless he possesses one or more of the qualifications specified in Sub-rule (4).

(3A) A company having a paid up share capital of two crore rupees or more but less than five crore rupees may appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980), as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956:

Provided that where a company has appointed under sub-rule (3) or this sub-rule, a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in whole-time practice under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

(4) No individual shall be appointed as secretary pursuant to Sub-rule (3) unless he possesses any one or more of the following qualifications, namely:

- (i) membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980);
- (ii) pass in the intermediate examination conducted either by the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980) or by the earlier Institute of Company Secretaries of India incorporated on 4th October, 1968 under the Companies Act, 1956 and licensed under Section 25 of that Act;
- (iii) post graduate degree of commerce or corporate secretaryship granted by any University in India;
- (iv) degree in law granted by any University;
- (v) membership of the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949);
- (vi) membership of the Institute of Cost and Works Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);

- (vii) post graduate degree or diploma in management sciences, granted by any University, or the Institutes of Management, Ahmedabad, Calcutta, Bangalore or Lucknow;
- (viii) post graduate diploma in company secretaryship granted by the Institute of Commercial Practice under Delhi Administration or Diploma in Corporate Laws and Management granted by the Indian Law Institute, New Delhi;
- (ix) post graduate diploma in company law and secretarial practice granted by the University of Udaipur; or
- (x) membership of the Association of Secretaries and Managers, Calcutta, registered under the West Bengal Registration of Societies Act, 1961 (XXVI of 1961).

Provided that where the paid-up share capital of such company is increased to rupees five crores or more, the company shall, within a period of one year from the date of such increase, comply with the provisions of Sub-rule (1) and (2) of Rule 2.

Explanation. In this Rule, "University" has the meaning assigned to it in the University Grants Commission Act, 1956 (No. 3 of 1956) and includes any University outside India which is recognised by the Union Public Service Commission for the purposes of recruitment to public services and posts in connection with the service affairs of the Union or of any State.

3. Provisions relating to existing secretaries

Notwithstanding anything contained in Sub-rules (1) and (2) of Rule 2, the qualifications possessed by a person holding the office of whole-time secretary of a company immediately before 30th October, 1980, in terms of the second proviso to clause (a) of Rule 2 of the Companies (Secretaries Qualifications) Rules, 1975, shall be deemed to be the qualifications which he shall be required to possess in order to be eligible to continue as whole-time secretary in that company.

5. APPOINTMENT OF A COMPANY SECRETARY

We have seen that in terms of Section 383A of the Companies Act, it is necessary to appoint a secretary in a company having a paid-up capital of Rs. 5 crore or more. Further the Secretary should be a member of the Institute of Company Secretaries of India.

The secretary being a whole-time employee, his appointment, and remuneration will be similar to that of other employees in his cadre in that organisation. Normally the appointment of a company secretary is done by means of a resolution of the Board as the position of a company secretary is slightly different from that of other officers, as he is an officer recognised under the Companies Act, 1956. He is an officer of the Board. In view of the statutory provisions relating to his appointment, it would be desirable even though it is not incumbent, that such appointment is made by means of a resolution passed at a meeting of the Board of directors.

Appointment of a person who is a director as a secretary in the company would

fall within the ambit of Section 314 and would require approval of the company by special resolution. Even for appointment of certain persons specified under Section 314 other than directors would require approval of the company by special resolution or special resolution and approval of the Central Government, as per the requirement of the Section.

A specimen board resolution is given below for such appointment though it will vary from company to company:

“Resolved that Mr..... who possesses the requisite qualification under the Companies (Appointment and Qualifications of Secretary) Rules, 1988 be and is hereby appointed as a secretary on the terms and conditions contained in the draft letter of appointment, a copy of which was initialled by the Chairman for the purposes of identification and tabled and approved at the meeting.”

In terms of Section 303 of the Companies Act, 1956, the appointment and cessation of office of a person as secretary must be recorded in the Register of Directors/Manager/Secretary, and e-Form 32 relating to such appointment and cessation must be filed with the Registrar of Companies within 30 days from the date of appointment/cessation as the case may be, alongwith the requisite filing fee.

Appointing more than one Secretary

Section 383A(1) of the Act makes it obligatory for every company having a prescribed capital, to have a whole time secretary. This shall mean that the company should have a minimum of one secretary. In practice, there is no bar on appointment of two or more secretaries in a single company. Hence, if there are two or more secretaries in a company, it shall not be in violation of the provisions of this section. However, e-Form 32 shall be filed with ROC for every individual appointed as the secretary of the company. Work allocation between different secretaries is the prerogative of the company.

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

If there are two or more secretaries in a company, it shall be in violation of the provisions of Section 383A(1).

- True
- False

Correct Answer: False

If there are two or more secretaries in a company, it shall not be in violation of the provisions of Section 383A(1).

6. DISMISSAL OF A COMPANY SECRETARY

The appointment of a company secretary is generally done by means of a resolution of the Board and his dismissal, therefore, can be done by the Board of directors or by the Managing Director, if he is so authorised by the Board.

In the case of *Haryana Seeds Development Corporation Ltd. v. J.K. Aggarwal*,

Company Secretary (1989) 65 Comp. Cas. 95, the Punjab and Haryana High Court held that where the articles so provide, it will not be within the jurisdiction of the managing director of the company to remove the secretary in exercise of the power delegated to him by the Board of directors to suspend or remove secretaries, officers, etc. The power to remove or appoint a secretary, being explicitly vested in the Board of directors by the articles, can also be delegated to the managing director.

The secretary must be given notice of termination of his employment in accordance with the terms of his contract of appointment. In the absence of express provision in the contract, the employee is entitled to a reasonable notice or compensation in lieu of such notice.

But, dismissal of a secretary without notice cannot be looked upon as improper in all cases. An employee may be dismissed summarily without notice:

- (i) for wilful disobedience of any lawful order of the company [*Spain v. Arnott*, (1817) 2 Stark 256].
- (ii) for misconduct and for speculating on the stock exchange [*Pearce v. Foster*, (1886) 17 Q.B.D. 536, 541].
- (iii) for incompetence or permanent disability. [*Harmer v. Cornelius* (1858) 5 C.B. (N.S.) 236]. Even an act of forgetfulness by an employee has been held as sufficient cause for dismissing him without notice if it has or is calculated to have serious results [*Addis v. Gramophone Co.* (1909) A.C. 488].

Even where the engagement of a secretary is for a fixed term, the company may determine the employment earlier after giving proper notice in this regard [*African Association and Allen, Re.* (1910) 1 K.B. 396].

7. POWERS OF COMPANY SECRETARY

The secretary of a company is empowered to perform the following:

- (i) All functions which he is required to perform under various enactments like the Companies Act, the MRTP Act, the Income Tax Act, FEMA, Excise Customs Act, Customs Tariff Act etc.
- (ii) All acts which the Board of directors specifically direct him to perform.
- (iii) All acts which are essential to enable him to discharge his duties smoothly as the administrative head in his department.

The powers of the secretary mentioned above are conferred on him either under the Act or by the Board or out of his service agreement with the company. At times, the general meetings also authorise him to perform an act. However, if the secretary performs an act without being so authorised the company may not be bound by it.

8. DUTIES OF A COMPANY SECRETARY

The role and position of a company secretary varies from company to company and, therefore, it would be difficult to codify his duties. However, it can be said that the company secretary acts in three-fold capacity, namely:

- (a) as an agent of the Board of directors, i.e. as a liaison or link between the Board on the one hand and the executive and staff, shareholders, customers and general public on the other;
- (b) as an officer-in-charge of secretarial work;
- (c) as a chief business executive or chief administrative officer of the company, if he is put in charge of office administration, including accounts, taxation and legal sections.

Whilst all the above three functions will possibly be performed by a company secretary for small or medium sized companies, in big companies there could be a chief accountant, a personnel manager or legal officer who may be in charge of the functions relating to accounts, personnel and law and they may report to the secretary or could report directly to the chief executive of the organisation.

In fact the duties of a company secretary in any modern organisation have greatly expanded and he is today considered as a generalist specialist. In fact his change of position was taken into consideration when the name of the Institute of Chartered Secretaries in U.K. was changed to Institute of Chartered Secretaries and Administrators.

In U.K. the Department of Employment conducted a survey on the role of a company secretary and a report entitled "Training for Company Secretaryship" by the sub-committee on company secretaryship/office management of the Joint Industrial Board Committee for commercial and administrative training was published. The report whilst mentioning that the duties and responsibilities of company secretaries vary widely depending on the size and type of activity carried on by the company and on the form of organisation adopted, emphasises that "in view of the importance of the role that the company secretary plays in companies of all sizes, in respect of both statutory requirements and administrative responsibilities, professional qualification is highly desirable". The report, therefore, indicates various aspects of training, the mode of training and how to make it more purposeful and effective.

The report enumerates the various desirable qualities of a company secretary for carrying on substantial responsibilities and working successfully with other staff at management level. It also indicates that one of the important tasks of a company secretary is collection and analysis of information and its presentation in concise and accurate form in memoranda or reports to the Board.

The Statutory and General duties are briefly illustrated below:

A. Statutory Duties

(I) Under the Companies Act:

- (i) To sign any document or proceedings requiring authentication by the company (Section 54).
- (ii) To arrange to file statement in lieu of prospectus (Section 70).
- (iii) To deliver for registration of return of allotment and contracts relating to allotment of shares for consideration other than cash (Section 75).

- (iv) To give notice of the increase in the share capital to the Registrar (Section 97).
- (v) To deliver the share or debenture certificate within 3 months of allotment or within 2 months of registration of transfer (Section 113).
- (vi) To make entries in the register of members on issue of share warrants (Section 115).
- (vii) To make available for inspection trust deed to every member or debenture holder and to forward a copy of it to the members or debenture holders on their request and within 7 days of request on payment of prescribed fee (Section 118).
- (viii) To deliver for registration particulars of mortgages and charges to the Registrar (Sections 125-127).
- (ix) To file Notice of situation of registered office or change thereof of the company in the prescribed e-Form 18 (Section 146).
- (x) To get painted or affixed the name plate of the company outside every office or the place of its business, to get it printed on documents of the company and to get it engraved on the seal of the company (Section 147).
- (xi) To make a statutory declaration for obtaining the certificate of commencement of business and file it with the Registrar (Section 149).
- (xii) To sign the Annual Return (Section 161).
- (xiii) To allow inspection of and to furnish copies of register of members and register of debentureholders (Section 163).
- (xiv) To send notices of general meetings to every member of the company (Section 171).
- (xv) To file resolutions and agreements requiring registration with the Registrar (Section 192).
- (xvi) To prepare minutes of every general meeting and of every meeting of Board of directors or of every committee of the Board within 30 days of the conclusion of every such meeting (Section 193).
- (xvii) To make available for inspection the minute books of general meetings (Section 196).
- (xviii) To sign the Balance Sheet of the company (Section 215).
- (xix) To send notices of the meetings of Directors (Section 286).
- (xx) To make available Register of directors for inspection (Section 304).
- (xxi) To assist in preparing the statement of affairs in a winding up for the purpose of submitting it to the liquidator (Section 454).
- (xxii) To inform auditor of his appointment (Section 224).
- (xxiii) To file returns with Registrar, if applicable under Section 95, 103, 187C, 220, 394(3) and 395.
- (xxiv) To maintain the following statutory books:
 - (1) Register of investments held by company in name of its nominee (Section 49).

- (2) Register of charges (Section 143).
- (3) Register and index of members (Section 150).
- (4) Register and Index of Debentureholders (Section 152).
- (5) Register of contracts in which directors are interested (Section 301).
- (6) Register of directors, manager and secretary (Section 303).
- (7) Register of directors' shareholdings (Section 307).
- (8) Register of Loans and Investments (Section 372A).
- (9) Register of renewed and duplicate certificates (Issue of Share Certificate Rules).

(II) Duties under other Acts:

1. *Under the Income-tax Act:* A company secretary is a „Principal Officer’ of a company under Section 2(35) of the Income-tax Act, 1961. The Act imposes certain obligations upon him:

- (1) To ensure that proper income-tax is deducted at source from the salaries paid to the employees, or from interest paid/payable to debenture holders or depositors respectively.
- (2) To see that a certificate of income-tax deducted at source is furnished to every debenture holder or depositor.
- (3) To ensure that the tax so deducted has been deposited in the Government treasury.
- (4) To submit and verify miscellaneous statements, forms and returns.
- (5) To ensure that the dividend tax has been deposited in the Government Treasury.

2. *Under the Indian Stamp Act:* It is the duty of the secretary to see that documents like letters of allotment, share certificates, share warrants, debenture certificates and transfer forms, etc. are properly stamped as per the requirements of the Indian Stamp Act.

3. *Under Other Acts:* In addition to the above, the secretary is also required to perform the various duties specified in The Industrial Disputes Act, 1947, The Employees State Insurance Act, 1948, The Minimum Wages Act, 1948, The Payment of Wages Act, 1936, The Factories Act, 1948, The Provident Fund Act, 1952, Foreign Exchange Management Act (FEMA), 1999, Monopolies and Restrictive Trade Practices (MRTP) Act, 1969, the Securities and Exchange Board of India Act, 1992 (SEBI), the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1986.

B. General Duties

Duties towards Directors, Managing Director, Manager, etc.

The duties of the company secretary in relation to the directors may be stated briefly as follows:

1. To do all those acts which a director (where authorised) or any other managerial personnel specifically directs him to do.

2. To assist the chairman to convene Board and general meetings and to make necessary arrangements in this regard.
3. To advise directors and managing directors, regarding complying with their statutory duties.

Duties towards shareholders and public

1. To perform all the necessary things relating to shares and debentures, issuing a prospectus, inviting applications for the subscription of shares and debentures, arranging for allotment and issuing share certificates and debentures, handling transfer and transmission of shares and debentures, arranging payment of dividend and interest on shares and debentures respectively.
2. To handle all correspondence between the company and the shareholders, creditors and public. But should abstain from disclosing any confidential or secret information relating to the affairs of the company.
3. To allow the inspection of various books and registers desired by the members and other persons as per the provisions of the Companies Act, 1956 unless such inspection is prohibited under the said Act.
4. To ensure transparency and accountability in the operations/functioning of the company by vouching good corporate governance practices.

Duties towards office staff

The status of Company Secretary as the chief administrative head of the organisation, wherever applicable, bestows upon him the duty of planning, organising, directing and co-ordinating the office work effectively. The work *inter-alia* involves recruiting new employees, informing the employees about the policies and decisions concerning them.

9. LIABILITIES OF A COMPANY SECRETARY

The liabilities of the company secretary can be discussed under two broad heads, namely (a) statutory liabilities, and (b) contractual liabilities.

Statutory Liabilities

There are many sections under the Companies Act, 1956 which impose penalty on an officer who is in default for non-compliance of certain provisions of the Act. As the Company Secretary is primarily responsible for the company complying with the requirements of the provisions it is, therefore, necessary that he should whilst discharging his duties under the Companies Act, 1956 ensure that there is no default in compliance with the statutory provisions in this regard. Some of the important sections and the penalty levied for default or non-compliance which affect the day-to-day functions of the secretary in a company are:

- (i) default in filing a return of allotment-fine upto Rs. 5000 for every day during which the default continues (Section 75),
- (ii) default in keeping ready for delivery share certificates, debenture certificates etc., within 3 months after allotment and within 2 months of the application

- for registration of transfer-fine upto Rs. 5000 for every day during which the default continues (Section 113),
- (iii) default in filing particulars of charges on properties acquired subject to charge-fine upto Rs. 5000 (Section 127),
 - (iv) failure to comply with the requirements of Section 147 of the Act regarding exhibiting the name of the company-fine may extend upto Rs. 5000,
 - (v) default in filing annual return-fine upto Rs. 500 for every day during which the default continues (Section 162) and failure to allow inspection of documents-five of Rs. 500 per day (Section 163).
 - (vi) default in holding statutory meeting or filing the statutory report with the Registrar-fine upto Rs. 5000 (Section 165),
 - (vii) default in holding the annual general meeting of the company-fine upto Rs. 50,000 plus fine upto Rs. 2,500 for every day after the first during which such default continues (Section 168),
 - (viii) default in the circulation of the members' resolution-fine upto Rs. 50,000 (Section 188),
 - (ix) default in registering certain resolutions and agreements requiring registration-fine upto Rs. 200 per day of default and failure to comply with Sub-sections (2) and (3) of Section 192 - Rs. 100 per occasion,
 - (x) failure to record the minutes of the Board and General Meetings-fine upto Rs. 500 (Section 193).
 - (xi) refusal in allowing inspection of minutes of general meeting or failure to furnish a copy of such minutes on request by any member within 7 days of such request-fine upto Rs. 5000 in respect of each offence (Section 196),
 - (xii) default in laying down before the company at the annual general meeting the profit and loss account and Balance Sheet — fine up to Rs. 10,000 or imprisonment up to 6 months or both (Section 210),
 - (xiii) failure to give the due notice of Board meeting-fine upto Rs. 1000 (Section 286),
 - (xiv) failure to maintain the following statutory books:
 - (a) Register of members — fine upto Rs. 500 per day of default (Section 150),
 - (b) Index of register of members — fine upto Rs. 500 (Section 151),
 - (c) Register and index of debenture holders — fine upto Rs. 500 (Section 152),
 - (d) Register of directors' shareholdings — fine upto Rs. 50,000 and further fine of Rs. 200 per day (Section 307),
 - (e) Register of directors — fine upto Rs. 500 per day of default (Section 303),
 - (f) Register of Loans and Investments — fine upto Rs. 50,000 or imprisonment upto two years (Section 372A).

Section 628 provides the liability in general of the secretary under the Companies Act. The section provides that if in any return, report, certificate, balance

sheet, prospectus, statement or other document required by or for the purposes of any of the provisions of the Act, any person (including an officer) makes a 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, save as otherwise expressly provided in the Act, be punishable with imprisonment upto two years and shall also be liable to fine.

Section 629 provides for imprisonment upto seven years and fine for giving false evidence, upon any examination, under oath or solemn affirmation authorised under the Act, or in any affidavit, deposition or solemn affirmation in or about the winding up of the company or any matter arising under the Act.

Section 629A prescribes penalty for any person contravening the provisions of the Act for which no specific penalty is provided elsewhere in the Act. Under this section, a company and every officer thereof in default shall be punishable with fine up to Rs. 5000 and where the contravention is a continuing one, with a further fine up to Rs. 500 for every day after the first during which the contravention continues.

But Section 633 of the Act provides for the court to grant relief to officers (including a secretary) of the company in certain cases. It provides that where in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company, it appears to the court hearing the case that the officer is or may be liable for such action, but he has acted honestly and reasonably and having regard to all the circumstances of the case, including those connected with his appointment, that the officer ought to be excused, the court may relieve him from his liability either wholly or in part and subject to such terms it deems fit. [Sub-section (1) of Section 633].

However, the court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust in the case of any criminal proceedings under this sub-section.

Where any such officer has reason to apprehend that any proceeding will or might be brought against him, he may apply to the High Court for relief. [Sub-section (2) of Section 633]

Contractual Liabilities:

In addition to the statutory liabilities, a number of liabilities arise out of the Secretary's contract of service with the company and such liabilities are called his contractual liabilities.

The secretary is in a fiduciary relationship (position of trust) to the company and, therefore,

- (1) he should not allow his personal interest to clash with the interest of the company.
- (2) he should not make secret profit by virtue of his office and would be certainly

accountable to the company for any secret profit or similar gain made from the company.

- (3) he is personally liable for loss to any third party if he acts beyond his authority.
- (4) he is liable for damages caused to the company by wilful misconduct and negligence in the discharge of his duties.
- (5) he should not indulge or engage in any other activity not relating to his company unless he obtains authority in this regard from the board/managing directors, and
- (6) he cannot reveal trade secrets which he comes to know during his course of employment.

10. RIGHTS OF A COMPANY SECRETARY

Rights are given to the secretary by the Companies Act, Board of directors and the general body of shareholders. He also derives some rights out of his service agreement with the company. A secretary has the following rights:

- (i) He has the right to control and supervise the working of his department.
- (ii) As a principal officer of the company, he has the right to sign a document or proceeding requiring authentication by the company.
- (iii) He has a right to be indemnified by the company for any loss suffered by him while discharging his duties.
- (iv) As an employee of the company, he has the right to receive remuneration. In the event of winding-up of the company, he has a right to be treated as a preferential creditor for his salary subject to a maximum of Rs. 1,000.

But a company secretary has no right to borrow money in the name of the company [*Cleadon Trust Ltd. Re. (1938) 4 ALL EF 518*]. He cannot also make allotment of shares [*Shida Mines Ltd. v. Anderson (1905) 22 TLR 27*] or register transfer of shares without the express authority or consent of the Board of directors. He has no authority to convene a meeting of the company unless directed by the Board or to remove a name from the Register of members, or to take policy decisions.

However, if the articles empower the directors to delegate any of their powers to any of the agents they choose, they may delegate such powers to the secretary and this is not uncommon, especially when the secretary is also a director.

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

A company secretary has a right to borrow money in the name of the company.

- True
- False

Correct Answer: False

A company secretary has no right to borrow money in the name of the company.

11. ROLE OF COMPANY SECRETARY

Generally speaking, the role of a secretary is three-fold, viz., as a statutory officer, as a co-ordinator and as an administrative officer if so authorised. Similarly, the responsibility of company secretaries extends not only to a company, but also to its shareholders, depositors, creditors, employees, consumers, society and government.

The relevant judicial pronouncements give a picture of the scope and ambit of the role of a company secretary. However, neither the definition nor the laws case can give the real and true position of a company secretary in the hierarchy of any company. We have already seen that his role varies in different companies.

The role of a company secretary may conveniently be studied from three different angles:

- (a) as a statutory officer,
- (b) as a co-ordinator,
- (c) as an administrative officer.

COMPANY SECRETARY AS A STATUTORY OFFICER OF A COMPANY

The company secretary is an officer responsible for compliance with numerous legal requirements under different Acts including the Companies Act, 1956 as applicable to companies. Under the Companies Act, 1956 he is responsible for performance of the duties of a secretary and such other ministerial and administrative duties as may be assigned to him. However, the Companies Act, 1956 has not defined the functions of a secretary but has specifically fixed the statutory responsibilities on a secretary for compliance with legal requirements under the provisions of the Act. The responsibility of secretary has also increased as he has been particularly specified by the Companies (Amendment) Act, 1988 to be an officer who is in default, bracketed alongwith the managerial personnel and is liable to punishment by way of imprisonment, fine or otherwise for violation of the provisions of the Companies Act which hold the "officers in default" liable (Section 5).

However, for a proper understanding of the role of a company secretary under different Acts, it would be desirable to study the provisions of those Acts in this regard.

We have already seen the statutory position of a company secretary under the Companies Act, 1956. In 1975, Section 2(45) of the Act was amended by deleting the word 'purely' before the words 'ministerial and administrative duties' which indicates that a secretary could also be assigned managerial duties. However, he is not a managerial personnel within the meaning of Section 197A of the Act as this covers only the managing and whole-time directors and the managers within the meaning of the Act. The various provisions and rules framed under the Companies Act make it obligatory for the secretary to sign the annual return filed with the Registrar [Section 161(1)], make declarations regarding commencement of business (Section 149), authenticate the Balance Sheet and Profit and Loss Account (Section 215) and to make declaration under Section 33(2) of the Act before incorporation of a company confirming that all the requirements of Act and the Rules thereunder have

been complied with in respect of registration of a company and the Registrar may accept such a declaration as sufficient evidence of such compliance.

Under the Indian Stamp Act it is the duty of a secretary to see that the documents such as letter of allotment, share certificate, debentures, mortgages are issued duly stamped. He is the principal officer under Section 2(35) of the Income Tax Act, 1961. Under the MRTP Act, 1969 and its rules, the term 'principal officer' includes a secretary who has been so authorised by a resolution of the Board.

The most important task of the company pertaining to statutory and legal obligations comes upon the secretary. Under the Companies Act he has to either comply with the various provisions of the Act or is liable to be fined or imprisoned for non-compliance of his obligations.

Thus the responsibility of a secretary as a statutory officer has been greatly expanded by enactment of various economic statutes, like MRTP Act, Industries (Development and Regulation) Act, Foreign Exchange Management Act, SEBI Act, SCRA and Depositories Act. Accordingly, the numerous provisions which a Company is obliged to comply with, makes the secretary's job onerous and difficult. The duties imposed upon a secretary by various statutes clearly indicate the important place he occupies in the corporate administrative hierarchy.

COMPANY SECRETARY AS A CO-ORDINATOR

On dealing with the Board functions, Peter Drucker has this to say — "But there are real functions which only a Board of directors can discharge. Somebody has to give final approval to the objectives, the company has set for itself and the measurements it has developed to judge its progress towards these objectives. Somebody has to look critically at the profit planning of the company, its capital investment policy and its managed expenditure budget. Somebody has to discharge the final judicial function in respect of organisation problems."

This concept of Peter Drucker provides for the company secretary to co-effectively play a co-ordinating role to achieve the tasks the Board has set itself to.

The Company Secretary as a co-ordinator has an important role to play in administration of the company's business and affairs. It is for the secretary to ensure effective execution and implementation of the management policies laid out by the Board. The position that the company secretary occupies in the administrative set-up of the company makes his function as one of co-ordinator and link between the top management and other levels. He is not only the communicating channel between the Board and the executives but he also co-ordinates the actions of other executives *vis-a-vis* the Board. The ambit of his role as a co-ordinator also extends beyond the Company and he is the link between the Company and its shareholders, society and the Government. Thus, the role of a company secretary as a co-ordinator has two aspects, namely internal and external. The internal role of a co-ordinator extends to the Board including the Chairman and Managing Director, various line and staff personnel, the trade unions and the auditors of the company. His role as an external co-ordinator extends to the relationship of the company with shareholders, Government and Society.

In India, most companies have an increasing dependence on the financial institutions for assistance. Every big-sized project involves assistance from the

financial institutions. These institutions expect the Board of directors to oversee the overall management and performance of the assisted companies and for this purpose, would insist on all basic policy issues to be discussed at the Board meetings and decisions reached. For this purpose, it would be necessary for the company's management to place all the salient features and information before the Board in order that they can arrive at a proper decision.

This is evidenced by the various conditions imposed in the loan agreements entered into between the financial institutions and the assisted companies. Company managements look to the company secretary for implementation of the conditions in the loan agreements.

The financial institutions stipulate in the case of companies assisted by them financially that certificate format duly certified by the company secretary should be furnished periodically at the Board meetings.

Furnishing of the certificate requires a skill of coordination between the company secretary and the functional heads and the factory manager.

Relationship with the Board, Chairman and Managing Director

Whilst the Directors discuss and decide policy matters as a body, the Secretary is responsible for transmitting the policies and decisions of the Board, to all levels in the company and outsiders. His duties in relation to the Board include amongst others:

- (i) Arranging meetings, both Board and general, drafting out the minutes and reports.
- (ii) Keeping the Board informed as an advisor on matters regarding legal, financial and other laws and problems as far as they relate to the company. This will include advising the Board of the various obligations imposed on the directors by various statutes.
- (iii) He must ensure that all decisions taken by the Board are in consonance with legal requirements, and the powers they exercise do not require approval of the shareholders, Central Government or any other authority.
- (iv) Since meetings of the Board are confidential in nature, he should ensure secrecy regarding matters discussed at such meetings.

Whilst the Board decides on policy matters, the day-to-day administration of companies is vested in the managing director, if there is one. In other cases, where the company is a board-managed company, i.e. where none of the directors is a managing director or a whole-time director, the Secretary has to seek guidance and instructions from the Chairman on all important matters. Where, the company has a managing director, he must seek his guidance and instructions regarding implementation of the policies laid down by the Board and also on matters arising out of the implementation of the decisions. He is also required to keep the chairman and managing director apprised of changes in policies of the Government, obligations under various statutes and to give balanced advice on matters which have legal ramifications.

Relationship with other Functionaries

We have seen that the Secretary is responsible for conveying the Board's decisions on various aspects of the company's policies to the persons in-charge of

such functions. He is, in addition, responsible to ensure that the returns and reports received from various operational executives are submitted in time, complete in all respects, and do not conflict with the corporate objectives.

Even where different persons are in-charge of other functions, e.g., sales, personnel, etc., it is usually the Secretary who normally communicates with outside agencies, particularly with government and semi-government bodies to ensure that the information given to various agencies do not conflict with each other and are in accordance with the corporate objectives of the organisation.

COORDINATING WITH TRADE UNION(S)

Where the Secretary is responsible either directly or through his assistants with industrial relations, he must exercise extreme caution while dealing with trade union officials whether they belong to recognised unions or not. He must ensure that proper notes are kept of the discussions and negotiations and all decisions arrived at during such negotiations. Whenever long-term settlement with recognised unions are finalised he should see that the agreement embodying these settlements are in accordance with the relevant statutes applicable.

It is the responsibility of the Secretary through the Human Relations/Industrial Relations to ensure compliance with the provisions of various labour legislations such as Industrial Disputes Act, 1947, Employees' Provident Funds and Miscellaneous Provisions Act, 1952, Payment of Bonus Act, 1965, Payment of Gratuity Act, 1972, Payment of Wages Act, 1936, etc.

In many companies there is a system whereby a report is submitted to the Board at every meeting confirming that there has been no delay in the compliance with the statutory formalities like deposit of Provident Fund Money, E.S.I. Contribution etc.

Whilst he must ensure that the employees guilty of misconduct are charge-sheeted and punished, he must simultaneously ensure that all formalities, e.g., holding of enquiries etc., must also be scrupulously followed. He should ensure that industrial labour relations are always cordial and he should take steps to further ensure that various creative activities of the employees are encouraged wherever possible by grants and subsidies from the company.

COORDINATING WITH AUDITORS

Apart from the statutory audit, service of the company's auditors are required for certifications required under various statutes and, therefore, the Secretary must liaise very closely with the auditors. It may be pointed out that copies of minutes of Board meetings and general meetings should be made available for the inspection to the auditors during the statutory annual audit. He is to ensure that before their appointment proper certificate is obtained under Section 224(1B) of the Companies Act, 1956. He should intimate them about their appointment/re-appointment as the case may be, within seven days from the date of the annual general meeting so as to enable them to file the necessary return with the Registrar of Companies in time.

COORDINATING WITH SECRETARIAL AUDITOR

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for

corporate compliance management. It helps to detect non-compliance and to take corrective measures.

A Company Secretary in Practice has been assigned the role of Secretarial Auditor under section 2(2)(c)(v) of the Company Secretaries Act, 1980.

The Company Secretary (in whole-time employment) has to liaise with Secretarial Auditor to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc. to ensure that the company has complied with the legal and procedural requirements and also followed the due process.

Coordination with Shareholders

The relationship with the shareholders is an important sphere of his co-ordinating role and, therefore, the Secretary will have to maintain proper relationships with the shareholders of the company.

He should ensure that there is no delay in the inspection of books and registers required by a shareholder provided all formalities are complied with. He must ensure that extracts of registers demanded by shareholders are furnished to them within the prescribed time.

However, the most important thing for a Secretary is to ensure that all correspondence from shareholders is dealt with promptly and their queries are answered as far as possible keeping the statutory provisions in mind. As part of public relations he should be able to give time without prior notice to shareholders who personally come for information, to furnish documents or any other matter. He must also ensure that requests for issues of duplicate certificates/dividend warrants and intimation of address are dealt with properly and promptly. This is important as the image of the company will, to a great extent, depend on the relationship of the Secretary with the shareholders.

Institutional investors are organizations which pool large sums of money and invest those sums in securities, real property and other investment assets. They can also include operating companies which decide to invest its profits to some degree in these types of assets.

Company Secretary will have coordinate very diligently with the Institutional investors because they usually have a lot of influence in the management of corporations and are entitled to exercise the voting rights in a company. They can actively engage in corporate governance. Furthermore, because institutional investors have the freedom to buy and sell shares, they can play a big role in making a company stay solvent. Influencing the conduct of listed companies, and providing them with capital are all part of the job of institutional investors.

Coordination with Government

All the information and correspondence with the government are normally co-ordinated or routed through the Secretary to ensure uniform reporting. The Secretary has a very important role *vis-a-vis* the government. He should endeavour to have information on government policies and programmes in advance wherever possible

to ensure effective implementation. Good relationship with the Government can be developed where the company sincerely tries to implement various statutes in law as well as in spirit.

Coordination with Community

In recent years the responsibility of a company towards society has become very important since the company has to function within the parameters of the environment of the country. With this in view, a number of companies have undertaken rural development including adoption of villages and have built schools, colleges and hospitals to cater to the needs of society. In respect of companies in consumer goods industry, it is necessary to project that the products and their prices are in consonance with the standards expected by the consumers. Arising out of such social responsibility many companies have also allowed small sectors to manufacture ancillaries and raw materials required by the organisation for promotion of employment opportunities. The provisions of the Consumer Protection Act, 1986, the Pollution Control Laws, Public Liability Act, 1991, etc., are important in the operations of companies and the role of Company Secretaries in these areas is quite important.

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

It is the duty of the company secretary to ensure that there is no delay in the inspection of books and registers required by a shareholder.

- True
- False

Correct Answer: True

(c) Administrative Officer

We have seen that the role of a Company Secretary has widened over the years, especially as an administrator.

The principal duty of a secretary as an administrator is to ensure that the activities of a company are in conformity with the company’s policy. In his role as an administrator, the secretary provides the very foundation on which the entire structure of company administration is constructed.

The role of a company secretary as an administrator can be sub-divided into organisational, financial, office and personnel administration.

Organisational Administration

Since the secretary has an opportunity of looking at the entire organisation he has the scope to advise the top management including the Board of directors on the need to develop a good structure. Since the secretary collects, interprets and assimilates information relating to all aspects of business to aid and assist the Board in carrying out its function, he, therefore, gets an opportunity to know the strengths and the weaknesses of the functional executives.

In his role as administrator, wherever applicable he has to make a detailed analysis of various activities, decision-making machinery, inter-relations of

departments and functions. He has, therefore, to ensure that the organisational structure is always under constant study. The making of such examination and study and the consequent advice and recommendation for making changes is a task which the company secretary has to perform.

Financial Administration

Since various monthly and periodical operating reports and financial statements are routed for consideration of the board through the secretary, he should analytically study these statements. Thus, as a secretary to the board, the Company Secretary in consultation with the Finance Manager has to devise suitable and proper systems of accounting procedure, internal control and internal audit with a view to safeguard the company's funds. The Company Secretary should have a good knowledge of budgetary control and procedures, accounts and other related matters. He is also expected to be proficient in dealing with matters connected with taxation.

The Company Secretary is generally assisted by the Chief Accountant in the discharge of his functions relating to financial administration. In many companies, the Secretary is also the Chief Accountant. He has to negotiate with banks and financial institutions the terms of finance both for working capital requirements and capital expenditure.

Office Administration

In all big companies, the office administration is carried on by an officer called the Office Manager who generally reports to the Company Secretary. It is the duty of the Secretary to ensure that different departments of the office are properly staffed, organised, co-ordinated and supervised.

He has to review from time to time the various procedures and systems with a view to making the administration effective. He is also responsible in most organisations for office services including transport. The image of a company depends on the design and office layout from the reception to the records. The Secretary has not only to ensure that these services are maintained and increased but to also ensure that the cost of such services are reviewed from time to time.

Personnel Administration

Personnel administration includes recruitment, training, remuneration, promotion retirement, discharge and dismissal of staff. This is a very important yet difficult task to administer. Whilst in large organisations there may be a separate personnel or Human Resources Manager or Officer, in smaller companies the Secretary may be called upon to advise and assist the directors on principles and legal points involved in this area of administration.

The Company Secretary should ensure that implication of new rules, orders, in this field of management are advised to all concerned for effective implementation.

Administration-Company's Properties

The secretary has an important role to play in safeguarding the company's interest in property matters. He has to ensure that all properties are properly maintained and insured and maintain a suitable register for each property containing relevant information. He should have a good knowledge of relevant rules and by-laws applicable to property. He should also ensure that registration of trade marks,

patents, licences are done from time to time and take legal action in respect of infringement of such industrial rights.

Corporate Records

The Secretary is required to maintain certain other records in addition to those specified under the Companies Act. The volume, method and procedure will vary with the size and nature of the company.

The secretary also has to ensure that the statutory time limits relating to directors' and shareholders' meetings, payment of dividend and interest, filing of returns under the Companies Act, 1956, Income-tax Act and Sales Tax Act, etc., renewals of contracts and leases and the formalities under stock exchange and SEBI regulations and the listing agreements are complied with.

Personnel and Property

The secretary has to ensure that adequate systems of safety and security of personnel based on technical advice are available in the factory and office. He is also responsible for devising and maintaining systems to safeguard the valuable company records, or information against loss, theft, fire, etc. He is to review these from time to time to ensure that the properties of the company are adequately insured. The company secretary should have good knowledge of insurance law and practice.

Whilst the above discussion only gives a brief outline, the duties and responsibilities of the company secretary are subject to continuous change and therefore, has to be reviewed from time to time to ensure that he effectively contributes in respect of the above matters. He should, therefore, keep himself abreast with legal changes and practices.

Changing Requirements

With the professionalisation of the boardroom, the company secretary's duties are gaining importance. In addition to the statutory duties, he is to assist the board of directors in:

1. formulation of policies to achieve the objectives of the company;
2. establishing guiding principles for the functional and line executives of the company;
3. conducting the affairs of the company in accordance with the provisions of the memorandum and articles of association of the company; and
4. participating in the fulfilment of the company's obligations legal, commercial, and social, arising out of its operations.

Multiple choice question

The role of a company secretary as an administrator can be sub-divided into:

- (a) Organisational
- (b) Financial
- (c) Property Administration
- (d) Personnel Administration

Correct answer: a, b and d

(d) Company Secretary as a Governance Professional

A Company Secretary, is a close confidante of the board thereby

- acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities
- provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations
- ensures that the culture of independence is promoted at the board and committee meetings and at the level of individual directors.
- plays a key role in ensuring that the Board procedures are followed and regularly reviewed.
- acts as a compliance officer as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporates, business, economic and tax laws.
- is an important member of the corporate management team.

12. COMPANY SECRETARY IN PRACTICE

The Companies (Amendment) Act, 1988 has recognised the concept of a Secretary in whole-time practice by inserting a new section, viz., Section 2(45A) which reads as under:

“Secretary in whole-time practice” means a secretary who shall be deemed to be in practice within the meaning of Sub-section (2) of the Company Secretaries Act, 1980 and who is not in full-time employment. Thus, a member of the Institute in practice and not in full-time employment becomes a Secretary in whole-time practice. The Companies (Amendment) Act, 1988 has also defined certain areas of practice for secretaries in whole time practice.

Section 7 of the Company Secretaries Act, 1980 provides that only the members of the Institute of Company Secretaries of India come within the purview of the concept of „Company Secretaries’. Section 7 provides that every member of the Institute in practice shall, and any other member may, use the designation of a company secretary and no member using such designation shall use any other description, whether in addition thereto or in substitution therefor.

The use of designations "Practising Company Secretary" or "Company Secretary in Practice" or "Company Secretary in Whole-time practice" was earlier held to be not permitted for use by members in practice. The Council of the Institute on reconsideration of its earlier view, has opined that the use of designation "Practising Company Secretary", "Company Secretary in Practice" or "Company Secretary in Whole-time Practice" by members in practice would not offend Section 7 of the Company Secretaries Act, 1980.

It is further provided that this section does not prohibit any such member from adding any other description or letter to his name, if entitled thereto, to indicate membership of such other Institute whether in India or elsewhere as may be recognised in this behalf by the Council, or any other qualification that he may possess. It also does not prohibit a firm, all the partners of which are members of the Institute and in practice, from being known by its firm name as Company Secretaries.

A member of the Institute may prefix CS to his name in order to distinguish himself from other professionals and to create brand image of the CS profession.

Who can Practice as a Company Secretary?

According to Section 6 of the Company Secretaries Act, 1980 only a member of the Institute whether in India or elsewhere shall be entitled to practice provided he has obtained from the Council of the Institute, a Certificate of Practice.

A member who desires to be entitled to practice should make an application in the prescribed form and pay such annual fee for his certificate as may be prescribed by the Council of the Institute. Such fees shall not exceed rupees three thousand, and such fees shall be payable on or before the 1st day of April in each year. Council may determine the fees exceeding rupees three thousand but not rupees six thousand, with prior approval of the Central Government. Further, the certificate of practice may be cancelled by the Council under such circumstances as may be prescribed.

Regulation 10(2) of Company Secretaries Regulations provides that the Council shall on acceptance of the application for issue of a certificate, issue a certificate in the appropriate form which shall be valid until it is cancelled. Further, in the case of renewal of the certificate of practice, the Secretary of the Institute of Company Secretaries of India shall issue a letter extending the validity period for that year in the appropriate form [Regulation 10(3)].

Section 26 of the Company Secretaries Act, 1980 prohibits companies whether incorporated in India or elsewhere from practising as Company Secretaries. Any company contravening this provision shall be punishable on first conviction with fine which may extend to one thousand rupees, and on any subsequent conviction with fine which may extend to five thousand rupees.

Further, any person other than a member of this Institute is prohibited from signing any document on behalf of a company secretary in practice or a firm of such company secretaries in his or its professional capacities [Section 27(1)].

Any person contravening the provisions of Section 27(1) of the Company Secretaries Act, 1980 shall be punishable on first conviction with a fine not less than five thousand rupees but which may extend to one lakh rupees, and in the event of a second or subsequent conviction with imprisonment for a term which may extend to one year or with a fine not less than ten thousand rupees but which may extend to two lakh rupees or with both.

Choose the correct answer

Which of the following Sections of the Company Secretaries Act, 1980 prohibits companies whether incorporated in India or elsewhere from practising as Company Secretaries?

- (a) Section 6
- (b) Section 26
- (c) Section 7
- (d) Section 27

Correct answer: b

The evolution of the profession

Company Secretaryship is essentially a British institution and it has struck roots in the Commonwealth countries. The profession of secretaries is very old. Like the East Indian Company, the Companies Act and the Congress movement for independence, the company secretaries too as an independent profession that originally took birth in U.K. It all started with the advent of the limited company. The then secretary carried out the staff function of merely recording the decisions and maintaining the records of the company. When his legal status was tested in 1887 in England, he was stated as a mere servant. In this context, the Chartered Institute of Secretaries was formed in 1891 by Eighteen London Secretaries and was granted Royal Charter in 1902. The Indian Civil Procedure Code of 1908 also recognised the Secretary. When the Companies Bill, 1953, was under consideration of Parliament, the Institute of Secretaries was founded in Bombay consisting of secretaries and Indian Association of these two Bodies made a clarion call to elevate the status of company secretaries by providing a clause in the Bill similar to one in English Companies Act, 1948, making it obligatory for every company to have a secretary. The Companies Act, 1956 for the first time defined "Secretary" and "Secretaries & Treasures". Thus the genesis of the profession of company secretaries taking its roots from the U.K. took birth in India along with the enactment of the Companies Act, 1956.

In Britain, the first professional association of accountants was formed in 1854. The first association of company secretaries, the Chartered Institute of Secretaries, was formed only in 1891. It was incorporated by a Royal Charter in 1902. The name of this body was changed to the Corporation of Secretaries in 1951, and it has since been merged with the Chartered Institute of Secretaries in 1971. It is presently known as the Institute of Chartered Secretaries and Administrators.

In India, the pioneers of the profession were:

- (a) The Indian Association of Chartered Institute of Secretaries of Joint Stock Companies and other Public Bodies (London) in Calcutta;
- (b) The Indian Society of Corporation of Secretaries Limited (London) in Bombay; and
- (c) The Institute of Secretaries, Bombay.

The first two were branches of the U.K. organisations. In addition, students who qualified in India for the Government Diploma in Company Secretaryship formed the Company Secretaries Students Association which was later converted into the Company Secretaries Association of India to make a representation to the Government for statutory recognition.

Areas of Practice for Company secretary

The Company Secretaries Act, 1980 recognises that a member individually or in partnership with other members, can engage in practice of the profession of company secretaries and has specified the areas of practice.

Section 2(2) of the Company Secretaries Act, 1980 has prescribed the following areas of practice for a company secretary in practice:

- (a) to engage himself in the practice of the profession of company secretaries to, or in relation to, any company; or

- (b) to offer to perform or perform services in relation to the promotion, formation, incorporation, amalgamation, reconstruction, reorganisation or winding-up of companies; or
- (c) to offer to perform or perform such services as may be performed by:
 - (i) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications, and returns) by or on behalf of the company;
 - (ii) a share transfer agent;
 - (iii) an issue house;
 - (iv) a share and stock broker;
 - (v) a secretarial auditor or consultant;
 - (vi) an adviser to a company on management, including any legal or procedural matter falling under the Capital Issues (Control) Act, 1947*, the Industries (Development and Regulation) Act, 1951; the Companies Act, 1956; the Securities Contracts (Regulation) Act, 1956; any of the rules or bye-laws made by a recognised stock exchange, the Monopolies and Restrictive Trade Practices Act, 1969; the Foreign Exchange Regulation Act, 1973**; or under any other law for the time being in force.
 - (vii) to issue certificates on behalf of, or for the purposes of a company; or
- (d) to hold himself out to the public as a company secretary in practice; or
- (e) to render professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of company secretaries; or
- (f) to render such other services as, in the opinion of the Council are or may be rendered by a Company Secretary in practice;

In terms of Clause (f) of Section 2(2) of the Act, the Council of the Institute has power to specify any other service that can be rendered by a member. Pursuant to this, the Council has specified the following categories of Management, Advisory and other services, which may be rendered by practicing members to corporations, bodies corporate, societies, trusts, associations, enterprises, undertakings, clubs, non trading corporations, industrial co-operatives, co-operative societies, non-government organizations, local self government bodies, estates, firms, small, medium and large industrial undertakings, entrepreneurs, investors, and other persons in carrying out their activities and operations:

- (i) Providing all services in MCA-21 systems including those relating to Front Office, Facilitation Centre, Filing Centre, Local Registration Authority of Digital Signature Certificate Providers.
- (ii) Conceptualisation, identification, crystallization of business enterprise, industrial-project or business activity.

* Capital Issues (Control) Act, 1947 has been repealed and SEBI Act, 1992 has been enacted.

** Foreign Exchange Regulation Act, 1973 has been repealed and Foreign Exchange Management Act, 1999 has been enacted.

- (iii) Carrying out feasibility studies, preparation of project reports, proposals for business operations including setting up a new unit or enterprise, as well as expansion, or diversification and also representations, follow-up with financial institutions, Government and other authorities for procurement of the requisite approval, clearance or permission in respect of such proposals.
- (iv) Guidance and support in relation to collaborations, joint-ventures, business agreements, arrangements, restructuring, contracts, tie-ups in India and abroad.
- (v) Business planning, policy and management in all fields including manpower, recruitment, employment, industrial relations, human resource development, management information systems, marketing, publicity and public relations.
- (vi) Planning, supervision and carrying out of internal audit, systems audit, labour audit, management audit, operational audit, quality audit, social audit, environment audit and energy audit.
- (vii) Risk management of properties, profits, resources, know-how and operations.
- (viii) Management, planning, representation and protection of trade marks, patents and intellectual property service.
- (ix) Procurement and management of materials and inventories.
- (x) Assessment, procurement and management of financial requirements and resources including project finance, working capital finance, forex management, loan syndication, portfolio management.
- (xi) Evaluation and management of deployment of funds in investments, assets and securities, loans, collaborations, tie-ups, joint-ventures.
- (xii) Formulating and implementing all activities relating to capital structure including creation, issue, offer, allotment, placement, procurement, listing of shares, debentures, bonds, deposits, coupons, ADR, GDR, IDR and all types of financial instruments.
- (xiii) Recovery-consultant in banking and financial sector.
- (xiv) Insurance advisor and other related activities.
- (xv) Acting as an arbitrator, mediator or conciliator for settlement of disputes or being on the panel of arbitrators or representing in arbitration, mediation or conciliation matters.
- (xvi) Acting as advisor to investors, depositors, mutual fund unit holders and stakeholders.
- (xvii) Acting as advisor in relation to intermediary in securities and commodities markets.
- (xviii) Due diligence and legal services.
- (xix) Corporate governance services.
- (xx) Competition law and practice.
- (xxi) Business process outsourcing, knowledge process outsourcing and legal outsourcing.

- (xxii) Valuer, surveyor and loss assessor.
- (xxiii) Investigator, private liquidator, insolvency practitioner; operating agency.

The words “to be in practice”, with their grammatical variations and cognate expressions, shall be construed accordingly.

Further, the Council has passed a resolution, permitting the members in practice to engage in the following other business or occupation under Regulation 168 of the Company Secretaries Regulations, 1982:

Permission granted generally

- (i) Private tutorship.
- (ii) Authorship of books and articles.
- (iii) Holding of Life Insurance Agency Licence for the limited purpose of getting renewal commission.
- (iv) Holding of public elective offices such as M.P., M.L.A., M.L.C.
- (v) Honorary office-bearership of charitable, educational or other non-commercial organisations.
- (vi) Acting as Justice of Peace, Special Executive Magistrate and the like.
- (vii) Teaching assignment under the Coaching Organisation of the Institute or any other organisation, so long as the hours during which a member in practice is so engaged in teaching do not exceed average four hours in a day irrespective of the manner in which such assignment is described or the remuneration is receivable (whether by way of fixed amount or on the basis of any time scale of pay or in any other manner) by the member in practice for such assignment.
- (viii) Valuation of papers, acting as a paper-setter, head examiner or a moderator, for any examination.
- (ix) Editorship of professional journals.
- (x) Acting as ISO lead auditor.
- (xi) Providing Risk Management Services for non-life insurance policies except marketing or procuring of policies.
- (xii) Acting as Recovery Consultant in the Banking Sector.
- (xiii) Becoming non-executive director/promoter/promoter director/subscriber to the Memorandum and Articles of Association of a company the objects of which include areas, which fall within the scope of the profession of Company Secretaries irrespective of whether or not the practising member holds substantial interest in that company.
- (xiv) Becoming non-executive director/promoter/promoter director/subscriber to the Memorandum and Articles of Association of a company which is engaged in any other business or occupation provided that the practising member does not hold substantial interest in the company.

Permission to be granted specifically

Members of the Institute in practice may engage in the following categories of business or occupation, after obtaining the specific and prior approval of the

Executive Committee of the Council in each case:

- (i) Interest or association in family business concerns provided that the member does not hold substantial interest in such concerns.
- (ii) Interest in agricultural and allied activities carried on with the help, if required, of hired labour.
- (iii) Editorship of journals other than professional journals.

For the purpose of the above:

- (i) A non-executive director means an ordinary director who fulfils the following conditions:
 - (a) he is required to attend the meetings of the Board or its committees only.
 - (b) he is not paid any remuneration except the sitting fees for attending the Board/Committee meetings and any remuneration to which he is entitled as ordinary director.
 - (c) he is devoting his time for the company only to attend meetings of the Board or Committees thereof and not for any other purpose.
- (ii) a member shall be deemed to have a "substantial interest" in a concern :
 - (a) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty-five per cent of voting power at any time during the previous year, are owned beneficially by such member.
 - (b) in the case of any other concern, if such member is entitled at any time during the previous year, to not less than 25% of the profits of such concern.

Further in cases of permission to be granted specifically the Council will, however, be always entitled to refuse permission in individual cases."

Regulation 168(2) provides that without prejudice to the discretion vested in the Council in this behalf, a company secretary in practice may act as a secretary, trustee, executor, administrator, arbitrator, receiver, appraiser, valuer, internal auditor, management auditor, management consultant or as a representative on financial matters including taxation and may take up an appointment that may be made by the Central or any State Government, Courts of Law, Labour Tribunals, or any other statutory authority.

Major Areas of Practice for Company Secretaries

Compliance Certificate

The Companies (Amendment) Act, 2000 inserted a proviso to Sub-section (1) of Section 383A of the Companies Act, 1956, with regard to issue of Compliance Certificate, which reads as under:

"Section 383A(1). Every company having such paid-up share capital as may be prescribed shall have a whole-time secretary, and where the Board of directors of

any such company comprises only two directors, neither of them shall be the secretary of the company:

Provided that every company not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all the provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in Section 217".

As per rule 2 of the Companies (Appointment and Qualifications of Secretary) Rules, 1988, every company having a paid-up share capital of rupees five crore or more is required to have a whole-time secretary.

Similarly, every company having a paid-up share capital of rupees ten lakhs or more but less than rupees five crore not having a whole-time secretary is required to file with the Registrar of Companies (ROC) a Compliance Certificate from a secretary in whole-time practice and also attach a copy of that certificate with Board's report.

The Institute has issued Guidance Note on Compliance Certificate to help members in undertaking Compliance Certificate.

Corporate Governance Compliance Certificate

Clause 49 of the Listing Agreement provides that a company shall obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of the conditions of Corporate Governance.

Clause 49 VII(i) mandates that, the Corporate Governance Compliance Certificate ("CGCC") shall be annexed to the Directors' Report, which is required to be sent to all the shareholders of the company. The CGCC is also required to be sent to the Stock Exchange(s) along with the Annual Report filed by the company.

Clause 49 VI(i) provides that, there shall be a separate section on Corporate Governance in the Annual Reports of listed entities, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of Clause 49 of the Listing Agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted in the CGCC.

Para 8.2 of the Guidelines on Corporate Governance for Central Public Sector Enterprises (CPSEs) issued by the Department of Public Enterprises, Ministry of Heavy Industries and Public Enterprises provides that the company shall obtain a certificate from either the auditors or practising Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in the Guidelines.

The Institute has issued "Guidance Note on Corporate Governance Certificate" to help members undertaking Corporate Governance Compliance Certification.

Diligence Report for Banks

The Reserve Bank of India vide its Circular No. DBOD.NO.BP.BC.46/08.12.001/2008-09 dated September 19, 2008 advised all the scheduled commercial Banks (excluding RRBs and LABs) to obtain regular certification (DILIGENCE REPORT) by a

professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions by the borrowing companies that are in vogue. Further RBI vide its Circular dated January 21, 2009 also advised all Primary Urban Co-operative Banks to obtain Diligence Report. Subsequently, the RBI revised the format of Diligence Report for Scheduled Commercial Banks and also for primary Urban Co-operative Banks vide its Circular dated February 12, 2009. The RBI also advised the Banks to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks vide Circular No. RBI/2008-2009-313/DBOD. No. B.P.BC.94/08.12.001/2008-2009 dated December 08, 2008.

The Practising Company Secretaries have been authorized to certify compliance in respect of matters specified in the RBI Circular No. DBOD No. BP.BC. 46/08.12.001/2008-09 dated September 19, 2008. Para (2)(iii) of the RBI Circular specifies that the Diligence Report shall be in the format given in Annex III thereto. The format has been subsequently revised and streamlined by RBI. Annex III to the RBI Notification provides that the Diligence Report shall be made on a half yearly basis.

The Institute has issued Guidance Note on Diligence Report for Banks containing parawise detailed checklists and guidance to Company Secretaries undertaking Diligence Report for Banks.

Secretarial Audit

The CORPORATE GOVERNANCE VOLUNTARY GUIDELINES, 2009 issued by the Ministry of Corporate Affairs in December, 2009 recommended, the introduction of Secretarial Audit. Para V of the Guidelines reads:

“Since the Board has the overarching responsibility of ensuring transparent, ethical and responsible governance of the company, it is important that the Board processes and compliance mechanisms of the company are robust. To ensure this, the companies may get the Secretarial Audit conducted by a competent professional. The Board should give its comments on the Secretarial Audit in its report to the shareholders.”

The Institute has brought out a Referencer on Secretarial Audit to help the members undertaking the exercise of Secretarial Audit.

The Companies Bill, 2011 proposes to provide for Secretarial Audit by Company Secretary in Practice in every listed company and other prescribed class of companies.

Members in practice to carry out non-attestation services through the new business structure of Limited Liability Partnership

The Council has given general permission to the members in practice to:

- (a) become passive partner of a limited liability partnership (LLP) the objects of which include carrying out non-attestation services which fall within the scope of the profession of Company Secretaries irrespective of whether or not the practicing member holds substantial interest in that LLP;
- (b) become passive partner of LLP which is engaged in any other business or occupation provided that the practicing member does not hold substantial interest in that LLP.

Guidelines for Conversion of Firms of PCS into LLPs and setting up of Firms of PCS under LLP mode

In exercise of powers conferred by Clause (1) of Part II of Second Schedule to the Company Secretaries Act, 1980 (56 of 1980), as amended by the Company Secretaries (Amendment) Act, 2011, the Council of the Institute of Company Secretaries of India has issued the guidelines for conversion of firms of PCS into LLPs and setting up of firms of PCS under LLP mode.

13. PROFESSIONAL DUTIES AND CODE OF CONDUCT FOR A COMPANY SECRETARY

In every profession when it becomes organised, certain traditions and practices are developed by its members which are looked upon and cherished by the members of the profession as noble. Such traditions and practices are called „Code of Conduct’. Violation of such noble practices by any member of the profession rouses the indignation of the other members and in days of old they did not even hesitate „to excommunicate the erring member’.

In order to evoke the necessary interest and awareness among the members and create the necessary climate for laying down the right type of code which should govern the profession, the Institute organised a Convention in February, 1976, primarily to evolve the necessary frame of reference. Soon after the convention was over, the Council of the Institute appointed a Committee, which was entrusted with the task of formulating a model code of conduct. Pursuant to the recommendations of the code of conduct committee, the Council of the Institute adopted a uniform code of conduct for Company Secretaries. The „Code of Conduct’ outlines the expected conduct of members, first as a member as such, next as a member in employment or practice and lastly, as a member holding a public office in his professional capacity. The Code consists of a set of simple rules accompanied by explanatory notes and action points both for the Institute and the member.

The Code, however, has now become historical record as the Company Secretaries Act, 1980 has adopted the provisions of the Code in its sections and schedules giving a „legislative prospect’ to it.

14. RULES APPLICABLE TO A COMPANY SECRETARY IN PRACTICE

1. Professional Independence: A Practising Company Secretary should exercise professional independence in relation to his work. He should scrupulously observe the criterion of objectivity in his work and should not detract himself from independent and objective approach. He should deny his services of Practising Company Secretary to a company manifestly known for its unfair, unethical practices.

2. Quality of Service: The quality of services rendered by a Practising Company Secretary should be the highest attainable by him without reference to the monetary compensation received or receivable by him for his professional services. Where a particular assignment is that he cannot efficiently accomplish even with the utmost exercise of his own skill and expertise, he should not hesitate to consult other professionals, if found necessary. Whenever the Practising Company Secretary feels that a complex problem warrants consultation with the ICSI, he should approach the Institute for necessary guidance.

3. Position of Trust: Unless so required by any law for the time being in force or unless the professional Code of Conduct prescribed by ICSI for Members in practice, the Practising Company Secretary should not disclose any information received by him in the course of his work from his client to an outsider. He should not use such information received confidentially to his own personal advantage or allow such information to be used, with his knowledge, by anyone in such a way that he may become an indirect beneficiary. Further, a Practising Company Secretary should not be a party to any unlawful, unfair, unethical activity of his client company to derive any direct or indirect benefit.

4. Duty Towards the Profession: It shall be the duty of a Company Secretary in Practice:

- (a) to conduct himself in a manner consistent with the high ideals of the profession of Company Secretaries and the dignity of the Institute of Company Secretaries of India;
- (b) to uphold the cause of the profession and the ICSI in corporate, national and international affairs in which he may have the opportunity to participate;
- (c) to help the younger members in the profession and inculcate in them a sense of professional discipline; to co-ordinate the various functions with a view to reaching a harmonious result, reconcile rather than create conflict of views with different professions and in this direction behave himself with utmost courtesy and consideration towards all with whom he may come in contact with in the course of his work.

Professional Misconduct

Every member is required to be conscious so as to behave in such a manner that his conduct is not attracted by any provisions of the First and Second Schedules to the Act which give instances and which will be construed as misconduct defined in Section 22 of the Act.

(i) Definition of Professional Misconduct: Section 22 of the Act read with the Schedules to the Act, contains an illustrative, though not a conclusive definition of „Professional Misconduct“. These constitute the code of professional conduct applicable to the Company Secretaries. Section 22 of the Company Secretaries Act provides that professional misconduct shall be deemed to include any act or omission specified in any of the schedules but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under Sub-section (1) of Section 21 to inquire into the conduct of any member of the Institute under any other circumstances.

(ii) Schedules to Company Secretaries Act, 1980: The different types of behaviour on the part of a member which would be deemed to be professional misconduct within the meaning of the Company Secretaries Act are comprised in two Schedules, the First Schedule being divided into three parts and the Second Schedule into two parts.

First Schedule – Professional Misconduct cases to be dealt with by the Council

Part I of the First Schedule deals with the misconduct in relation to members of the Institute in practice which would have the effect generally of compromising his position as an independent person. Part II deals with professional misconduct in relation to members of the Institute in service. Part III of the First Schedule deals with misconduct of members generally. The offences covered by any of the clauses in the three parts of the First Schedule are to be adjudicated upon by the Council except where the Council decides to remove the member's name from the register of members for a period exceeding five years or permanently.

Second Schedule – Professional Misconduct cases to be dealt with by the High Court

The Second Schedule deals with misconduct in relation to members of the Institute in practice and members generally requiring action by a High Court. This Schedule is in two parts.

A member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm in the manner and subject to the guidelines for advertisement by company secretary in practice as issued by the Council of Institute of Company Secretaries of India, in exercise of powers conferred by clause (1) of Part II of Second Schedule to the Company Secretaries Act, 1980.

15. QUALITY REVIEW BOARD

The Company Secretaries (Amendment) Act, 2006 has inserted a new Chapter VIIA pertaining to Quality Review Board. The Central Government shall, by notification, constitute a Quality Review Board consisting of a chairperson and four other members, who shall be appointed from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy. Two members shall be nominated by the Council and the other two by the Central Government (Section 29A).

Section 29B provides the functions to be performed by the Board:

- (i) to make recommendations to the Council with regard to the quality of services provided by the members of the Institute.
- (ii) to review the quality of services provided by the members of the Institute including secretarial services.
- (iii) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

The procedure of the Board and terms and conditions of service of Board shall be as specified (Section 29C & 29D). However, the expenditure of the Board shall be borne by the Council.

The Central Government has constituted a Quality Review Board vide Notification NO. G.S.R 490(E) dated 13.7.07. The terms and conditions of Service and allowances of the chairperson and the members of the Board shall be governed by Company Secretaries procedures of Meetings of Quality Review Board and terms and conditions of services and allowances of the chairperson and members of the Board, Rules, 2006.

16. PEER REVIEW

In order to enhance the quality of professional services being rendered by practicing Company Secretaries, the Council, as empowered under Section 15 is also proposing to issue guidelines for peer review/quality review. Peer review in general shall refer to an examination and review of the systems and procedures so as to determine whether they have been put in place by the practice unit for ensuring the efficacy and quality of attestation services as envisaged and mandated by the technical standards i.e. standards to be laid down by the Council in this regard. Peer review contemplates examination of the systems and approach of a Practice Unit (PU) by another member of the Institute with the objective of identifying the areas, where the practicing member may require guidance in improving the quality of his performance and adherence to the requirements of various technical standards.

The focus lies on the promotion of continuing quality improvement in an atmosphere of openness and mutual trust that contributes to enhancing transparency and comparability. Good practice is valued and mutual learning encouraged in a dynamic and motivating process, from which both the PU and Reviewer can benefit.

With a view to regulate the profession of Company Secretaries and in terms of the powers vested, the Council has issued guidelines for Peer Review of Attestation Services by Practising Company Secretaries. The guidelines serve as a mechanism intended to further enhance the quality of professional work of Practising Company Secretaries (PCS) over a period of time, thereby ensuring that the profession of Company Secretaries continues to serve the society in the manner envisaged.

The Guidelines on Peer Review are issued in relation to conduct of members in attestation services:

- to promulgate an appropriate mechanism for ensuring the quality of attestation services and guide the members to conduct themselves in a manner that the Council considers appropriate;
- to provide guidance in relation to the statutory powers and obligations with respect to the parties involved in peer review;
- to prescribe the scope of peer review and the procedures to be adopted during the conduct of a peer review; and
- to establish the expected conduct of members during a peer review.

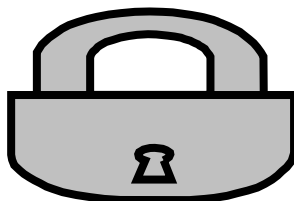
LESSON ROUND-UP



- Under Section 2(45) of the Companies Act, 1956, a Secretary is defined as a Company Secretary within the meaning of Clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, 1980, and includes any other individual possessing the prescribed qualifications in the respective rules and appointed to perform the duties which may be performed by a secretary under the Act.

- Every Company having a paid up share capital of Rs. 5 crore or more is compulsorily required to have a Company Secretary u/s 383A.
- Every company secretary is expected to adhere not only to the letter of the law but also ensure that the spirit of the law is followed.
- A Company Secretary exercises supervisory and checking role so as to prevent any chance of negligence in implementing various laws applicable to a particular company.
- Ministry of Corporate Affairs has framed Companies (Appointment and Qualifications of Secretary) Rules, 1988.
- Appointment of Company Secretary is made by means of a resolution passed at meeting of Board of Directors.
- Dismissal of a company secretary can be done by the Board of Directors or by the Managing Director (if authorized by the Board).
- Companies Act, through its various sections cast upon company secretary various duties and liabilities called statutory duties and statutory liabilities.
- Role of company secretary is three-fold, namely, as a statutory officer, as a coordinator, and as an administrative officer.
- Practising company secretaries provide plethora of corporate services to the corporate world beginning from the incorporation of a new company to filing of various documents with the authorities concerned, representing the company in front of various government authorities etc. One of the most important roles of practising company secretaries is to provide advisory services to various companies.
- Practising members are allowed to advertise the services provided and particulars of his firm subject to the Guidelines for Advertisement by Company Secretary in practice.
- A company secretary in practice is entitled to issue and/or sign compliance certificate and/or Annual Return for not more than 80 companies in aggregate in a calendar year.

SELF-TEST QUESTIONS



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

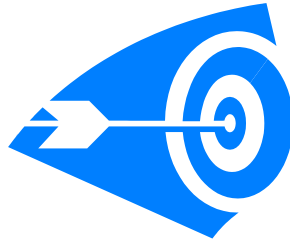
1. Explain the term secretary under the Companies Act, 1956. Is it necessary for every company to have a secretary?
2. The status of secretary in the Indian corporate scene has undergone significant changes during the last three decades. Discuss.
3. State the qualifications which a company secretary should possess for being

appointed as company secretary in a company.

4. How is the secretary in a company appointed? Also state, how the secretary can be dismissed.
 5. Enumerate the duties and liabilities of a Secretary.
 6. Discuss the role of company secretary as a statutory officer, as co-ordinator and as an administrative officer.
 7. State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980.
 8. Define Secretary in whole-time practice.
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STUDY XVIII
MANAGEMENT AND CONTROL OF COMPANIES-V
MEETINGS

LEARNING OBJECTIVES



Members of a company or the directors of a company can exercise their powers and can bind the company only when they act as a body at a validly convened and held meeting. An individual member or shareholder, irrespective of his shareholding cannot bind a company by his individual act.

It is to be noted that every gathering or assembly does not constitute a meeting. These must be convened and held in perfect compliance with the various provisions of the Companies Act, 1956 and rules framed there under. This chapter covers the following topics:

- Introduction
- Meaning of a Meeting
- Kinds of Company Meetings
- Requisites of Valid Meeting (General Meeting)
- Quorum
- Proxy
- Voting at General Meeting
- Chairman
- Clause 49 of Listing Agreement on Corporate Governance
- Motion
- Methods of ascertaining sense of the Meeting
- Resolutions
- Registration of Resolutions and Agreements
- Passing of resolutions by Postal Ballot
- Adjournment
- Holding of Meeting through teleconferencing
- Minutes of proceedings of Meetings.

1. INTRODUCTION

Protection of investors is one of the main objectives of the Companies Act. Companies Act, 1956 provides the shareholders, a forum of self-protection which is

the general meeting of shareholders. The incorporation of a company under the Companies Act, 1956, whether as a private or as a public limited company gives it the unique privilege of having a separate identity as a legal entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held Meetings. Determining what constitutes a Meeting is therefore an important issue. A Meeting has been defined as “coming together of two or more persons face to face so as to be in each other’s presence or company”. [In Re. *Associated Color Laboratories Ltd.* (1970) 12 D.L.R.]. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures.

The decision making powers of a company are vested in the Members and the Directors and they exercise their respective powers through Resolutions passed by them. General Meetings of the Members provide a forum to them to express their will in regard to the management of the affairs of the company.

One of the basic requirements of meetings is that the members or shareholders of a company or the directors of a company can exercise their powers and can bind the company only when they act as a body at a validly convened and held meeting. They must act collectively and not individually. An individual member or shareholder, irrespective of his shareholding, cannot bind a company by his individual act.

Convening of one such meeting is compulsory every year. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting.

The shareholders must have advance information of the date of the meeting. The right to information has been provided a special status by providing that denial of information would be an act which can be used to activate the machinery of investigation under Section 237 or to provide a ground for disqualification under Section 203 or constituting an act of oppression under Section 397 or mismanagement under Section 398. The shareholder can use the forum for the power to appoint directors as well as auditors of their own choice who may safeguard them from possible manipulations. They also have the power to remove the directors and auditors so appointed if they do not find them up to their expectations. The business of the meeting is conducted in the form of resolutions proposed and passed. Some resolutions require simple majority and some special majority of those present and voting. Resolutions once passed become binding upon the company and all its members.

2. MEANING OF A MEETING

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business. There must be atleast two persons to constitute a meeting. Therefore, one shareholder usually cannot constitute a company meeting even if he holds proxies for other shareholders. However, in certain exceptional circumstances, even one person may constitute a meeting.

It is to be noted that every gathering or assembly does not constitute a meeting. Company meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 1956 and the rules framed thereunder.

3. KINDS OF COMPANY MEETINGS

Meetings under the Companies Act, 1956 may be classified as:

- I. Shareholders' meetings:
 - (i) Statutory Meeting as per Section 165 of the Act;
 - (ii) Annual General Meetings as per Section 166 of the Act;
 - (iii) Extraordinary General Meetings;
 - (a) Convened by directors to transact business of special importance that arises in between the two annual general meetings and justifies the convening and holding a meeting of the shareholders — Regulation 47, Table A of Schedule I to the Companies Act; and
 - (b) Convened by directors on the requisition of the shareholders as per Section 169 of the Act.
 - (iv) Class Meeting of Shareholders.
- II. Meetings of the debentureholders.
- III. (a) Meetings of creditors for purpose other than winding up.
(b) Meetings of creditors for winding up.
(c) Meetings of contributories in winding up.
- IV. Board Meetings of the Board of Directors.
- V. Meetings of the Board Committees.

1. SHAREHOLDERS' MEETINGS

(i) *Statutory Meeting*

Section 165 of the Companies Act, 1956 lays down:

“(1) Every company limited by shares, and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called “the statutory meeting.”

A meeting held before the statutory period of one month could not be called a statutory meeting. Moreover, the notice must set out that meeting is intended to be statutory meeting. [*Gardner v. Iredale* (1912) 1 Ch. 700].

Failure to hold such a meeting renders the company liable to be wound up under Section 433 (b).

Section 165(10) provides that the provisions of Section 165 are not applicable to a private company. It, therefore, follows that statutory meetings are required to be convened only by a public company limited by shares or limited by guarantee and

having a share capital. Thus, such meetings are not required to be held by a company limited by guarantee and not having a share capital or by a private company.

The position of a private company which is converted into a public company is as follows:

According to the department's clarification (Now, the Ministry of Corporate Affairs), the provisions of sections 149 and 165 of the Companies Act, 1956, relating to the certificate of commencement of business and the statutory meeting would not be applicable to a private company which has converted itself into a public company. (Department's File No. 44/50-CL-IV/62)

Statutory Report

Sub-section (2) of Section 165 of the Act provides :

"The Board of directors shall, at least twenty-one days before the day on which the meeting is to be held, forward a report (referred to as "the statutory report") to every member of the company:

Provided that if the statutory report is forwarded later than is required above, it shall, notwithstanding that fact, be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting."

Contents of the Statutory Report

Sub-section (3) of Section 165 lays down the contents of the statutory report, which in brief are:

- (a) Shares allotted, amounts paid up thereon, and the consideration received, if cash not received on those shares;
- (b) Cash received on shares with an abstract of receipts and payments and balance in hand;
- (c) Preliminary expenses of the company—an account or estimate thereof;
- (d) Names, addresses and occupations of the directors, auditors, manager and secretary, and changes, if any, since incorporation;
- (e) Particulars of contracts or modifications thereof, if any, proposed to be submitted to the meeting for its approval;
- (f) The extent, if any, to which each underwriting contract, if any, has not been carried out, and the reasons therefor;
- (g) Calls, if any, unpaid by the directors and manager;
- (h) Particulars of commission and brokerage paid or payable to the directors or the manager.

Certification of the Statutory Report

Sub-section (4) of Section 165 makes it obligatory that the Statutory Report be certified by at least two directors, including the managing director, if there is one, and also by the company's auditors in so far as the report relates to the shares allotted by the company, cash received in respect of the shares and the receipts and payments of the company.

Registration of the Statutory Report

In accordance with the provisions of Section 165(5) of the Act, the Board of directors must file a copy of the Statutory Report duly certified as per Sub-section (4), with the Registrar of Companies for registration, after copies thereof have been sent to the shareholders of the company.

Notice of Statutory Meeting

In accordance with the provisions of Section 171 of the Act, notice for calling every general meeting of a company, including a statutory meeting, must be given at least twenty-one clear days before the meeting unless consent is accorded to a shorter notice by members, holding not less than 95% of such paid-up capital as gives right to vote or not less than 95% of the total voting power exercisable at the meeting. The notice convening the meeting should state it to be the statutory meeting. [*Gardner v. Iredale* (1912) 1 Ch. 700].

Time and Place for holding a Statutory Meeting

Section 165 of the Companies Act 1956 does not specify time and place for holding a statutory meeting. Hence, it can be assumed that the meeting can be held at any time and place as suited to the company.

Production of list of members at the Statutory Meeting

Sub-section (6) of Section 165 states that the Board shall cause a list showing the names, addresses and occupations of the members of the company and the number of shares held by them respectively, to be produced at the commencement of the Statutory meeting. The list shall remain open and accessible to any member of the company during the continuance of the meeting.

Scope of the Statutory Meeting

Sub-section (7) of Section 165 gives absolute liberty to members to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice has been given or not; but no resolution may be passed of which notice has not been given in accordance with the provisions of the Act.

Adjournment of the Statutory Meeting

In accordance with the provisions of Sub-section (8) of the said Section, statutory meeting may be adjourned from time to time, and at any adjourned meeting any resolution of which notice has been given in accordance with the provisions of the Act, whether before or after the former meeting, may be passed; and the adjourned meeting shall have the same powers as the original meeting.

Penalty for Default

If default is made in complying with the provisions of Section 165, every director or other officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees.

(ii) Annual General Meeting (AGM)

An annual general meeting is required to be held every year by every company whether, public or private, limited by shares or by guarantee, with or without share

capital or unlimited company. Section 166(1) of the Companies Act, 1956 states that every company must, in each calendar year hold an annual general meeting, so specified in the notice calling it, provided that not more than 15 months shall elapse between two annual general meetings. However, a company may hold its first annual general meeting within 18 months from the date of its incorporation. In that event it need not hold any annual general meeting in the year of its incorporation or in the following year. Thus, if a company is incorporated in December 2003, it may hold its first annual general meeting in May 2005 and that meeting will be deemed to be the annual general meeting for 2003, 2004 and 2005.

Sections 166 and 210 of the Companies Act provide that the subsequent annual general meeting should be held on the earliest of the following dates:

- (a) 15 months from date of the last annual general meeting;
- (b) the last day of the calendar year;
- (c) 6 months from the close of the financial year.

The fact that the company did not function is no excuse for not holding the annual general meeting [*Madan Gopal Dev v. State of West Bengal*, (Q969) 39 Com Cases 119: AIR 1968 Cal 790] or that its management was taken over by the Government, [*Hindustan Co-operative Insurance Society Ltd.*, Re, (1961) 31 Com Cases 193 : AIR 1961 Cal 443].

Extension of Validity Period of AGM

In the event of any difficulty in holding an annual general meeting (except the first annual general meeting), the Registrar may, for any special reason shown, grant an extension of time for holding the meeting by a period not exceeding three months. Application seeking extension of time should be made before the due date for holding annual general meeting.

The extension of time granted by the Registrar will apply to both the requirements of the Section. Ministry of Corporate Affairs expressed the following views:

“Sections 166 and 210 when read together clearly suggest that the annual general meeting should be held on the earliest date of the three relevant dates prescribed under these two sections, i.e. 6 months after the close of the financial year, 15 months from the previous annual general meeting and the last day of the next calendar year, whichever is earlier. Otherwise one or the other section is bound to be breached. Occasions may, however, arise where a company experiences genuine difficulty in holding its annual general meeting within 6 months of the close of the financial year though it can hold it within the time limit prescribed under Section 166. The Registrars should be departmentally instructed that in such cases they should, on the merits of each case, allow extensions under Section 166, even though the periods prescribed under that Section are not likely to be exceeded, so that the company can take advantage of the extension and is enabled to hold its annual general meeting beyond the period of 6 months prescribed under Section 210 and upto nine months of the financial year (as in that case the company shall be able

to add the period of extension to the prescribed period of 6 months), even though the meeting is held within the time prescribed under Section 166.” [Department’s File No. 8/16(1)/61-PR].

Due to conversion of a vacant piece of land into a township by a Tea estate company, there were industrial disputes, labour unrests, intensive agitations, police firing and death of a worker. The matter was reported in the media also. These inevitable circumstances made it impossible for the company to convene the AGM for 2001-02 in the stipulated period. The company could not even make use of the extension granted by ROC to convene its AGM by 31.12.2002. However, the company filed necessary documents and returns with ROC on 19.2.2003 and filed a petition in Calcutta High Court praying that the directors and the company should be relieved of the responsibility as such. The court observed that the default was committed by the company due to circumstances beyond its control and directed the ROC not to take any punitive action against the applicant director and made the company liable for payment of Rs. 1700 to ROC as the costs. [*Tapan Kumar Chowdhury v. Registrar of Companies*, (2003) 55 CLA 80 (Cal.)].

In terms of Section 166 of the Companies Act, 1956 an annual general meeting shall be held every year. Where a meeting called on 30th December, 1934 was adjourned to the 31st March, 1935 and the next meeting was held on 28th January, 1936 it was held that Section 166 was not complied with and the company was rightly convicted of an offence for not holding the meeting during the year 1935. [*Sree Meenakshi Mills Co. v Asst. Registrar, Madurai*, (1938) 8 Com Cases 175, 176]. The holding of an extraordinary general meeting will not do; only an annual general meeting must be held [*Emperor v. Nasurbhai Abdullah Bhai Lalji*, AIR 1923 Born 194].

In the case of a company whose accounting year ends on 30th June 2003, it is required to hold the Annual General Meeting latest by the 31st December 2003. If for any reason, the Annual General Meeting cannot be held in December 2003 and if on an application, the Registrar grants time to hold the meeting in February, 2004, the company by holding the Annual General Meeting in February, 2004 is not complying with the requirements of holding an Annual General Meeting every year. Still, it will not be said to have contravened the provisions of Section 166.

If there is a delay in holding the annual general meeting beyond the time permitted by a combined reading of Sections 166 and 210, including any extension granted by the Registrar of Companies, the company and every officer of the company in default shall be punishable with fine which may extend to fifty thousand rupees and in the case of continuing default, with a further fine which may extend to two thousand five hundred rupees for every day after the first day during which such default continues. However, this does not affect the validity of the annual general meeting itself. Consequently, all the resolutions passed at the annual general meeting for the approval of the accounts and the directors’ report, declaration of dividend, appointment of directors and auditors at the meeting are valid.

No distinction in regard to requirement of holding of an annual general meeting could be made between a private and public limited company. [*Registrar of Companies v. Cabral & Co. Pvt. Ltd. and others* (1988) 63 Comp. Cas. 126 (Bom)].

It has been clarified by the Department of Company Affairs (Now, Ministry of

Corporate Affairs) that delay in completion of audit of the annual accounts of the company does not ordinarily constitute a "special reason" justifying the extension of time for holding its annual general meeting. Similarly, a prosecution for failure to file the balance sheet etc. under Section 220 cannot be a defence for not holding the annual general meeting of the company. Each of them is an independent requirement and default to comply with either constitutes a separate offence punishable separately. [*ROC v. RP*, 1977 Tax LR 1610 (Orissa)].

Time and Place for Holding an Annual General Meeting

Every annual general meeting called after giving at least 21 clear days' notice must be held on a day other than a public holiday, i.e. it should be held on working day, during business hours at the Registered Office of the company or at some other place within the city, town or village in which the Registered office of the company is situated. The meeting can be held at any place within the postal limit and local limits of the city, town or village in which the Registered Office of the company is situated and where the two do not coincide, the wider of the two. (Circular No. 1/1/80-CLV, dt. 16/02/81). The Central Government may, however, exempt any class of companies from these provisions.

Section 2(38) defines a public holiday as "public holiday within the meaning of the Negotiable Instruments Act, 1881" and clarifies that if any day is declared by the Central Government to be a public holiday after the issue of the notice convening such meeting, it shall not be deemed to be a public holiday in relation to the meeting, so that the meeting can be held on that day as scheduled, regardless of the day having been declared as a public holiday.

Where 30th June and 31st December are declared as holiday under the Negotiable Instruments Act for the limited purpose of half yearly closing of accounts of banks, treasuries, etc. in that case these two holidays will not be treated as public holidays for the purpose of Section 166 as per clarification issued by the Department of Company Affairs vide letter No. 8/(66)/80-CL V dated 2.3.1981. Hence, an Annual General Meeting can be held on these days.

No annual general meeting of any company shall be held on a public holiday. The prohibition is, however, not extended to extraordinary general meetings.

There is no contravention of Section 166(2) if an adjourned meeting accidentally comes to be held on a public holiday. (*Department's Letter No. 8/16(1)/61-PR, dated 19th May, 1961*).

It is further laid down that a public company or a private company which is a subsidiary of a public company may, by its articles, fix the time for its annual general meetings and may also by a resolution passed in one general meeting, fix the time for its subsequent annual general meetings. A private company, which is not a subsidiary of a public company, may in a like manner and also by a resolution agreed to by all the members thereof, fix the time and place for its annual general meeting.

Section 166 does not prevent the articles of association from prescribing any time limit for holding annual general meeting so long as the two mandatory conditions in the section are fulfilled. The articles can, therefore, lay down that annual general meeting shall be held before 31st March (or any such date) every year. [*Balakrishna Maheshwari v. Uma Shanker Mehrotra*, (1947)].

Where the articles provided that meetings should be held in the month of August and in keeping with that provision meetings were generally held on the 3rd or 4th Monday of every August, but when in one year differences arose between the management and a big shareholder and a meeting was fixed on 3rd August, at which date it would have been too difficult for the big shareholder to exercise his voting rights on recently purchased shares, the court stayed the meeting and ordered that it should not be held before August 13, because by that time the big shareholder's right would accrue to him. [*Cannon v. Trask*].

Any direction by a court that the annual general meeting may be held simultaneously at three different cities is invalid, because the section clearly requires that the meeting must be held either at the registered office or at some other place within the same city, town or village where the registered office is situated. [*Dinekar Rai D. Desai v. R.P. Bhasin*, (1985) 1 Comp LJ 38].

It was held in the case of *A. MYLSAMY v. SRI GAJENDIRA PAPER AND BOARDS P. LTD.* [2010] 153 COMP CAS 2 (CLB) that Company Law Board cannot pass an interim order under section 403 of the Companies Act, 1956 directing the company hold its Annual General Meeting at its factory premises instead of holding it at the registered office of the company.

Participation by shareholders or Directors in meetings through electronic mode (General Circular Nos. 27/2011 & 28/2011 dated 20.05.2011 and 35/2011 dated 06.06.2011)

It has been clarified by Ministry of Corporate Affairs that a shareholder or a director of the company may participate in meetings under the provisions of the Companies Act, 1956 through electronic mode.

Electronic mode means video conference facility i.e. audio-visual electronic communication facility which enables all persons participating in that meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

The notice of the meeting must inform shareholders regarding availability of this facility.

In a general meeting, where shareholders are allowed to participate through electronic mode, the quorum as required under Section 174 of the Companies Act, 1956 as well as chairman of the meeting shall have to be physically present at the place of the meeting.

In the case of Board meeting, the notice of the meeting shall also seek confirmation from the director as to whether he will attend the meeting physically or through electronic mode. In the absence of such confirmation, it will be presumed that he will physically attend the Board meeting.

It is also clarified that a director participating in a meeting through use of video conference shall be counted for the purpose of quorum. The minutes shall also disclose the particulars of the Directors who attended the meeting through electronic mode.

It is not mandatory for companies to provide the directors or shareholders the facility to attend meetings through video conferencing.

For e-voting in general meeting, any agency providing electronic platform for e-voting is required to obtain Certificate from Standardization Testing and Quality Certification Directorate, under Ministry of Communication and IT. (General Circular No. 72/2011 dated 27.12.2011)

Default in Holding Annual General Meeting

If a company defaults in holding an annual general meeting two consequences will follow.

Firstly, any member may apply to the Company Law Board which may call, or direct the calling of the meeting, and give such ancillary or consequential directions as it may consider expedient in relation to the calling, holding and conducting of the meeting. The Company Law Board may direct that one member present in person or by proxy shall be deemed to constitute the meeting. A meeting held in pursuance of this order will be deemed to be an annual general meeting of the company (Section 167).

Secondly, the failure to call this meeting as required by Section 166 of the Act, either generally or in pursuance of the order under Section 167(1) is an offence punishable with fine which may extend to Rs. 50,000, on the company and every officer of the company who is in default and for continuing default, a further fine of Rs. 2,500 per day during which the default continues [Section 168].

In *Gracy Thomas v. Four Square Estates (P.) Ltd.* [(2008) 83 SCL 404 (CLB-Chennai)]. It was held that application dismissed, by virtue of section 167, if default is made in holding an annual general meeting by a company in accordance with section 166, the CLB may direct the calling of the annual general meeting. This section explicitly provides that the CLB may exercise the power only if there is a default committed in holding annual general meeting, as envisaged in section 166. In the present case Validity of the AGMs held by the company was pending in a civil suit - Applicants sought the CLB to issue directions to the company to hold AGM - Whether it is possible for the CLB to do so. The verdict was in the negative.

Subject to the provisions in the articles, any general meeting of the company can be called only on the authority of a Board resolution. If the managing director, manager, secretary or other officer calls a meeting without the authority of the Board of directors it will not be effectual unless the Board ratifies the convening before the meeting is held. [*Re. Haycraft Gold Reduction and Mining Co.*, (1900) 2 Ch 230]. Also refer *British Asbestos Co. Ltd. v. Boyd.* (1903) 2 Ch 439.

A meeting can be called in accordance with a decision of the Board and does not require confirmation at the next Board Meeting. [*Karnataka Bank Ltd. v. A.B. Datar* (1993) 2 Kar LJ 230 at 243, 244: (1994) 79 Com Cases 417 (1994) 4 Comp LJ 125 (Kar)].

In *Re. Asia Udyog Pvt. Ltd.* (1961) 31 Comp. Cas. 269 the directors were unable to convene the annual general meeting as the account books were lying in the custody of the police. The offence was not punishable.

The annual general meeting must be called, whether or not the annual accounts are ready for consideration at the meeting. "There is a clear statutory duty on the directors to call the meeting whether the accounts, the consideration of which is only one of the matters to be dealt with at an annual general meeting are ready or not" [*Re El Sombre Ltd.*, (1958) 3 All ER 1 at 6 (1958)].

The requirement of Section 166 for holding AGM within fifteen months of the preceding AGM is independent of Section 210 requiring presentation of annual accounts at the AGM. The tenure of additional directors would end on the date on which an AGM following their appointment is held. The presentation of annual accounts has no relevance to the duration of their appointment. But where the AGM has been stayed or deferred at the orders of CLB, there is no default in holding AGM and consequently the nominee director will remain in office till the stay order is vacated or the meeting is actually held. [*Ador-Samia Ltd. v. Indocan Engineering Systems Ltd.* (2000) 100 Comp. Cas. 370: (1999) 35 CLA 224 (CLB-PB)]. If the annual accounts (i.e., the balance sheet and profit and loss account) are not ready for being laid before the meeting, as required by Section 210(1), the usual practice is to hold the meeting within the prescribed period and then adjourn it to a suitable date, say a month later for considering the accounts.

This could be done earlier by a suitable resolution adjourning the annual general meeting to a specific future date later on for the purpose of adoption of the accounts. As an adjourned meeting is only the continuation of the original meeting and not a new meeting [*M.D. Mundhra v. Assistant Registrar of Companies* (1980) 50 Comp. Cas. 346 (Cal.)], the statutory requirement as to laying of the accounts before the annual general meeting would be satisfied if the accounts were laid before the adjourned meeting. [*Sudhir Kumar Seal v. Assistant Registrar of Companies* (1979) 49 Comp. Cas 462]. This was in accordance with the circular bearing No. 35/9/72-CL-III dated 2.2.1974, issued by the Company Law Board, Ministry of Law, Justice and Company Affairs, which has been superseded by their circular dated 20.3.1985 mentioned below:

A plea has been made that in accordance with the aforesaid Circular dated February 2, 1974 it is possible for a company to adjourn the annual general meeting in case the accounts are not ready without complying with the requirements of Section 210 of the Act. In this connection, it may be stated that it is mandatory on the part of the Board of directors of the company to lay the accounts at every annual general meeting within the statutory period, as laid down in Sub-section (3) thereof. In case the annual general meeting is held in accordance with the provisions of Section 166 of the Act, and the accounts are not placed thereat, the same not being ready, it is no doubt open to the company concerned to adjourn the said annual general meeting to a subsequent date for laying the accounts but then, the adjourned annual general meeting must itself be held within the statutory period (including the period of extension thereof, if any allowed, as provided in Section 166(1)). That being so, procedure of adjourning the annual general meeting cannot be so adopted as to bypass the provisions of Section 210 of the Act. Thus, in case the accounts are not placed at the annual general meeting or the adjourned annual general meeting, in either case, within the statutory period laid down in Sub-section (3) of Section 210 of the Act, the delinquent directors are liable for prosecution under Sub-section (5) thereof. In this connection, a reference may be made to decision of the Division Bench of the Calcutta High Court in *Bejoy Kumar Karnani v. Assistant Registrar of*

Companies (W.B.), (1985) 58 Com Cases 293 (1985) 1 Comp LJ 21 (Cal), wherein it has been held that if the said Circular dated February 2, 1974, is to be literally construed divorced of the provisions of Sections 166 and 210 of the Act, such adjournments may go on *ad infinitum* and in such an event not only the provisions of Section 166 but also the provisions of Sections 168 and 210 of the Act would be rendered negatory, leading to chaos and confusion in the matter of enforcement of the relevant provisions of the Act by the Registrar of Companies." [Circular No. 8/1 (2)/220/85-CL.V., 2 of 1985, dated 25th March, 1985].

In the view of the Department of Company Affairs also vide Circular No. 2/85 dated 25.3.1985, it is not possible for a company to adjourn Annual General Meeting in case accounts are not ready without complying with the requirements of Section 210. The Circular No. 35/9/72-CL II dated 2.2.1974 of Department of Company Affairs cannot be taken for support for by passing obligations of Section 210.

As per Section 220, as amended by Amendment Act of 1988, a company is required to file the balance-sheet etc. with the Registrar even if the Annual General Meeting is not held in time and is adjourned for any reason without adoption thereof.

The fact of not holding the annual general meeting cannot be pleaded in defence to a prosecution for failure to file the balance-sheet etc. under Section 220. Each of them is an independent requirement and default to comply with either constitutes a separate offence punishable separately.

If after the Board of directors of a company failed to convene the annual general meeting despite the directions of the Court and another Board of directors was elected, the latter Board can neither be disqualified nor be held liable for failure of the previous Board to hold the annual general meeting as per Court Order [*Dirkar Rai D. Desai v. R.P. Bhasin* (1982) 3 Comp LJ 198 (Del)].

Again, if, at the time the annual general meeting is due to be held, there is only one shareholder (the other having died), no offence is committed when the annual general meeting is not held. [*State of Kerala v. West Coast Planners Agencies Pvt. Ltd.* (1958) 28 Com. Cas. 13].

Consideration of Accounts of More than One Year at Annual General Meeting

The scheme of the Companies Act contemplates that there shall be at least one annual general meeting in the course of one year. The Annual General Meeting shall be in relation to the financial year as defined under Section 210(4) and the business to be transacted at the annual general meeting must be in respect of the financial year. On that account, it is not open to the company to submit accounts for consideration at an annual general meeting of the Company in respect of more than one year. For consideration of the Balance Sheet and Accounts of the Company, there must be an Annual General Meeting and the accounts must be considered at such meeting or at an adjourned annual general meeting.

Cancelling/Postponing of Convened General Meeting

Directors who have issued notice of Annual General Meeting for a particular date have the power to postpone the date for valid, *bonafide* and proper reasons [*Raj Pal Singh v. State of U.P* (1968) Comp LJ 21]. The more proper course would be for the

Board not to postpone the meeting but to hold the convened meeting and then have the matter decided at the adjourned meeting.

In *Smith v. Paranga Mines Ltd.*, (1996) 2 Ch 193, the Board of directors gave notice of a general meeting and later desired to adjourn by a subsequent notice. It was held that the Board of directors does not have this power. The best course would be to hold a meeting and then adjourn it to any future convenient date.

Object of holding an Annual General Meeting

An annual general meeting is an important meeting for safeguarding the interests of the shareholders of a company. Since the ultimate control of the company should vest in the hands of the shareholders, it is desirable, and, necessary that they should meet at least once every year to review the working of the company during the previous year. This meeting affords an opportunity to the shareholders to meet and discuss about the working of the company. The annual general meeting is particularly important because of the business essentially transacted at this meeting.

Business transacted at an Annual General Meeting

Section 173 of the Companies Act lays down that all business to be transacted at an annual general meeting shall be deemed Special Business with the exception of the Ordinary Business, relating to:

- (a) the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors;
- (b) the declaration of dividend;
- (c) the appointment of directors in the place of those retiring; and
- (d) the appointment of, and the fixing of remuneration of the auditors.

At the annual general meeting, all other business is special business. At an extraordinary general meeting, every business is special business.

Applicability of provisions of Sections 171 to 186

Section 170 of the Act provides that —

- (i) Notwithstanding anything contained contrary in the Articles, the provisions of Sections 171 to 186 apply to all public companies and private companies which are subsidiaries of public companies.
- (ii) In the case of other private companies also the provisions of these sections will apply unless otherwise specified or unless the articles of the Company provide otherwise. A private company which is not subsidiary of a public company may exclude the application to itself of the provisions of any of these sections (excepting provisions in any of these sections expressly made applicable to all private companies such as Sub-section (1) of Section 174) and unless like in Section 182, it is stated that the provisions of the section would not apply to a private company.

Sub-section (2) of Section 170 provides that

- (a) Section 176, with such adaptations and modifications as may be prescribed

[i.e. by Rules made by the Central Government - Cf. Section 2 (33)] will apply to meeting of any class or classes of members or of debenture-holders and any class of debenture-holders of a company, in like manner as it applies with respect to general meetings of a company.

- (b) The other Sections 171 to 175 and 177 to 186 will apply to such class of meetings to the extent to which the articles of the company whether public or private do not provide otherwise.

(iii) Extraordinary General Meetings

All the general meetings of a company, with the exception of the statutory meeting and the annual general meetings, are called extraordinary general meetings.

Types of Business Transacted at Extraordinary General Meetings

As already stated according to the provisions of Section 173 of the Companies Act, 1956 all the business to be transacted at an Extraordinary General Meeting with the exception of business relating to:

- (i) the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors,
- (ii) the declaration of a dividend,
- (iii) the appointment of directors in the place of those retiring, and
- (iv) the appointment of, and the fixing of the remuneration of the auditors

shall be deemed special. In the case of any other meeting, all business shall be deemed special. At the Extraordinary General Meeting, only special business which arises between two Annual General Meetings being urgent and cannot be deferred to the next Annual General Meeting, is transacted.

Who may Convene Extraordinary General Meetings

Usually the articles of association of companies contain provisions with regard to the calling of extraordinary general meetings.

Regulations 47 and 48 in Table A of Schedule I to the Companies Act, 1956 contain the following provisions:

“Regulation 47: All general meetings other than annual general meetings shall be called extraordinary general meeting.

“Regulation 48: (1) The board may, whenever it thinks fit, call an extraordinary general meeting.

(2) If at any time, there are not within India directors capable of acting who are sufficient in number to form a quorum, any director or any two members of the company may call an extraordinary general meeting in the same manner, as nearly as possible, as that in which such a meeting may be called by the Board.”

Notice of a general meeting given by secretary without the sanction of the directors or proper authority is invalid [*Re: State of Wyoming Syndicate* (1901) 2 Ch 43]. A meeting convened as a meeting of the directors may be valid as a meeting of

the company if all the members are present [*Re: Express Engineering Works* (1920) 1 Ch 466].

Calling of Extraordinary General Meeting on Requisition

Section 169 of the Companies Act, 1956 provides:

- (1) The Board of directors of a company shall, on the requisition of such number of members of the company as is specified in Sub-section (4), forthwith proceed duly to call an extraordinary general meeting of the company.
- (2) The requisition shall set out the matters for the consideration of which the meeting is to be called, shall be signed by the requisitionists, and shall be deposited at the registered office of the company.
- (3) The requisition may consist of several documents in like form, each signed by one or more requisitionists.
- (4) The number of members entitled to requisition a meeting in regard to any matter shall be:
 - (a) In the case of a company having a share capital, such number of them as hold at the date of the deposit of the requisition, not less than one-tenth of such of the paid-up capital of the company as at that date carries the right of voting in regard to that matter;
 - (b) In the case of a company not having a share capital, such number of them as hold at the date of the deposit of the requisition, not less than one-tenth of the total voting power of all the members having at the said date a right of vote in regard to that matter;
- (5) Where two or more distinct matters are specified in the requisition, the provisions of Sub-section (4) shall apply separately in regard to each such matter; and the requisition shall accordingly be valid only in respect of those matters in regard to which condition specified in that sub-section is fulfilled.
- (6) If the Board does not, within twenty-one days from the date of the deposit of a valid requisition in regard to any matter, proceed duly to call a meeting for the consideration of those matters on a day not later than forty-five days from the date of the deposit of the requisition, the meeting may be called—
 - (a) by the requisitionists themselves;
 - (b) in the case of a company having a share capital, by such of the requisitionists as represent either a majority in value of the paid-up share capital held by all of them or not less than one-tenth of such of the paid-up share capital of the company as is referred to in clause (a) of Sub-section (4), whichever is less; or
 - (c) in the case of a company not having a share capital, by such of the requisitionists as represent not less than one-tenth of the total voting power of all the members of the company referred to in clause (b) of Sub-section (4).

The word 'valid' used above has no reference to the object of the requisition but rather to the requirement of section itself as to its contents; number of signatories

etc. and it would not be open to the Board of directors of a company to refuse to act on a requisition on the grounds that although such requisition was in accordance with the requirements of Section 169 it was otherwise invalid. [*Cricket Club of India Ltd. v. Madhav L. Apte* (1975) 45 Comp. Cas. 574 (Bom.)].

- (7) A meeting called under Sub-section (6) by the requisitionists or any of them—
- (a) shall be called in the same manner as nearly as possible as that in which meetings are to be called by the Board;
 - (b) shall not be held after the expiration of three months from the date of the deposit of the requisition.

Sub-section (9) of Section 169 provides that any reasonable expenses incurred by the requisitionists by reason of the failure of the Board to duly call a meeting shall be repaid to the requisitionists by the company; and any sum so repaid shall be retained by the company out of any sums due or to become due from the company by way of fees or other remuneration for their services to such of the directors as were in default.'

However, it has been held in *A.D. Chaudhary v. Mysore Paper Mills Ltd.* (1976) 46 Comp. Cas. 548, that the Board of directors is right in refusing to call and hold an extraordinary general meeting on the requisition of members where an order of injunction restraining the company from holding any meeting is in force.

The Supreme Court has in the case of *Life Insurance Corpn. of India v. Escorts Ltd.* (1986) 59 Comp. Case. 548 held that every shareholder of a company has a right to requisition an extraordinary general meeting in accordance with the provisions of the Companies Act. He cannot be restrained from requisitioning an extraordinary general meeting and he is not bound to disclose the reasons for the resolutions proposed to be moved at the meeting.

Under Section 173(2) of the Companies Act, a duty has been cast on the management to disclose, in an explanatory statement all material facts relating to every special business coming up before the general meeting to enable the shareholders to form a judgement on the business before them. The Act contains no provision requiring the shareholders requisitioning a meeting to disclose the reasons for resolutions, which they propose to move at the meeting.

In convening a requisitioned meeting a company's role is limited to forwarding of material received by it from requisitionists to all members and nothing more and where company had reproduced explanatory statement as given by requisitionists, even assuming that explanatory statement attached by company did not reveal alleged material particulars, company could be said to have complied with provisions of law and as such, resolution passed in meeting would be valid. [*Vijay M. Porwal v. Pentokey Organy (india) Ltd.* [1995] 6 SCL 123].

Calling of Extraordinary General Meeting by Company Law Board

Section 186 of the Companies Act, 1956 provides:

“(1) If for any reason it is impracticable to call a meeting of a company, other than

an annual general meeting, in any manner in which meetings of the company may be called, or to hold or conduct the meeting of the company in the manner prescribed by this Act or the articles, the Company Law Board may, either of 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 —

- (a) order a meeting of the company to be called, held and conducted in such manner as the Company Law Board thinks fit; and
- (b) give such ancillary or consequential directions as the Company Law Board thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act and of the company's articles.

It should, however, be noted that this section even permits Company Law Board (earlier “the Court”) *suo-moto* to call a meeting of the company where it has become impracticable to call a meeting other than an annual general meeting [*Smt. Jain v. Delhi Flour Mills Co.* (1974) 44 Comp. Cas. 228 (Delhi)].

(2) Any meeting called, held and conducted in accordance with any such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.”

A meeting which is not conducted in accordance with directions of Company Law Board is not a meeting contemplated under Section 186(2) and business conducted in that meeting will be invalid.

For seeking an order of the Company Law Board to convene an extraordinary general meeting of the company, a petition under the Company Law Board Regulations, 1991, is required to be preferred.

In *Re. Lothian Jute Mills Ltd.* (1950) 55 CWN 646, there was a dispute between the shareholders of a company as to who were lawful directors of the company entitled to call a meeting of the company. The word impracticable has been held to mean impracticable from a reasonable point of view. It was held to be proper that the Company Law Board should step in and call a meeting, the validity of which is beyond question. “The Company Law Board will interfere very sparingly, and only when the application has been made *bona fide* in the larger interests of the company for removing the deadlock [*In Re. Ruttonjee & Co. Ltd.* (1968) 2 Comp. L.J. 155].

The Company Law Board may exercise the power to order a meeting to be convened even though it is opposed by some of the shareholders. [*Re. El. Sombrero Ltd.* (1958) 3 All E.R.].

If there is no allegation of impracticability of holding the meeting, the Company Law Board will direct the holding of the meeting [*In Re. Edward Ganj Public Works A.P. Ltd.* (1977) 47 Comp. Cas. 283].

Further the Company Law Board (earlier “the court”) has no power to make an order regarding holding and conducting of a meeting which has already been called under Section 186. [*R. Rangachari v. Suppiah* (1975) 45 Comp. Cas. 641 (S.C.)].

Where there were disputes among members of an association and the members

formed two rival groups running two parallel organisations, holding separate meetings and appointing separate sets of office-bearers and claiming separate places as the registered office of the association, it was held that there was sufficient material before the Board to come to the conclusion that the calling of a meeting through the domestic forum would be impracticable. Section 186 empowers the Company Law Board to give ancillary and consequential directions in relation to the meeting as is considered expedient; the Board¹/Tribunal² could, therefore, decide to allow undisputed nominees to attend the meeting so that an effective meeting could be held, because allowing nominees to attend the meeting would defeat the meeting. [*Baptist Church Trust Association and Another v. Member, Company Law Board & Others* (1986) 60 Comp. Case 381 (Cal.)].

Company Law Board dismissed the application by the applicant requisitioning EGM, where the applicant had not satisfied provisions of Section 186 of the Act in terms of want of a list of the shareholders of the company. But as no material was found to show that the applicant had called upon the company to furnish the same, Company Law Board came to the conclusion that there was no impracticability for the applicant to convene the extraordinary general meeting. [*United Shippers Ltd. v. Aluminium Industries Ltd.* (2006)].

(iv) Class Meetings (Section 106)

Class meetings are those meetings which are held by holders of a particular class of shares, e. g. preference shares. Need for such meetings arises when it is proposed to vary the rights of a particular class of shares. Thus, for effecting such changes, it is necessary that a separate meeting of the holders of that class of shares is held and the proposed variation is approved at the meeting. For example, for deciding not to pay the arrears of dividends on cumulative preference shares, for which it is necessary to call a meeting of such shareholders and pass the resolution as prescribed by Section 106 of the Act.

(II) MEETINGS OF DEBENTUREHOLDERS

When a company issues debentures it provides in the trust deed executed for securing the issue for the holding of meetings of debentureholders and also gives power to them to vary the terms of security or to alter their rights in certain circumstances. All matters connected with the holding, conduct and proceedings of the meetings of the debentureholders are given in the Debenture Trust Deed. The decisions arrived at such meetings with the requisite majority, are valid and binding upon the minority.

Very often a provision is made in the Debenture Trust Deed to dispense with the holding of the meeting of the debentureholders. A provision is made whereby a resolution by circulation duly signed by the debentureholders would be treated as the decision of the debentureholders. In such a case, it is not necessary to adopt the procedure for convening and holding a meeting of the debentureholders.

(III) MEETING OF CREDITORS

Sometimes, a company, either as running concern or in the event of winding up,

has to make certain arrangements with its creditors, which has to be worked out in meetings of creditors. Strictly speaking, meetings of creditors are not company meetings. Section 391 to 393 of the Act authorise the company to enter into arrangements with the creditors with the sanction of the Court. The Court on application, may order the holding of creditors meeting. If the scheme of arrangement is agreed to by majority in number holding debts to the value of three-fourths of the total value of the debts, the Court may sanction the scheme. A certified copy of the Court's order is then filed with the Registrar and it is binding on all the creditors and the company only after it is filed with the Registrar.

When a company goes into liquidation, a meeting of creditors and of contributories is held to ascertain the total amount due by the company to its creditors and also to appoint a liquidator to wind up the affairs of the company.

(IV) MEETINGS OF THE BOARD OF DIRECTORS

The affairs of a company are managed by Board of directors. It is, therefore, necessary that the directors should often meet to discuss various matters regarding the management and administration of the affairs of the company in the best interests of the shareholders and the public interest.

The power of directors may be grouped under three heads:

(1) *Powers exercisable only at meetings of the Board.*

These comprise the following:

- (a) the power to make calls on shareholders [Section 292(1)(a)].
 - (aa) the power to authorise the buy back referred to in the first proviso to clause (b) of Sub-section (2) of Section 77A [Section 292(1)(aa)].
 - (b) the power to issue debentures and borrow moneys otherwise than on debentures [Section 292(1)(b) and (c)];
 - (c) the power to invest the company's funds and make loans [Section 292(1)(d) and (e)];
 - (d) the delegation of the power to borrow (otherwise than by the issue of debentures which cannot be delegated), and to invest and make loans can also be effected only by means of resolutions passed at meetings of the Board [Section 292(1) proviso and (2), (3) and (4)];
 - (e) the filling of casual vacancies on the Board (Section 262);
 - (f) appointing as managing director or manager a person who is managing director or manager of another company (Sections 316 and 386);
 - (g) giving consent to contracts of company with any director or his relative, firm, private company etc. in which he has interest (Section 297);
- (2) Powers exercisable (in the case of a public company or a private company which is subsidiary of a public company) only with the consent of the company in general meeting:
- (a) the power to sell, lease, otherwise dispose of the whole or substantially

- the whole of the undertaking of the company [Section 293(1)(a)];
- (b) power to remit debt due by a director to the company [Section 293(1)(b)];
 - (c) power to borrow in excess of capital and reserves of the company [Section 293(1)(d)];
 - (d) power to contribute to charities not directly relating to the business of the company [Section 293(1)(e)];
 - (e) power to invest otherwise than in trust securities compensation amounts received on compulsory acquisition of any of its undertaking referred to in clause (a) of Section 293(1);
- (3) the power to appoint sole selling agents (Section 294(2)).
- (4) All other powers which, subject to the provisions of the Act, the company is authorised to exercise. These may be exercised either at meetings of the Board or by circular resolutions (Section 289) or by delegating the same to committees or others.

Section 285 of the Act prescribes that in the case of every company, a meeting of the Board of directors shall be held at least once in every three months and at least four such meetings shall be held in every year. It has been clarified so long as four board meetings are held in a calendar year, one in each quarter, the interval between two meetings may be more than three months. For instance, if a meeting is held on January 1, the next meeting may be held on June 30, the third on 1st July and the fourth on the 31st December.

However, Clause 49 of listing agreement as inserted vide SEBI F.No. SMDRP/ Policy Cir. 10/2000 dated 21/2/2000, requires the listed companies to which this clause is applicable to hold at least four Board meetings in a year with a maximum time gap of four months between any two meeting.

Notice of Board Meetings

Section 286 of the Companies Act prescribes: "(1) Notice of every meeting of the board of directors of a company shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.

(2) Every officer of the company whose duty it is to give notice as aforesaid and who fails to do so shall be punishable with fine which may extend to one thousand rupees."

The notice should contain the time, date and place of meeting. Section 286 does not provide for a minimum days for giving a notice for convening a Board meeting. However, the articles of a company may prescribe such time-limit. It has been held that even a few hours notice would suffice. [*Browne v. La Trinidad*, (1887) 37 Ch D 1 (CA)]. However, in another case it was held that a few hours' notice was not sufficient because the Board meeting was held by certain directors, who wanted to ensure that by giving a short notice the other directors would not be able to attend the same. [*In Re, Homer District Consolidated Gold Mines*, (1988) 39 Ch D 546 (CA)].

It would, of course, be sufficient compliance with the provisions of Section 286 if, for instance, the directors are duly informed that in future the meeting would be held on the first Saturday of every month. But even then the notice of meeting should be given.

Notice must be given even to a director who has stated that he will be unable to attend the meeting.

If notice of the meeting is not given to one of the directors, meeting of Board of directors is invalid and resolutions passed are inoperative. [*Parmeshwari Prasad Gupta v. Union of India* (1947) 44 Comp. Cas. 1 (SC)]. Where, however, notice is not given as required but all the directors attend the meeting and do not object to the absence of notice, the proceedings of the meeting will not be invalid. [*Bharat Fire and General Insurance Co. Ltd. v. P.P. Gupta* (1974) Comp. Cas. 1 (S.C.)].

If, by an accidental omission the notice is not given to any director and a meeting of the Board of directors is held, it is rendered irregular. If the directors nevertheless transact business on behalf of the company at such a meeting. e.g. allot shares, make contracts etc. the rule of indoor management as laid in *Royal British Bank v. Turquand* applies where outsiders will not be prejudiced by such irregularities if they have no notice of them. A subsequent regularly constituted board meeting may ratify and confirm what was done irregularly, and it will then be valid *ab initio*.

There is no provision in the Act for notice of adjourned meeting and the Articles of Association may provide for the same. [*Promod Kumar Mittal v. Southern Steel Ltd.*, (1980) 50 Com Cases 555]. Since an adjournment is only a continuation of the meeting, the notice for the first meeting holds good for all the adjournments. [*Kerr v. Wilkie*, (1860) 1 LT 501]. However, notice of adjourned meeting may be given to directors, who did not attend the original meeting. Where the meeting is adjourned *sine die*, a fresh notice must be given. Where new business is to be transacted, a fresh notice would be required.

A director is entitled to a notice even though he is residing abroad provided he has furnished his address to the company for sending such notice to him as the right to receive notice cannot be waived. [*H.M. Ebrahim Sait v. South Indian Industrial Ltd.* (1938) 8 Com Cases 308]. Exception can be made in cases where the Board has decided to meet at fixed intervals. It is necessary to send notice to each and every director who is for the time being in India, even if a particular director has informed the company about his inability to attend the meeting.

When it is known to the directors that one of their colleagues is residing mostly out of India and they give him a notice of the Board meeting at his local address, it is quite obvious that the notice is inadequate and it may not even reach him. Such conduct would show lack of probity and fair play on the part of the directors incharge of the company's affairs. It was held that the meeting and allotment of shares at the meeting could be declared as null and void. [*Kamal K. Dutta (Dr.) v. Ruby General Hospital Ltd.* (2000) 36 CLA 214, 231 (CLB-PB)].

If the articles are silent; the notice can be sent by pre-paid post or hand delivery. Notice sent by fax is adequate notice [*Ferruccio Sias v. Jai Manga Ram Mukhi*, (1994) 1 Comp L.J. 345 (Del.)]. But where a director gives specific directions about serving notices, they must be adhered to as far as practicable.

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

If notice of the meeting is not given to one of the directors then the meeting of Board of Directors is invalid.

- True
- False

Correct answer: True

Time and Place of Board Meetings

Unlike the provisions of Section 166, which require the Annual General Meeting of the company to be held at the registered office of the company during the working hours and on a day that is not a public holiday, there are no such restrictions in the Act regarding the meeting of the Board of directors. The meetings of the Board of directors may, therefore, be held at any place convenient to the Directors outside the business hours and even on a public holiday unless the articles provide otherwise.

It has to be noted that there is no restriction regarding the holding of Board meetings on any day, even if it be public holiday unless the articles provide otherwise. But if, for want of quorum, a Board meeting has to be adjourned to the same day next week as required by Sub-section (1) and if that day happens to be a public holiday, the adjourned meeting should be held on the next day succeeding the holiday or if that is a public holiday, till the next succeeding day which is not a public holiday at the same time and place. The Department has clarified in connection with Section 285 that it would not raise any objection if an adjourned Board meeting is held on 'a public holiday, for the convenience of the directors although it considers that an original meeting should also normally be held only on working day. [(Letter No 8/11 (285) 63-PR dated 2-1-1963].

Section 301(5) of the Companies Act, 1956 provides, *inter alia* that the Register of Contracts shall be kept at the registered office of the company. Accordingly, if a Board meeting is held at a place other than the registered office, it will involve removal of the register of contracts outside the registered office.

However, it has been clarified that it would be sufficient compliance with the requirements of Section 301(5) of the Act if the company gives adequate notice to its shareholders either once for all or from time to time indicating the precise periods during business hours and the dates on which they could inspect the register under Section 301(2) at the registered office of the company. In view of the Government's clarification it is apparent that it is legally possible to hold board meetings at any place if the requisite notice regarding inspection of register of contracts to shareholders has been given.

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

There is no restriction regarding the holding of Board meetings on any day.

- True
- False

Correct answer: True

Agenda of Board Meeting

The law does not require that an agenda for meeting of the directors shall be compulsorily sent. At this point a comparison of Section 172 (dealing with general meeting) with Section 286 (dealing with board meetings) is relevant. Section 172(1) provides that every notice of a meeting of a company shall specify the place and the day and hour of the meeting and shall contain a statement of the business to be transacted thereat. Section 286 requires that notice of every meeting of the Board of Directors of a company shall be given in writing to every director. Any business whatsoever, thus can be transacted at a board meeting, while the shareholders are required to be informed in advance of the agenda in the case of a general meeting.

But even in the case of a Board meeting a few sections e.g., Section 316 (appointment as managing director of a person who is already managing director/manager of another company); and 386 (appointment of a person as manager who is already managing director/manager of another company), stipulate that notice of the resolution to be passed thereat is required to be given to the directors in India. It would follow, therefore, that in such cases it would be incumbent on the company to circulate the agenda along with a copy of the proposed resolution in respect of every such item. Apart from the foregoing, in view of the enormity of problems faced by the companies and the number of important matters coming up for decision before the Board, if details of the items for discussion in the Board meetings are not circulated in advance, no meaningful discussion can take place in the Board meeting for none of the outside directors will be aware of the matters to be discussed in Board meetings. Therefore, good practice demands that the agenda containing business to be transacted is circulated preferably along with the notice at least a week before the date of the meeting. Most of the well-managed companies follow this practice.

The agenda should contain notes on the items to be discussed and should be circulated in advance so that the directors come to the meeting fully prepared to contribute their best to the deliberations on each item of business so that decisions taken at each Board meeting are sound and the best.

Usually a good part of the Board meeting agenda consists of routine items, the drafting of which does not pose any problem. But, where there are important items also, like reports on the working of the company, approval of capital projects, matters calling for major policy decisions etc., agenda preparation requires drafting skill.

In the case of the progress report, it would be useful for directors if brief notes on the present working of the company with comparative figures of the earlier period are given in tabular form. Detailed information with regard to working of each Division, Department or Branch or Segment of the company's activities should be attached as an annexure.

Likewise, in the case of capital projects, it would facilitate their consideration by directors if a short note is circulated along with the project report giving its justification, estimated expenditure to be incurred, mode of financing, expected return and probable time by which the project is likely to be completed.

As regards the items of business requiring policy decisions they must be very carefully and precisely written so that the directors can deliberate upon them in detail, consider every angle and take decisions in respect thereof.

It is advisable to circulate along with the notes on agenda, the proposed resolutions to be moved at the meeting and to be passed by the directors. If the directors have suggestions with regard to the proposed resolutions, they may offer the same at the meeting and have the proposed resolutions suitably amended. The agenda for the Board meetings should be conveniently grouped and divided so that minimum time and energy of the directors are consumed on less important items. Routine items are generally placed in the beginning and items which require detailed consideration are taken up thereafter.

Participation by Directors in the Board Meeting through Electronic Mode.

It has been discussed earlier in this Chapter.

Resolutions Passed by Circulation by Directors

According to the provisions of Section 289 of the Companies Act, 1956, the right to pass a resolution by circulation has been given only to the directors and their committees. No such resolution will be deemed to have been duly passed unless (1) it has been circulated in draft form together with necessary papers, if any, to all the directors or to all members of the Committee of Directors, then in India, and to all other directors, or members at their usual address in India, and (2) it has been approved by such of the directors as are then in India or by a majority of them, as are entitled to vote on the resolution. The number of directors or members in India to whom the resolution is circulated should not be less than the quorum fixed for a meeting of the Board or the Committee, as the case may be.

The passing of resolutions by circulation does not dispense with the statutory requirement of holding the Board meeting at least once in every three months. Where a resolution is passed by circulation, it should be got formally noted at the next Board meeting and recorded in the Minutes Book.

The articles of association usually provide provisions for passing of board resolution by circulation. Regulation 81 of Table A contains a provision in this regard. It states that save as otherwise expressly provided in the Act, a resolution in writing signed by all the members of the Board or of a committee thereof, for the time being entitled to receive notice of a meeting of the Board or committee, shall be as valid and effectual as if it had been passed at a meeting of the Board or committee, duly convened and held.

Matters which cannot be decided by circular resolution

The opening words in Regulation 81 of Table A, namely "Save as otherwise expressly provided in the Act" indicate that those matters which, by the provisions of the Act, are required to be decided at meetings of the Board cannot be decided by circular resolutions. These matters are as follows:—

- (1) To fill a casual vacancy occurred in the Board [section 262(1)].
- (2) Power to make calls on shareholders in respect of money unpaid on shares, [section 292(1)(o)].

- (3) To authorise buy-back of securities upto ten percent of the total paid-up equity capital and free reserves [section 292(1)(aa)].
- (4) Power to issue debentures [section 292(1)(&)].
- (5) Power to borrow moneys otherwise than on debentures. [section 292(1)(c)].
- (6) Power to invest the funds of the company. [section 292(1)(d)].
- (7) Power to make loans [section 292 (l)(e)].
- (8) Power to delegate to any committee of directors, managing director, manager or any other principal officer of the company or in the case of branch office of the company, a principal officer of the branch office, the powers specified in clauses (c), (d) and (e) of sub-section (1) of section 292 [proviso to section 292(1)].
- (9) Decision to make any political contribution [section 293A(2), proviso]
- (10) Disclosure of interest by a director who is in any way directly or indirectly concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into on behalf of the company [section 299(1)].
- (11) To give general notice of interest specifying firms or bodies corporate in which the director may be deemed to be concerned or interested [section 299(3)(c)].
- (12) To accord consent to a contract in which a director or other specified persons are interested [section 297(4)].
- (13) To give a notice of disclosure of interest by a deemed director under section 307 [section 308(2)].
- (14) In the case of a public company or a private company, if it is a subsidiary of a public company, to appoint a person as a managing director, if he is already a managing director or manager of any other company, by an unanimous resolution [section 316(2)].
- (15) To invest in the shares of any other body corporate within the limits specified in sub-section (2) of section 372 [section 372(5)].
- (16) In the case of a public company or a private company, if it is a subsidiary of a public company, to appoint a person as a manager, if he is already a manager or managing director of any other company, by an unanimous resolution [section 386(2)].
- (17) To make a declaration of solvency where it is proposed to wind up the company voluntarily [section 488(1)].

Minutes of the Board Meetings

Section 193 requires that the minutes of the meetings of the Board of Directors should be maintained in a separate book meant for that purpose. The minutes book is to be bound and its pages should be consecutively numbered.

While preparing minutes of the proceedings of the meetings of the Board of

directors of a company, there are certain important statutory requirements, which should be taken care of. They are:

- (a) to give names of the directors present at the meeting;
- (b) to give names of the directors absent and requested for the grant of leave of absence by the Board;
- (c) to give names of the directors voting for or against the various resolutions under respective items of business;
- (d) to read notice given by directors, if any, with regard to their directorships in other companies as per Section 299(3) and their shareholdings as per Section 308 of the Act;
- (e) to specifically mention the fact of unanimity of decisions of directors as contemplated by Sections 316, 372A and 386;
- (f) to incorporate the resolutions for appointments of officers made at the Board meetings.

It is not obligatory to wait for the next Board Meeting in order to have the minutes of the previous meeting signed. Such minutes may be signed by the Chairman of the Meeting at any time before the next meeting is held.

Where there is a practice of presenting the minutes of a meeting for confirmation by the Board of Directors at the next meeting, it must be noted that if such minutes have already been signed by the Chairman of the meeting concerned, the minutes attract the presumption that until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat have duly taken place. It will be possible to have alteration in the minutes of the meeting only by way of fresh resolution in the Board Meeting in which the minutes of the meeting in question are discussed. Even if the minutes have not been signed but have been approved by the Chairman of the meeting concerned, the same position as indicated above will prevail. [Letter No. 8/2 (Misc) 75-CL dated. 5.5.75].

While drafting minutes of the Board meetings with regard to the delegation of powers, both financial and administrative, to officers, care should be taken to draft the resolutions in such a manner so as to provide for automatic cancellation of the powers delegated when the delegate ceases to be in employment of the company. Likewise, during the course of employment of a person in the company, the designation of delegates are frequently changed on promotion or otherwise. Care should be taken so that necessity of going to the Board too often may be avoided. In such cases, it will be useful to adopt the following type of a resolution:

“Resolved that the following powers be and are hereby delegated to Sarvashri X,Y and Z and they are empowered to exercise the powers so long as they are in the service of the company and notwithstanding change in their designations”.

Quite often it becomes necessary to revise the delegation of powers consequent upon the cessation of service of the delegates or the necessity of further delegation to provide for smooth flow of work in the organisation. Usually, in such cases, the original resolution delegating powers is modified to provide for the above. More often than not such modification of the earlier resolution may lead to the cancellation of the

entire delegation. Therefore, great care has to be taken in drafting of the resolution modifying the earlier delegation. Alternatively, in such cases, it is advisable to pass a fresh resolution so that all concerned including banks are clear as to whom and what powers have been delegated. The latter course is preferable.

As the minutes books of the meeting of Board of directors or of the general meeting of company are primary documents and are evidence of the proceedings recorded therein and where minutes are duly drawn and signed, presumption as specified in Section 195 of the Act are required to be drawn until the contrary is proved. It has been provided in the Act that the minute books should be kept at the registered office of the company (File No. 8/16 (1)/61 - PR).

Section 193 of the Act requires that minutes of the meeting should be recorded within thirty days and signed either by the Chairman of that meeting or by the Chairman of the next meeting.

Quorum of Directors

Quorum is the minimum number of directors required to be present to validly transact any business. The directors cannot proceed with a meeting unless the required quorum of directors is present. Provision for quorum for meeting of directors is not directory but it is mandatory. Any decision taken by a lesser number than the quorum is void [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 50 Comp. Case. 743 (SC)].

Section 287(2) has fixed the quorum as one-third of the total strength of the Board (any fraction contained in that one-third being rounded off as one) or two directors, whichever is higher. If at any time the number of interested directors exceeds or is equal to two-thirds of total strength, the number of remaining directors present at the meeting being not less than two shall be the quorum during such time.

In this section "total strength" means the total strength of the Board of directors of a company as determined in pursuance of the Act after deducting therefrom the number of the directors, if any, whose places may be vacant at that time.

The expression 'total strength' means the actual number of directors for the time being occupying the office irrespective of the maximum number of directors as stipulated in the articles. In the case of *Pradip Kumar Banerjee v Union of India* (2002) 108 Comp Cas 692 (Cal):(2001) 32 SCL 84 (Cal):(2001) 40 CLA (Snr) 3 (Cal), the articles of association fixed the maximum number of directors at 15. There were only six directors actually holding the office. It was argued that at a meeting of the Board at that point of time there was no requisite quorum as there were only two directors present. The articles provided that the quorum for Board meetings shall be one-third of the total strength of the Board. The court held that, the meeting had the requisite quorum.

"Interested directors" means any director whose presence cannot be counted for the purpose of forming a quorum at a meeting of the Board, at the time of the discussion or vote on any matter i.e., a contract or arrangement in which he is in any way, whether directly or indirectly concerned or interested. It may be noted that in case of Board meetings quorum is required throughout the meeting.

It follows that quorum at a Board meeting must be a disinterested quorum. In other words, it must consist of directors who are entitled to vote on the particular motion before the Board. If a director is concerned or interested in a transaction, which is to be discussed, he is not counted for the purpose of quorum with respect to that particular item of business. In this context, reference may be made to the provisions of Section 300 which lays down that an interested director shall not vote on the contract or arrangement in which he is interested and also that his presence will not be counted for the purpose of quorum. These provisions do not apply to a private company.

As a rule, in the case of a meeting of the Board of directors, the meeting cannot transact any business, unless a quorum is present at the time of transacting the business. It is not enough that a quorum was present at the commencement of the business.

The quorum of the Board is required at every stage of the meeting and unless a quorum is present at every such stage, the business transacted is void [*Balakrishna v. Balu Subudhi*. AIR 1949 Pat 184].

Though Regulation 49 of Table A stipulates that no business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business. Where out of the three directors required to form a quorum, two had resigned, the court held that the single remaining director had the following three courses open to him: (1) He could get members to call a meeting under Section 169, (2) he himself could call an extraordinary meeting of the shareholders under the articles, or (3) he could move the court (Now CLB) to call a general meeting under Section 186 [*Sorabje v. Sind Punjab Co.*, (1906) 8 Com LR 478].

To deal with such circumstances Regulation 75 of Table A provides that if the number of directors is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum or for summoning a general meeting of the company, but for no other purpose. It has been held that where a single director is validly in office, he cannot act for anything else than for calling a general meeting for the purpose of appointing directors so as to complete the quorum. [*Rajan Nagindas Doshi v. British Burma Petroleum Co. Ltd.*, (1972) 42 Com Cases 197 (Bom)].

It is open to the company, by its articles, to indicate a higher, but not a lower, number or proportion in constituting a valid quorum. [*Amrit Kaur Puri v. Kapurthala Flour Oil & General Mills Co. P. Ltd.*, (1984) 56 Com. Cases 194 (P&H)].

That a meeting is valid or invalid one due to absence of quorum will have to be challenged by the person aggrieved within a reasonable time. [*Re, Plymoth Breweries v. Penwill*, (1967) 111 SJ 715].

As regards meeting of committees of directors where there is no provision of a quorum, the whole of the Committee must meet. [*Re Liverpool Household Stores Association Ltd.*, (890) 59 LJ Ch 616]. Any excessive or irregular exercise of powers by a Committee may, however, be ratified by the Board, as the Board by delegating the powers to Committees, do not divest themselves of powers. [*Huth v. Clarke*. (1890) 25 QBD 391].

If the required quorum is not present, then, unless the articles otherwise provide, a meeting cannot be held and must automatically stand adjourned till the same day in the next week, at the same time and place, and if that day is a public holiday, to the succeeding day (Section 288).

Where the articles of association of a company provided that the quorum for a meeting of the Board of directors shall be two directors and meetings called for was adjourned for want of quorum and in the adjourned meeting only one director was present, it was held that the resolution passed in that meeting was void. [*Maharani Yogeshware Kumari v. Lake Shore Palace Hotel* [1996] 21 CLA 107 (Raj.)].

If for want of quorum a meeting of the Board duly called cannot be held then this would not be deemed to have contravened the provisions of Section 285 which requires the holding of a Board meeting at least once in every three months [Section 288 (2)].

If at any time the number of directors falls below the number fixed as the minimum by the company's articles, the remaining directors *prima facie* cannot act. [*Re Alma Spinning Co. (1880) 16 Ch. D. 681*]. But where there is an article on the lines of article 75 of Table A, this will validate acts of the directors although they are less than the specified minimum. This provision does not make the acts valid if the minimum number of directors as required by the Articles were never appointed [*Re. Sly, Spink & Co. (1911) 2 Ch. 430*].

Disclosure of Interest

Section 300 prohibits an interested director from being counted for the purpose of quorum at the time of voting on any resolution in which he is interested. Disclosure of interest has to be made at meeting of the Board of directors. It has to be made formally, even if the interest in question is otherwise known to them. [*Guinness PLC v. Saunders* (1988) 2 ALL ER 940].

If a director of a company or two or more of them together hold not more than 2% of the share capital of another company, disclosure of interest is not necessary. The duty to disclose his interests applies also to alternate director or any other director, including a Government nominee appointed under Section 408.

Chairman of Board Meeting

The term "Chairman" is not defined in the Act though regulation 76(1) of Table A to Schedule I to the Companies Act, 1956 provides that the Board may elect a chairman of its meetings and determine the period for which he is to hold office. Normally, the directors elect one of them to be the chairman of the Board who continues to be as such until he ceases to be a director or some other director is appointed as the chairman. Basically, a chairman is a director who is authorised to preside over the Board and general meetings. In *Taylor v. Nesfield*, it was held that where a number of persons assemble and put a man on the chair, they devolve on him by agreement the conduct of that body and give him the whole power of regulating themselves individually, within reasonable bounds. In some companies it is the practice to appoint an Executive Director namely the Managing Director or whole-time director as chairman of the Board and there are other companies who elect a non-executive director, i.e. the director who is not a managing or whole-time director as chairman of the Board.

Regulation 76(2) provides that if no chairman is elected or if at any meeting the chairman is not present within five minutes after the time appointed for holding the meeting the directors present may choose one among them to be the chairman of the meeting.

(V) MEETINGS OF COMMITTEE OF DIRECTORS

Directors must, as a general rule, act at Board meetings. The maxim *delegates nonprotest delegate* — “A delegate cannot further delegate” — applies to directors as it applies to all agents. But this rule is not rigid. In accordance with the articles the delegation by the Board will be proper and valid. A delegation may be made by the Board of any of its powers to a Committee consisting of its own members if it is authorised by the articles or the Act or the Rules made under the Act.

A committee may consist of such number of directors as the Board may decide. But in terms of Issue of Share Certificate Rules, 1960 where a committee is appointed it shall consist of at least three directors where the strength of the Board exceeds six directors.

Section 292 specifically empowers the board to delegate the following powers among others to a committee of directors :

- (a) to borrow moneys otherwise than on debentures;
- (b) to invest the funds of the company; and
- (c) to make loans.

Regulation 77 of Table A specifically permits delegation, stating that the Board may, subject to the provisions of the Act, delegate any of its powers to Committees consisting of such number of its body as it thinks fit. Any Committee so constituted shall conform to any regulations that may be imposed on it by the board in the exercise of powers delegated to it. The resolution delegating the powers generally contains the extent of authority granted to the Committee. The Committee cannot further delegate its power unless specifically empowered or authorised in this regard.

Under Section 292A, every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as Audit Committee. Further, the **Audit Committee** which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.

The members of the Audit Committee shall elect a chairman from amongst themselves. The annual report of the company shall disclose the composition of the Audit Committee. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

The Audit Committee shall have authority to investigate into any matter in

relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.

The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board. If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor and communicate such reasons to the shareholders.

The chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.

According to clause 49 of the listing agreement, the audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise. The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

The provisions relating to the meetings of a Committee of directors are by and large the same as those of the Directors' Meetings. For example, a Chairman presides over the Meetings, questions arising at any meeting of a committee shall be determined by a majority of votes of directors present, and in case of equality of votes, the Chairman shall have a second or casting vote in case the Articles so provide. (Regulations 78-80 of Table A).

According to Section 193 minutes of the proceedings of a Committee of directors are also to be made and these are not open for inspection to general public.

PROVISIONS RELATING TO GENERAL MEETINGS

4. REQUISITES OF VALID MEETING

For a meeting to be valid the following conditions must be satisfied:

- (a) It must be duly convened. This means that (i) the person entitled to attend it must have been summoned by the proper authority, i.e., normally the chairman of the Board of directors, and (ii) proper and adequate notice must have been given to all those entitled to attend.
- (b) It must be properly constituted. This means that (i) the proper person must be in the chair, (ii) the rules as to quorum must be observed, and (iii) the provisions of the Act and the articles must be complied with.
- (c) The business at the meeting must be validity transacted and sense of the meeting ascertained on matter before it.

The conditions for a valid meeting are discussed herein below:

General Meeting to be Convened by Directors

The articles of association of a company normally empower the Board of

directors to convene general meetings, and they have this power at common law even if they are not expressly conferred on them. The directors must convene a general meeting when called upon to convene and hold it. When, therefore, directors wish, or are bound by a requisition, to call a general meeting, they must do so by resolution passed at a duly convened and constituted meeting of the Board. Notice of a general meeting given by the secretary without the sanction of the Board of directors is invalid, but such a notice may be ratified by the directors before the meeting. However, the notice for a general meeting shall be approved by the Board in advance.

Notice of Meeting

A meeting cannot be validly held unless a proper notice of it has been given. Three things in connection with the notice have to be considered, namely (a) length of notice, (b) to whom it must be given, (c) what should be its contents.

Length of Notice: Section 171(1) prescribes that a general meeting may be called by giving not less than twenty-one days notice in writing. But Section 171(2) provides that an annual general meeting may be called by giving a shorter notice, if it is consented to by all the members entitled to vote at the meeting. And any other meeting may be called and held with a shorter notice, if the holders of 95 per cent, of the paid-up share capital or of the total voting power consent to a shorter notice. The consent for shorter notice may be given either at or before the meeting in Form No. 22A as prescribed in the Companies (Central Government's) General Rules and Forms, 1956.

The expression "not less than twenty-one days" has been construed as twenty-one clear days, meaning thereby that the date of posting and the date of the meeting are excluded when calculating the period of twenty-one days. Intervening holidays are counted as period of notice. Further, if the notice is to be sent by post, another 48 hours are to be added. [Section 53(2)(b)(i)]. If a meeting is to be held on the 25th of a month, notice is to be dated and posted not later than 23 days before that date i.e. 2nd of the month.

A private company may, by its articles, make its own regulations as regards the length of notice. Notice of a meeting posted on August 31 and September 1, would be deemed to be delivered on September 2 and 3 therefore, ineffective for a meeting to be held on September 21 [*Balwant Singh Sethi v. Sardar Z.H. Singh Anand* (1988) 63 Com Cases 310 (Bom)]. The presumption as to deemed delivery cannot be agreed to, when at the time of posting, the post-office was on strike within the knowledge of the company. [*Bradman v. Trinity Estate PLC*. 1989 BCLC and 5 BCC 33].

Merely the fact that notice of a meeting of shareholders to be held under direction of the Court for consideration of a scheme of amalgamation, is delivered late to a shareholder owing to postal delays or omissions on the postal authorities, would not invalidate the meeting. [*Maknam Investments Ltd., In re* (1996) 87 Comp.Cas.689 (Ca.)].

Where a secretary issued notice calling a general meeting but he had no power to do so under the articles of association of the company, it was held that the notices

were null and void and meeting held pursuant thereto was also null and void. [*Al-Amin Seatrans Ltd. v. Owners and Party Interested in Vessel M.V. 'Loyal Bird'* (1996) 1 Comp. LJ 258 (Cal.)]. But it will be valid if before the meeting is held the Board ratifies the act [*Hooper v. Kevr Stuart & Co.* (1900) 83 Law Tunes 729]. A meeting convened by or under the authority of a Board which was subsequently found to have been irregularly constituted was however held to be not invalidated for that reason.

Which of the following Sections prescribes that a general meeting may be called by giving not less than 21 days notice in writing?

- (a) Section 171
- (b) Section 53
- (c) Section 193
- (d) Section 292

Correct answer: a

Service of Notice

Section 53 of the Companies Act provides "(1) a document may be served by a company on any member thereof either personally, or by sending it by post to him to his registered address, or if he has no registered address in India, to the address, if any, within India supplied by him to the company for giving notices to him.

- (2) When a document is sent by post:
 - (a) service thereof shall be deemed to be effected by properly addressing, prepaying and posting a letter containing the document, provided that where a member has intimated to the company in advance that documents should be sent to him under a certificate of posting or by registered post with or without acknowledgment due and has deposited with the company a sum sufficient to defray the expenses of doing so, service of the document shall not be deemed to be effected unless it is sent in the manner intimated by the member; and
 - (b) such service shall be deemed to have been effected:
 - (i) in the case of a notice of a meeting, at the expiration of forty-eight hours after the letter containing the same is posted, and
 - (ii) in any other case, at the time at which the letter would be delivered in the ordinary course of post.
- (3) A document advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly served on the day on which the advertisement appears, on every member of the company who has no registered address in India and has not supplied to the company an address within India for the giving of notices to him.
- (4) A document may be served by the company on the joint-holders of a share by serving it on the joint-holder named first in the register in respect of the share.
- (5) A document may be served by the company on the persons entitled to a

share in consequence of the death or insolvency of a member by sending it through the post in a pre-paid letter addressed to them by name, or by the title of representatives of the deceased, or assignees of the insolvent, or by any like description at the address, if any, in India supplied for the purpose by the persons claiming to be so entitled, or until such an address has been so supplied by serving the document in any manner in which it might have been served if the death or insolvency had not occurred”.

The Department of posts has recently discontinued the postal facility under ‘Certificate of Posting’ vide their letter dated 23.02.2011. Further, the information Technology Act, 2000 permits service of documents etc. in electronic mode.

Keeping in view of above, the Central Government vide its General Circular 17/2011 dated 21.04.2011 clarified that a company would have complied with section 53 of the Companies Act, if the service of document has been made through electronic mode provided the company has obtained e-mail addresses of its members for sending the notice/documents through e-mail by giving an advance opportunity to every shareholder to register their e-mail address and changes therein from time to time with the company.

In cases where any member has not registered his e-mail address with the company, the service of documents etc will be done by other modes of service as provided under section 53 of the Companies Act, 1956.

If a notice is served by advertisement, as above, it is not necessary to advertise along with such notice, the explanatory statement but it should be mentioned in the advertisement that such explanatory statement has been forwarded to the members of the company. This is in accordance with the proviso to Sub-section (2)(iii) of Section 172 of the Act.

Where the documents were sent by Registered Post and for some reason they were not delivered to the addressee, it could not be said that the company becomes discharged from its obligations to send the documents again [*Inter Sales v. Reliance Industries Ltd.* (1999) 35 CLA 370 (Cal.)].

When considering the provisions of Section 171, attention may also be given to Section 53. In terms of clause (b) (i) of Sub-section (2) of Section 53, service of a document sent by post in the case of notice of a meeting shall be deemed to have been effected at the expiration of 48 hours after the document is posted.

But in *Bharat Kumar Dilwali v. Bharat Carbon Ribbon Manufacturing Co. Ltd.*, (1973) 43 Comp. Cas. 197 (Delhi), the Court held that reference to Section 53(2) while interpreting Section 171 has no justification. The Court further held that for counting 21 clear days, each of the 21 days must be full or calendar days and the day of service of the notice and the day of the meeting have to be excluded. Thus if a notice is sent 23 days before the day of the meeting, it will be in order.

Entitlement of Notice

According to Sub-section (2) of Section 172 of the Act, notice of every meeting of the company shall be given to (i) every member; (ii) to the persons entitled to share in consequence of the death or insolvency of a member; and (iii) to the auditor or auditors for the time being of the company.

It is to be noted that preference shareholders are also entitled to notice. But it is clearly understood that unless the meeting is to consider any matter which affects the rights of the preference shareholders or the dividend payable to them, they cannot take part in the proceedings or vote on any resolution [Clarifications and Circulars on Company Law p.83 Company News and Notes dated 16.6.64].

A Managing Director of a company who is not a shareholder cannot challenge the regularity on the ground that no notice of the meeting was served on him [*Joginder Singh Palte v. Time Travels P. Ltd.* (1984) 56 Com. Cases 103 (Cal.)]

Sub-section (3) of Section 172 lays down that an accidental omission to give notice to, or the non-receipt of notice by, any member or other person to whom it should be given, shall not invalidate the proceedings of the meeting. Even though a member may give in writing that no notice should be given to him, the company is bound to give notice in accordance with the statutory provisions.

The notice of a meeting of directors was claimed to have been handed over to the assistant of the director, but the despatch register did not show the details of the despatch. The court said that there could be no presumption of services. The meeting was invalidated and, therefore, the resolution passed at a meeting was of no effect. [*M.S. Madhusoodanan v. Kerala Kaumudi P. Ltd.* (2003) 117 Com Cases 19 (SC)].

Contents of the Notice

Section 172(1) prescribes that the notice of a meeting of a company shall specify the place and the day and hour of the meeting, and shall contain a statement of the business to be transacted thereat.

Where any item of business to be transacted at the meeting is deemed to be special (at AGM any business other than consideration of accounts, declaration of a dividend, appointment of directors in place of those retiring and the appointment of and the fixing of the remuneration of the auditors), there shall be annexed to the notice of the meeting, a statement setting out all material facts concerning each such item of business and interest by any director therein, if any [Section 173(2)]. This statement is called the "Explanatory Statement".

Section 173 of the Companies Act, 1956 is mandatory and not directory [*Lalji Bhai C Kapadia v. Lalji B. Desai* (1973) 43 Comp. Cas.17 (Bom.)]. Explanatory statements give all facts which have a bearing on the question on which the shareholders have to form their judgement [*Centron Industrial Alliance Ltd. v. Pravin Kantilal Vakil* (1985) 57 Comp.Cas. 12(Bom.)]. But a minor defect arising out of absence of strict conformity with the provisions of Section 173(2) might not render an amendment of the articles of association null and void [*Joseph Michael v. Travancore Rubber & Tea Co. Ltd.* (1986) 59 Comp.Cas. 898 (Ker.)].

A good notice must fairly disclose the purpose for which the meeting is called, must be open, and free from vagueness and trickiness and must be in language understood by common people [*Kaye v. Croydon Tramways Co.*, (1898) 1 Ch 358 (CA)].

A meeting cannot pass a resolution, the subject matter of which is not specified in the notice convening the meeting. [*Pacific Coast Coal Mines Ltd. v. Arbuthnot*, 1917 AC 607). Consequently if a resolution is passed without the notice fairly disclosing it, it will be void. [*Kaye v. Croydon Tramways Co.* (1898) 1 Ch 358 (CA)].

But where an item of business not mentioned in the notice was taken up under the caption 'any other business' with the permission of the chair, the transaction was held to be valid as it could have been ratified subsequently [*Sunil Dev v. Delhi & District Cricket Assn.*, (1990) 2 Comp LJ 245 : (1994) 80 Com Cases 174 Del].

If any item of business consists of the according of approval to any document by the meeting, the explanatory statement should indicate the time and place where the same can be inspected [Section 173(3)].

Venue of the Meeting

According to Section 166 of the Act, every annual general meeting of a company shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office is situated. For this purpose the twin cities of Delhi and New Delhi and Hyderabad and Secunderabad will be deemed to be a single city. However, there is no such restriction on holding any other general meeting of a company.

Notice for Adjourned Meeting

Articles of companies generally make provisions with regard to notice for adjourned meeting. For example, regulation 53 of Table A provides that the chairman may with the consent of any meeting at which a quorum is present and shall, if so directed, by the meeting adjourn the meeting from time to time and from place to place. The other requirements of regulation 53 are:

- (i) No business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place.
- (ii) When a meeting is adjourned for thirty days or more, notice of the adjourned meeting shall be given in the case of an original meeting.
- (iii) Save as aforesaid, it shall not be necessary to give any notice of an adjournment or of the business to be transacted in an adjourned meeting.

It has been held by the Madras High Court that an adjourned meeting is a mere continuation of the original meeting and so the provisions for the original meeting are applicable to the adjourned meeting.

Day of the Meeting

In terms of the provisions of Section 166 of the Act, every annual general meeting of a company shall be held on a day, that is not a public holiday.

There is, however, a view that as an adjourned Annual General Meeting which is only a continuance of the original meeting cannot be held on a public holiday. This is on the analogy provided in Section 288 of the Act which deals with the adjournment of Board Meetings. It specifically provides that unless the articles otherwise provide if the date of the adjourned Board meeting falls on a date which is a public holiday then such adjourned Board meeting shall be held on the next succeeding day which is not a public holiday. But if the intention of the law makers was that adjourned Annual General Meeting should not be held on a public holiday they would have included similar provisions in Section 174. The Department of Company Affairs has also

clarified that there is no contravention of Section 166(2), if the adjourned meeting comes to be accidentally held on a holiday [File No.8/16(1)/61-PR).

Time of the Meeting

Section 166 of the Act provides that every annual general meeting should be called for at a time during business hours which means that meeting should be held during the normal working hours of the company. Therefore, it is technically possible to call a general meeting other than the annual general meeting at a time which does not fall within the business hours. However, apart from technical possibility, general meetings should be held during business hours. But a general meeting, started during business hours, may continue till late in the evening before it is concluded.

Agenda

Detailed agenda for a general meeting is not circulated to the shareholders and is prepared only for the convenience of the chairman. All the items listed in a notice for a general meeting are taken in the same order. However, the order may be altered with the consent of the meeting. In the case of the annual general meeting Section 230 of the Act requires reading of the auditor's report and this is mandatory. This should be specifically indicated in the agenda and this requirement should be taken care of while drafting the minutes of the meeting.

The agenda for the general meeting given to the chairman should also contain all relevant supporting papers such as, precedents, previous dividend history, and a list of possible queries that could be raised by shareholders on the annual accounts together with suggested replies thereto to help the chairman in the smooth conduct of the meeting.

5. QUORUM

Quorum is the presence of requisite number of members when a meeting can validly commence its business. It is the minimum number of members of a company whose presence is necessary for the transaction of business. In the case of a company, the quorum is usually fixed by the articles.

Section 174(1) of the Act provides that unless the articles of a company provide for a larger number, five members personally present in the case of public company and two members personally present in the case of a private company shall be quorum for a general meeting of a company.

At one time it was considered essential that the required quorum should remain present throughout the proceedings. But in *Re. Hartly Baird Ltd.* (1955) Ch. 143, it was held that where the company's articles were similar to Table A, a quorum need be present only when the meeting commenced, and it was immaterial that there was no quorum at the time when the vote was taken. This decision follows from the wordings of Article 53 of the English Act, which states that no business shall be transacted unless quorum present when the meeting proceeds to transact business Regulation 49(1) of Table A of Schedule 1 of the Act also contains an identical provision.

Section 174(3) further states that unless the articles otherwise provide, if within half an hour from the time appointed for holding a meeting of a company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved. According to Section 174(4) in any other case, 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.

Section 174(5) lays down that if at the adjourned meeting also, quorum is not present within half an hour from the time appointed for holding the meeting, the members present shall constitute quorum.

A director who is not a member of a company cannot propose or second a resolution and his presence cannot be counted for the purpose of quorum. He can, however, be present at the meeting and with the permission of the chairman he can speak on specific matters.

A quorum will always be presumed, unless it is questioned at the meeting or the records show that quorum was not, in fact, present.

For the purpose of counting a quorum joint shareholders will be counted as one. Even if the articles do not make any specific provisions, any one joint-holder present at a meeting will be entitled to exercise voting power and will be counted for quorum. But only one of the several joint-holders will be entitled to exercise voting power.

The common rule of a meeting is that there shall be at least two persons to constitute a meeting and that a single member cannot do so even if he holds almost all the shares which carry voting right [*Sharp v. Dawes*, (1876) 2 QBD 26 (CA)]; followed in *London Flats Ltd. Re*, (1969) 2 All ER 744 : (1969) 1 WLR 711 or carries proxies for all other members. The use of the expression members also shows that one individual alone does not constitute a meeting even if he, for example, is a member and proxy for another member [*Re M.J. Shanley Contracting Ltd.* (1979) 124 SJ 239] or by being a member both in his own right and as trustee for another [*James Prain & Sons Ltd.*, petitioners 1947 SC 325].

The views of the Department (now MCA) on this issue are also that a single person cannot by himself constitute a quorum at the adjourned annual general meeting. [Letter No. 8/16(1)/61-PR, dated 19/5/1961].

As per Section 87 preference shareholders are entitled only to vote in respect of matters affecting their shares and they cannot be treated as members for a quorum at any general meeting in regard to items of business in respect of which they have no voting right under the Act. [*Henderson v. Louttit & Co. Ltd.*, (1894) 21 Rettie 674]. The Department of Company Affairs is of the view that preference shareholders cannot, therefore, be counted as members for determining quorum except in respect of items of business, if any, where they have right to vote under the Act.

On the other hand, the words used in Section 174(1) are "unless the articles of a company provide for a larger number, five members personally present in the case of a public company... shall be the quorum for a meeting of the company. Section 172(2)(i) requires that "notice of every meeting shall be given to every member of the company." The implication of both these sections is said to be that every member is to be given notice of the meeting and he can attend and be counted for quorum though he may not have a right to vote at the meeting.

The presence of a person, who has been appointed by the President of India or by the Governor of a State, in his capacity as a member of a company, to represent him at a company meeting, shall be counted for the purpose of a quorum in accordance with the provisions of Section 187A of the Companies Act as also persons authorised in terms of Section 187.

Even at an adjourned meeting, one member present will not constitute quorum, for the section says that the members actually present shall be a quorum.

However, exceptions to this rule do exist. (i) In *East v. Bennet Bros. Ltd.* (1911) Ch. 163, where all the preference shares in the company were held by one shareholder only it was held that a meeting of preference shareholders (class meeting) attended by only him was valid; (ii) when the Company Law Board calls or directs the calling of a meeting under Section 167 of the Act.

When default is made in holding an annual general meeting, the Company Law Board may direct that one member present in person or by proxy shall be deemed to constitute a meeting. Similarly, the Company Law Board may, under Section 186, direct a meeting of a company (other than an annual general meeting) to be called and held, where, for any reason it is impracticable to call a meeting, and also direct that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

But if all members of the company are present in person, the proceedings will be valid even if the quorum required by the articles is more than the total number of shareholders. This can happen where originally the number of members of a company was large, say 500 shareholders and the quorum fixed by the articles was 100 members present. Subsequently, 450 members have sold their shares which have been acquired by some of the remaining 50 members. If a meeting is held to transact some business, say to alter the articles to reduce the members required for quorum, all the 50 members present in person will constitute quorum.

6. PROXY

The word "proxy" has two different meanings. Firstly, it means the agent appointed by the members of a company to attend and vote on his behalf at a meeting of members and secondly, it means the document by which such an agent is appointed.

(Every member of a company having share capital has a right to appoint a proxy to attend and vote at a general meeting on his behalf. In the case of a company not having a share capital, this right is available only if the articles make a specific provision for it.)

(A notice calling a meeting of any other public company must state with reasonable prominence that a member entitled to attend and vote at a meeting is entitled to appoint a proxy to attend and vote instead of himself and that a proxy need not be a member of the company.) A member can appoint one or more proxies to vote in respect of the different shares held by him or he may appoint one or more proxies in the alternative, so that if the first named proxy fails to vote, the second one may do so, and so on. The proxy need not be a member of the company. (In case of a private company, a member can appoint only one proxy regardless of the number of votes he may hold.)

If a company is a member of another company, it may by resolution of its Board of Directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of the company, or at any general meeting or at a meeting of any class of members of the company.

A person authorised by resolution as aforesaid shall be entitled to exercise the same rights and powers (including the right to appoint a proxy) on behalf of the body corporate which he represents as that body could exercise if it were an individual member of the company (Section 187).

Meeting under Section 187 refers to meetings of a company and not a meeting of the Board of directors. [*Motion Pictures Association In Re.* (1984) 55 Comp. Cas. 375 (Delhi)].

Section 187A provides that where President of India or Governor of a State, is a member of a company, he may appoint anyone to represent him at any meeting of the company or at a meeting of any class of members of the company. A person appointed to act as aforesaid shall, for the purposes of this Act be deemed to be a member of such a company and shall be entitled to exercise the same rights and power (including the right to vote by proxy) as the President or, the Governor as the case may be, could exercise as a member of the company.

The right to appoint proxies would have been rendered ineffective if the Board of directors could insist on the document appointing proxies to be lodged with the company a considerable time before the meeting is held. Section 176(3), therefore, provides that any provision in the articles which requires longer period than forty-eight hours before the meeting for depositing a proxy, shall have the effect as if a period of 48 hours had been specified in such provision.

No public company or private company, which is subsidiary of a public company, can make any provision requiring that proxies should be deposited earlier than 48 hours before the meeting at which they are to be used. Other private companies are free to make their own regulations by their articles. The articles may also follow regulation 61 of Table A which provides that "the instrument appointing a proxy and the power of attorney or other authority, if any under which it is signed or a notarially certified copy of that power or authority shall be deposited at the registered office of the company not less than forty-eight hours before the time for holding the meeting or adjourned meeting at which the person named in the instrument proposes to vote, or in, the case of a poll, not less than 24 hours before the time appointed for the taking of the poll, and in default, the instrument of proxy shall not be treated as valid."

Sunday is included in computation of 48 hours. Therefore, 'a proxy delivered on Sunday for a meeting to be held on Tuesday, that is 48 hours later, would be valid provided the receipt of the proxy at the time stated could be identified in some way [*K.P. Chachochan v. Federal Bank* (1990)], 4, Section III, Corporate Law Adviser 1 (Kerala)].

Another statutory provision is contained in Section 176(4) which states that if an invitation is issued at the expense of the company asking any member to appoint a particular person as proxy, every officer in default shall be liable to fine upto

Rs. 10,000. But if a proxy instrument is sent at the request of a member, the officer shall not be liable.

Where a poll is ordered and the meeting is postponed to a particular date, the postponement does not tantamount to an adjournment of the meeting, but is only a continuation of the original meeting and unless the articles provide otherwise fresh proxies cannot be lodged 48 hours before the postponed meeting where the postponement is only for taking a poll. In case, 48 hours preceding the meeting happens to fall on a holiday, arrangements may have to be made for acceptance of proxies lodged 48 hours before the time of the meeting.

It is also common practice to make out alternative proxies i.e. in favour of X or, in his absence, Y so that if X is for any reason prevented from attending, Y may attend and vote under the proxy.

Right to Inspect Proxies

A director has right to inspect proxies lodged with the company. [*Armstrong v. Landmark Corporation Ltd.*, (1967) NSW 13 (Australia)].

Every member entitled to vote at a meeting of the company or on any resolution is entitled, during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting to inspect proxies at any time during business hours of the company by giving not less than 3 days notice in writing to the company of his intention to do so.

The Court has power to compel the company to give certified copies of proxy forms filed with it so as to enable the complaining member to have his question decided as to who is the right proxy of a member. [*Swadeshi Polytex Ltd. v. V.K. Goel*, (1988) 63 Com Cases 688].

Form of Proxy

The instrument of proxy should be in writing and be signed by the appointer or his attorney duly authorised in writing or if the appointer is a body corporate, be signed by an officer or an attorney duly authorised by it. An instrument in any of the forms set out in Schedule IX to the Companies Act, 1956 shall be accepted even if it does not comply with any special requirements in the articles of the company. Form-II in Schedule IX to the Companies Act, 1956, also gives an opportunity to the member to direct the proxy to vote for or against a particular resolution.

In the case of *General Commerce Limited v. Apparel Export Promotion Council (Delhi)* (1990), the question whether a company could frame rules prescribing the form of proxy which is at variance with the form given in Schedule IX of the Act, came up before the Delhi High Court. In this case the Election Rules framed by the AEPC provided that any proxy appointed through any instrument other than the printed instrument approved and despatched by the Council along with the notice of the meeting shall not be valid. These Election Rules were questioned on the grounds that they were in contravention of Section 176(6). Sub-section 6 of Section 176 provides that "An instrument appointing proxy, in an any form set out in Schedule IX shall not be questioned on the ground that it fails to comply with any special requirement specified for such instrument by the Articles". The Court therefore, held that Section 176(6) of the Act makes it clear that the only proxy form which is

required for the purposes of enabling a person to cast his vote is one which is provided in form set out in Schedule IX, that form cannot be added to or subtracted from. No special proxy form issued by any body of persons which adds to the requirement of proxy by imposing any condition or requiring it to be on specific proxy paper, as the case may be, can be sustained. The Court thus held that the members of the company were entitled to vote by proxies which were in accordance with the form prescribed by Schedule IX to the Act.

Signing of Proxy

In the case of a proxy, the signature in the proxy form should tally with the signature in the register of members or else the proxy will be liable to be rejected. If a company rejects an unsigned proxy form, the shareholder should be informed accordingly.

In the case of joint members all must sign the proxy, unless the articles authorise one joint-shareholder to sign proxies.

Where the name in the register of members is as attorney, executors, administrator or guardian, then papers showing the authority to sign a proxy should accompany the proxy.

Rights of Proxy

A proxy is entitled to vote only on a poll but the articles of any company may provide for a proxy voting by show of hands also. The chairman in ascertaining the number of votes given on a show of hands must count the vote of each member who also holds proxies as a single vote and not count a vote for each of the member whose proxies are held by the person [*Earnest v. Home Gold Mines Co.* (1897) 1 Ch.1]. A proxy is not, as of right entitled to speak at a meeting, though he may be permitted to put questions in writing and send the same to the chairman for an answer.

A proxy can make a demand for a poll. A member holding a proxy for another member may, on a poll, vote in respect of his own holding in a manner contrary to that of the person whom he represents by a proxy [*Foester v. Newlands West Grigualand Diamond Mines Ltd.* (1902) 18 TLR 497].

Consequences of Accepting Defective Proxies

If a company accepts defective proxies, the resolutions passed at the concerned meeting may be held invalid by the courts even though they will uphold certain categories of defective proxies on equitable grounds. Proxies with uncanceled stamps are not regarded as valid.

While major mistakes in a proxy, which affect the exercise of the voting right in any way will render it invalid, a small mistake on a proxy form which does not conform to the articles which is not likely to mislead anybody and which does not affect the proper exercise of the voting right in any way, does not render the votes cast by a proxy-holder in exercise of his right of proxy invalid, e.g., where the proxy form described the meeting as AGM when in fact it was an extraordinary general meeting. [*Oliver v. John Dalgleish* (1964) 1 Comp LJ 78].

Revocation of Proxies

The relationship between the proxy and the person appointing him is that of an agent and principal, and the former must act in accordance with the instructions of the latter. As their relationship is governed by the law of agency, proxy can be revoked by the member at any time, *Narayan Chettiar v. Kaleeswara Mills Ltd.* and is automatically revoked by the death or insolvency of the member. A member may revoke the proxy's authority by attending and voting himself before the proxy has voted, the member cannot retract his vote. The vote given by a proxy is valid notwithstanding its revocation provided no intimation in writing of the revocation is received at the office of the company or by the chairman of the meeting before the vote is given [*K.P. Chachochan v. Federal Bank* (1990)].

In Cousins v. International Bricks Co. Ltd., (1931) 2 Ch 90 (CA) at 101, it was held that there was nothing in the articles of a company to stop a shareholder to attend a meeting and vote in person, even though he had appointed a proxy to vote for him at the same meeting; the fact that the proxy was not revoked in the manner laid down in the articles did not prevent the member recording his vote in person to the exclusion of the proxy holder. But in *Narayanan Chettiar's case* (Supra), it was held that a shareholder's mere presence at the meeting will not have the effect of revocation.

The revocation should be communicated before the meeting. Revocation will be too late if communicated after the meeting commenced. In such a case the votes cast by the proxy will be valid in a poll. [*Spiller v. Mayo (Rhodeshia) Development Co. (1908) Ltd.*, (1926) WN 78].

If one shareholder makes out two proxies in respect of the same shares, the proxy bearing the later date will be valid as against the earlier proxy [*Swadeshi Polytex Ltd. Re.* (1988) 63 Com Cases 709 (Del)]. If the proxies have the same dates, both the proxies would be ineffective. But where a proxy was lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be accepted.

Unstamped Proxy

Proxy is liable to stamp duty. Stamp duty on proxy is provided for in the central list appended to the Constitution. The Chairman of a meeting is entitled to accept unstamped proxies. If the company wishes subsequently to use them as evidence, it may have them stamped, as an unstamped proxy cannot be accepted as evidence. On the other hand, if the chairman decides to reject the proxies he does not have to allow time for them to be got stamped. Therefore, where the chairman had once accepted unstamped proxies, and objection to the invalid proxy was taken many days after the meeting it was not sustainable and that the votes cast by proxy-holders were accepted to be valid [*Marx v. Estate and General Investment Ltd.* (1976) 1 WLR 380 : (1975) 3 All ER 1064 (Ch D)]. Even in the case of proxies executed outside India, a revenue stamp of appropriate value has to be affixed and cancelled within three months of its receipt in India [*Saudagar Singh v. G.S. Gill* (1980) 50 Com Cases 591 (DB (P&H))].

Validity of Proxies

It is for the Chairman to decide as to the validity of the proxies and his decision

will stand unless it was proved to the Court to be wrong [*Indian Zoedone Co., Re.*]

7. VOTING AT GENERAL MEETING

Section 183 of the Act regulates voting by members. It says that on a poll taken at a meeting of a company, a member entitled to more than one vote, or his proxy, or other person entitled to vote for him, as the case may be, need not, if he votes, use all his votes or cast in the same way all the votes he uses.

Voting and Demand for Poll

A member may either vote personally or by proxy. Section 176(1)(c) allows for the articles of a company to provide for voting by proxy on a show of hands. So unless the articles otherwise provide, a proxy shall not be entitled to vote except on a poll. A proxy has no right to speak at a meeting though; he can demand a poll and vote. Sections 177 to 185 regulate voting and poll.

At any general meeting all resolutions are decided in the first instance by a show of hands and each member has one vote (Section 177).

In a voting on a show of hands, proxies cannot be counted unless articles make express provision therefor [*Ernest v. Loma Gold Mines Ltd.*, (1897) 1 Ch 1, 5 (CA) overruling *Bidwell Bros, Re* (1893) 1 Ch 603.]

However, a poll can be demanded without going through the formality of a show of hands [*Holmes v. Keys (Lord)*, (1959) 1 Ch 99].

Since the voting by the show of hands may not always reflect the opinion of members on a value basis, Section 179 provides for the demand for poll. It states that before or on the declaration of the result of the voting on any resolution on a show of hands, the chairman may order *suo moto* (of his own motion) that a poll be taken, but when a demand for poll is made, he must order the poll to be taken. The chairman may order a poll when a resolution proposed by the Board is lost on the show of hands. Also, if the chairman knows that proxies have been lodged and that on a poll the decision taken on a show of hands is likely to be reversed, it is his duty to order a poll. When a poll is taken the decision on the show of hands has no effect.

Poll must be ordered by the chairman if it is demanded:

- (a) in the case of a public company, having a share capital, by any member or members present in person or by proxy and holding shares in the company:
 - (i) which confer a power to vote on the resolution not being less than one-tenth of the total voting power in respect of the resolution; or
 - (ii) on which an aggregate sum of not less than fifty thousand rupees has been paid-up.
- (b) In the case of a private company, having a share capital by one member having the right to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy, if more than seven such members are personally present.
- (c) In the case of any other company, by any member or members present in

person or by proxy and having not less than one-tenth of the total voting power in respect of the resolution [Section 179(1)].

As per Section 179(2), the demand for a poll may be withdrawn at any time by the person or persons who made the demand.

Where meeting in question was only an adjourned meeting there was nothing improper in using old proxies and it could not be said that the meeting was not properly held [*Kothari Industrial Corp. Ltd. v. Maxwell Dyes & Chemicals (P) Ltd.* (1995) 5 SCL 82].

While issuing notice for adjourned meeting, calling for fresh proxies is not illegal for the simple reason that fresh proxies ought to be called for, as it is a matter of right to the shareholders to change their respective proxies for the adjourned meetings and for the new shareholders to give their own proxies for the adjourned meeting.

Where the notice of the adjourned meeting was issued with the same wording as that of the previous notice, and the fresh proxy form was enclosed therewith, it could not be categorised as an unlawful act on the part of the company. It would suffice if the adjourned meeting transacts only the business left untouched in the original meeting and no new business was transacted [*Maxwell Dyes & Chemicals (P) Ltd. v. Kothari Industrial Corpn. Ltd.* (ibid)].

When poll is not demanded, chairman of meeting is not under an obligation to order poll and a shareholder who did not demand poll cannot challenge a resolution subsequently. [*Jetu Jacques Tara Lalwani v. IBA Printing Inks Ltd.* [1996] 20 CLA 12 (Bom.)].

The Chairman may also order for taking the poll *suo moto*, even though there is no demand of poll by any member. When a poll is demanded, it must be taken immediately by the Chairman and meeting is regarded as continuing until the ascertainment of the result of the poll. [*Holmes v. Lord Keyes* (1958) 2 All ER 129; (1958) 28 Com. Cases 419 (CA)].

Each resolution must be put to the poll separately, *Blair Open Hearth Furnace Co. Ltd. v. Reigart*; (1913) 108 LT 665, and the result announced must indicate the number of votes cast in favour and against each resolution.

Section 180 states that, if a poll is demanded, then, if it relates to the question of election of chairman or adjournment of the meeting, the poll must be taken forthwith; in other cases, it may be taken later, but within 48 hours of the demand.

A member, though he was not present at the meeting when the poll was ordered to be taken, may vote personally on the poll. [*Cf. Campbell v. Mound* (1836) 5 Ad & El 1: (1835-42) All ER Reprint p. 648].

It should be noted that every holder of equity shares has a right to vote at a general meeting. Section 182 provides that a company cannot prohibit any member from exercising his voting right on the ground that he has not held his shares for any specified period before the meeting or on any other ground. The only ground on which the right to vote may be denied is non-payment of calls by a member or other sums due from him or where the company has exercised its right of lien on his shares.

Unless the articles of a company otherwise provide only a person whose name is entered in the register of members could vote and not a transferee of shares or a person entitled to any shares by transmission by operation of law.

An insolvent shareholder so long as he remains in the register of a company as a member, is entitled to exercise the votes, which are attributed to his status as member. [*Mergain v. Gray*. (1953)].

Regulation 58 of Table A provides that a member of unsound mind, in respect of whom an order has been made by any Court having jurisdiction in lunacy may vote, whether on a show of hands or on a poll, by his Committee or other legal guardian, and any such Committee or guardian may on a poll, vote by proxy.

Even if the articles do not make any specific provisions, any joint-holder present at a meeting will be entitled to exercise voting power. But only the votes of one of the several joint-holders will be accepted. The articles of a company may provide a regulation similar to regulation 57 of Table A that in the case of joint-holders, the votes of the senior who tenders a vote, whether in person or by proxy shall be accepted to the exclusion to the votes of other joint-holders.

If the shares held by a minor are fully paid, the minor will be entitled to vote at the meeting of the company in which he is a shareholder. The voting rights on shares are regulated by the company's articles and by the provisions of Section 87(1) of the Act. Section 87(1) provides that any member of a company limited by shares and holding any equity share capital shall have the right to vote on every resolution put before the meeting and his voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company. Since no distinction has been made out in case of minors, minors will also be entitled to vote in general meetings of the company both on a show of hands and on a poll. However, as per Section 86 as amended by Companies (Amendment) Act, 2000, equity shares with differential rights as to dividend, voting can be issued.

Section 178 states that a declaration by the chairman, in pursuance of Section 177 that on a show of hands, a resolution has or has not been carried, or has or has not been carried either unanimously or by a particular majority, and an entry to that effect in the books containing the minutes of the proceedings of the company, shall be conclusive evidence of the fact, without proof of the number or proportion of the votes cast in favour of or against such resolution.

Regulation 60 of Table A provides that no objection shall be raised to the qualification of any voter except at the meeting or adjourned meeting at which vote objected to is given or tendered, and every vote not disallowed at such meeting shall be valid for all purposes. If objection is made in due time then it should be referred to the chairman of the meeting whose decision is final and conclusive. It was held in *Wall v. London and Northern Assets Corporation* (1898) 2 Ch. 469, that if the articles so provide, the Chairman's decision as to the validity of a vote is conclusive but it will not protect fraudulent or *mala fide* acts.

The provision here that the chairman's declaration shall be conclusive evidence only means that, the entry in the minutes books is conclusive as between the parties bound by the minutes.

The chairman's declaration may be disputed where fraud is proved or mistake is shown or there is only a mistake and no fraud, the proper course is to call another meeting.

Section 184 provides that where a poll is to be taken, the chairman of the meeting shall appoint two scrutineers to scrutinise the votes given on the poll and to report thereon to him. The chairman shall have power, at any time before the result of the poll is declared, to remove a scrutineer from office and to fill vacancies in the office of scrutineer arising from such removal or from any other cause. Of the two scrutineers appointed under this section, one shall always be a member (not being an officer or employee of the company) present at the meeting, provided such a member is available and willing to be appointed.

Section 185 states that subject to the provisions of this Act, the chairman of the meeting shall have power to regulate the manner in which a poll shall be taken. The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

The voting right of preference shareholders are restricted by Section 87(2) to the extent that a preference shareholder has the right to vote only on a resolution which directly affects the right attached to his preference shares. Any resolution for winding up of the company or for the repayment or reduction of its share capital shall be deemed directly to affect the rights attached to preference shares.

A preference shareholder shall also be entitled to vote on every resolution placed before the company at any meeting, if the dividend has remained unpaid:

- (a) in the case of cumulative preference shares, in respect of an aggregate period of not less than 2 years preceding the date of the commencement of the meeting; and
- (b) in the case of non-cumulative preference shares, either in respect of a period of not less than 2 years ending with the expiry of the financial year immediately preceding the commencement of the meeting or in respect of an aggregate period of not less than 3 years comprised in the 6 years ending with the expiry of the financial year aforesaid.

Under Sections 187 and 187A, if a body corporate or the President of India or the Governor of a State is a member of the company, the authorised representative will be deemed to be exercising voting rights himself or through proxy appointed regardless of the amount of shareholding [*M.K. Sonthalia v. Nariman Private Ltd.* (1995) 84 Com Cases 559 (Madras)].

A casting vote is a second vote exercised by a chairman of a meeting in addition to his own vote as a member.

8. CHAIRMAN

The Chairman plays a crucial role in a company meeting and is usually appointed by the articles.

Section 175(1) states that unless the articles otherwise provide, the members present in person at a meeting shall elect on a show of hands one of their members to be the chairman. In this context, regulation 50, 52 of Table A are relevant.

Regulation 50 of Table provides that Chairman, if any, of the Board shall preside as Chairman at every general meeting of the company.

If there is no Chairman or he is not present within fifteen minutes after the appointed time of the meeting or is unwilling to act as Chairman of the meeting, the directors present shall elect one among themselves to be Chairman of the meeting (Regulation 51).

If, at any meeting, no director is willing to act as Chairman or if no director is present within fifteen minutes after the appointed time of the meeting, the members present should choose one among themselves to be the chairman of the meeting (Regulation 52).

If after the election of a Chairman on a show of hands, poll is demanded, it must be taken forthwith and the Chairman elected by show of hands will exercise the powers of chairman till the poll is taken. If a different person is elected as chairman on a poll, then he will be the chairman for the rest of the meeting. If the articles are silent, the members can elect one among themselves as chairman of the meeting through a show of hands, unless a poll is demanded. Usually the permanent chairman is allowed a few minutes grace time, before another member is elected to the chair. Such a chairman appointed to chair the meeting in question gives way to the regular chairman upon the arrival of the latter, by vacating the chair. This operates as a virtual resignation since in the absence of specific provision, no special formality is required for a chairman to resign [*Cane v. Jones* (1981) All ER 533 at 543].

A person who has been chosen to chair the meeting in the absence of the chairman may (but not necessarily) vacate if the chairman subsequently arrives. He can however be removed by the meeting by a motion of no confidence in the chair [*Cornwall v. Woods* (1846) 4 Notes of Cases 555]. If such a resolution comes up, it is necessary for the person to step down from the chair, until the result of the voting is known.

Duties and Role of Chairman

The chairman's position is of great importance, as he is responsible for the successful conduct of a meeting. The chairman has a duty to keep order, to see that the business is properly conducted and to ensure that the sense of the meeting is properly ascertained in regard to any question before it. A person who has no right to be present is an intruder and is deemed to commit the tort of trespass. If any such trespasser is present at the meeting, the chairman can order him to be removed by use of minimum force necessary for the purpose. The chairman's duties *inter alia* are:

1. He must ensure that the meeting is properly convened and constituted, i.e. proper notice has been given, rules as to quorum have been observed, and his own appointment is in order.
2. He must ensure that the provisions of the Act and the articles in regard to the meeting and its procedures are observed, and that the business is taken in the order set out in the agenda, and that the business is within the scope of the meeting.
3. He must act at all times *bona fide* and in the interest of the company as a whole. He must give a reasonable chance to the members present, to

discuss any proposed resolution and ensure that views of all are adequately heard. He must maintain strict impartiality.

4. He must decide questions arising for decisions during the meeting and must ensure that the majority hears the minority. However, when the views of the minority have been heard, the chairman must, with the sanction of the majority, declare the discussion closed and put the question to vote.
5. He must ensure that the sense of the meeting is properly ascertained in regard to any question before it.
6. He must exercise correctly his powers of adjournment. He has no powers to adjourn the meeting at his own will and pleasure. If he declares the meeting closed prematurely and leaves the chair, the members may resolve to proceed with the meeting and elect another chairman and continue with the business for which it was convened. He may, however, adjourn a meeting if circumstances demand and he acts *bona fide* in the interest of the company.
7. It is his duty to preserve order and to see that the business is properly conducted. He has the discretion with regard to the general conduct of the meeting and he may not allow a member to talk as much as he likes. If a member acts in a disorderly manner and frequently interrupts the proceedings and obstructs transaction of business, the chairman may ask him to withdraw. If the member refuses to do so, the chairman can order his removal.
8. He must exercise his power to order a poll correctly and must order it to be taken when demanded properly.
9. He must exercise his casting vote, if available, *bona fide* in the interest of the company.

Section 178 states that a declaration by the chairman, in pursuance of Section 177 that a resolution has been carried, is conclusive evidence of the fact without proof of the number or proportion of the votes cast for or against the resolution. But if on the face of the declaration that the resolution is passed, it is clear that the statutory majority had not voted in its favour, the chairman's declaration, it seems will not be conclusive.

The court will not normally interfere with the *bona fide* decisions of the Chairman unless there is an evidence of fraud or injustice. If the meeting has been conducted regularly and is not fraudulent of the members, the Court will normally accept the Chairman's declaration of the result of the voting as conclusive without further enquiry.

9. MOTION

'Motions' and 'resolutions' are used synonymously but in legal sense there is difference between the two. "Motion" is a proposal submitted for a discussion and a decision adopted by means of a resolution. A motion becomes a resolution only after the requisite majority of members have adopted it. A motion should be in writing and signed by the mover and put to the vote at the meeting by the chairman. In case of company meetings, only such motions are proposed as are covered by the agenda. However, certain motions may arise out of the discussion and the standing orders of various bodies allow such motions to be discussed at the meeting without proper notice in writing. There is no provision either in common law or under the Companies Act, which provides that a motion should be proposed and seconded though this is the commonly accepted practice.

Proposer and Seconder

It is common practice in company meetings that a motion is proposed by one member and the same is seconded by another. But unless the articles of association otherwise provide, no seconding is necessary for taking up a motion. After the motion is discussed, the chairman puts the motion formally to vote by stating what the resolution is and that it is proposed by 'A' and seconded by 'B' and then calls upon the members for a show of hands to decide the issue.

Amendment

An amendment is any alteration, proposed by a member, of the main motion, before it is voted upon and adopted. Amendment may be proposed by any member who has not already spoken on the main motion or has not previously moved an amendment, but a formal motion cannot be amended. Like the main motion, an amendment should ordinarily be in writing, signed by the mover. The terms of the amendment should be definite and in the affirmative and it should not raise any question already decided upon at the same meeting. It should be relevant to and in keeping with the main motion which it seeks to amend and must not merely negate the main motion or introduce entirely a new subject.

The Chairman has the absolute discretion to accept or reject an amendment on various grounds such as inconsistency, redundancy, irrelevance etc.

When an amendment has been moved, admitted and seconded discussion on the main motion ceases and discussion on the amendment starts. Any one may speak on the amendment even if he has already spoken on the main motion, but no one is allowed to speak twice on the same amendment. After the amendment has been thoroughly discussed, it is put to vote. If the amendment is carried, it is incorporated in the body of the main motion. The altered motion which is known as "substantive motion" is then put before the meeting. If the amendment is lost, discussion on the main motion is resumed, but if the substantive motion is put to vote and lost, the original motion cannot be revived.

Any number of amendments to the main motion can be moved. An amendment to alter another amendment can also be moved, but an amendment can be amended only once. When a large number of amendments to the main motion have been moved, the original motion may be withdrawn by common consent and a new motion incorporating all the amendments may be taken up. The Chairman has the discretion to decide in what order the various amendments should be taken up for consideration.

General rules regarding Amendments

1. The amendment should always be worded in the affirmative and should be in writing.
2. It should be seconded.
3. It should never be a counter proposal and therefore the person moving an amendment should ensure that it is relevant to the main motion.
4. Amendments are incorporated in the main motion by the chairman of the meeting only after the amendments have been carried out.
5. When the amended motion is put to the meeting, it becomes a substantive

motion and after a sufficient discussion, if passed, it becomes a resolution.

6. If the substantive motion is lost, the original motion to which an amendment was moved cannot be revived.
7. All the amendments are placed before the meeting by the chairman in such order as would affect the main motion.
8. All amendments pertaining to the same motion are put to the meeting by the chairman for discussion in the order in which they have been moved.
9. When discussion on one amendment is going on and the decision to the effect is not yet taken no member is allowed by the chairman to propose another amendment. However, an amendment to an earlier amendment may be allowed to be moved.
10. The mover of a motion with due consent of the meeting can withdraw it before it is put to vote and also have a right to reply to the points raised during the discussion on the motion moved by him.

The secretary advises and assists the chairman in regard to the above points whenever an amendment is received from a member.

10. METHODS OF EXERCISING SHAREHOLDERS RIGHTS WITH REGARD TO VOTING

The various methods by which the shareholders exercise their rights with regard to voting are as follows:

- (i) by show of hands;
- (ii) by poll;
- (iii) by postal ballot; and
- (iv) by e-voting.

(i) **Voting by show of hands:** According to this method, the Chairman calls upon the persons present who are entitled to vote to raise hands in favour of the motion and on counting them he proceeds to count the hands raised against the motion also. On comparison of the hands shown for and against the motion, the Chairman announces his verdict whether the resolution is carried or lost. Each member, irrespective of his shareholding, or voting right, has one vote. Unless otherwise specified in the articles, a proxy cannot vote here in terms of Section 177 at a general meeting of the company, a resolution put to vote shall, unless a poll is demanded, be decided on a show of hands.

Care, however, should be taken that a person does not raise both the hands on a motion, if the Chairman's declaration is to be challenged, a second show of hands should be demanded. Therefore, any objection as to its accuracy etc. should be made at once. Section 177 of the Act provides that a resolution when put to vote at a meeting shall be decided by a show of hands unless a poll is demanded under Section 179.

(ii) **Voting by poll:** Poll means "counting of heads". We know that normally the members present at a meeting are entitled to one vote each on a show of hands irrespective of the number of shares held by them in the company. Accordingly, under the method of show of hands the result of the meeting may not reflect the true

position. Therefore, Section 179 provides that the poll be taken if the Chairman or a prescribed number of members are dissatisfied with the result of voting by show of hands.

In a poll, since the votes are counted on the basis of shareholdings of members, the true sense of meeting can be ascertained. Further in a poll proxies can also exercise their vote. In this system too, like ballot, the poll papers are given to persons who are entitled to vote who indicate on them their names and whether they are voting for or against the motion and also indicate therein the number of votes which they are entitled to. Chairman appoints two scrutineers to scrutinise these poll papers and submit the report to him, who declares the result of the poll. In company meetings, the members present at a meeting can demand a poll either before or after the declaration of the result of voting by show of hands. If there are several resolutions, separate poll papers will be used for each resolution.

(iii) Voting by Postal ballot: Section 192A of the Act as inserted by the Companies (Amendment) Act, 2000 provides for passing of resolution by postal ballot. Where a company decides to pass a resolution by postal ballot, it shall send notice to all the shareholders alongwith a draft resolution explaining the reasons thereof. The shareholders are asked to send their assent or dissent in writing on a postal ballot within a period of thirty days from the date of posting of the letter. Such notice must be sent by registered post acknowledgement due or by any other method as may be prescribed by the Central Government. The said notice shall also accompany a postage pre-paid envelope for facilitating the communication from the shareholder. If a resolution is passed by assent or majority of the shareholders by means of postal ballot, it shall be deemed to have duly passed at a general meeting.

(iv) Voting by Electronic Mode: The Central Government vide general circular 27/2011 dated 20.05.2011, general circular 21/2011 dated 02.05.2011 and 35/2011 dated 06.06.2011 allowed shareholders participation in general meetings through video conferencing and electronic voting in general meetings. Further, any agency may provide electronic platforms for electronic voting subject to the conditions that they obtain a certificate from Standardization Testing and Quality Certification (STQC) Directorate, Department of Information Technology, Ministry of Communication and IT, Government of India, New Delhi.

Section 192A of the Companies Act, 1956 already recognizes voting by electronic mode for postal ballot. Accordingly, Central Government has also introduced Companies (Passing of the Resolution by Postal Ballot) Rules, 2011 (in supersession of earlier rules) which contains rules for e-voting under postal ballot and provides that the company shall follow the procedure for e-voting as recommended by the agency.

11. RESOLUTIONS

Decisions of a company are made by resolutions passed by the prescribed majority of the members present at the meetings. Resolutions under present Act are of three kinds, (a) ordinary, (b) special, and (c) resolutions requiring special notice.

Sections 189 of the Act defines the ordinary and special resolutions:

- (a) A resolution, which requires simple majority of the members entitled to vote and voting in person, or, where proxies are allowed, by proxy, is called an

ordinary resolution. The draft of a proposed ordinary resolution need not be set out in the notice convening the meeting. If however, some special business has to be transacted through an ordinary resolution, the notice must state it as special business and the proposed resolution is set out in the notice.

- (b) A special resolution is one passed at a general meeting of a company when
 - (i) notice of the meeting specifying the intention to propose the resolution as a special resolution has been duly given as required under the Act, and
 - (ii) the votes cast in favour of the resolution (whether on a show of hands or on a poll by members who being entitled so to do, vote in person, or where proxies are allowed by proxy) are not less than three times the number of votes, if any, cast against the resolution by members so entitled to vote.

In short, a resolution is said to be a special resolution if notice of the intention to move it as a special resolution is given specifically and it is passed by three-fourths majority of the votes. The validity of a resolution passed at a meeting depends on the proper constitution and conduct of the meeting, which means:

- (a) a notice convening the meeting had been given on proper authority and in accordance with the law;
- (b) quorum was present;
- (c) proper person was in the chair;
- (d) the meeting was competent to pass the resolution;
- (e) reasonable discussion was allowed;
- (f) the motion was correctly voted upon.

Resolution requiring special notice

According to Section 190 of the Act, where by any provision in this Act or in the articles, special notice is required of any resolution, notice of the intention to move the resolution shall be given to the company not less than fourteen days before the meeting at which it is to be moved, exclusive of the day on which the notice is served or deemed to be served and the day of the meeting. On receipt of such a notice, the company must give to its members, notice of the resolution in the manner in which it gives notice of the meeting. In case it is not practicable, the company must give a minimum of seven days notice to members through an advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles.

Resolutions passed at Adjourned Meeting

A resolution passed at an adjourned meeting either of a company or the holders of any class of shares in a company or board of directors of a company shall be treated as having been passed on the date on which it was in fact passed and not on an earlier date (Section 191).

Circulation of Members' Resolution

Section 188 of the Act makes available to members the administrative machinery of the company to introduce resolutions at the annual general meetings. Accordingly, Section 188 provides that if members having one-twentieth of the total voting power

of all the members having right to vote on the resolution or business to which their requisition relates, or if not less than 100 members having right to vote and holding a paid-up share capital of Rs. 1,00,000 or more, require the company to do so, the company must at the expense of the requisitionists, unless the company otherwise resolves:

- (a) give to the members entitled to receive notice of the next annual general meeting notice of any resolution which may properly be moved and is intended to be moved at that meeting;
- (b) circulate to the members entitled to have notice of any general meeting sent to them, any statement of not more than 1,000 words with respect to the matter referred to in any proposed resolution, or any business to be dealt with at that meeting.

The requisition, signed by all the requisitionists, must be deposited at the registered office of the company at least 6 weeks before the meeting in the case of requisition requiring notice of a resolution and not less than 2 weeks before the meeting in case of any other requisition together with a reasonable sum to meet the expenses.

However, where a copy of the requisition requiring notice of resolution has been deposited at the registered office of the company and an annual general meeting is called for a date six weeks or less after the requisition is deposited, the copy though not deposited within the time required by Section 188, is deemed to have been properly deposited.

The company is required to serve notice of the resolution and/or the statement to the members as far as possible in the manner and so far as practicable at the same time as the notice of the meeting, otherwise as soon as practicable thereafter. The following are the requirements for circulation of members' resolution as incorporated in Section 188.

- (1) Requisition is given in writing duly signed by the following members:
 - (a) representing at least one-twentieth of the total voting power; or
 - (b) at least one hundred members holding shares of the paid-up value of Rs. One lakh.
- (2) Copy of the requisition signed by the requisitionists is deposited at the registered office of the company (a) in case of a requisition requiring notice of a resolution at least six weeks before the meetings (b) in any other case, at least two weeks before the meetings
- (3) Expenses for circulation of the resolution/statement by the company are tendered by the requisitionists.
- (4) The company shall not be bound to give notice of any resolution or to circulate any statement unless the requisitionists comply with the conditions as mentioned above.
- (5) The company shall also not be bound under this section to circulate any statement if, on the application either of the company or of any other person who claims to be aggrieved, the Company Law Board is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter; and the Company Law Board may order the company's costs on an application under this section to be paid in whole or in part by the

requisitionists, notwithstanding that they are not parties to the application. A banking company need not circulate such statement, if in the opinion of its Board of directors the circulation will injure the interests of the company.

The company is no doubt to give notice of any resolution or to circulate any statement provided there is full compliance of the provisions as contained in Sub-section (4) of Section 188. These are mandatory provisions and there is no escape from their application [*Naresh Kumar Jain v. Union of India* [1995] 23 CLA 238 (Delhi)].

12. REGISTRATION OF RESOLUTIONS AND AGREEMENTS

Section 192 of the Companies Act states that a copy of each of the following resolutions (together with a copy of the statement of material facts annexed under Section 173 to the notice of the meeting in which such resolution has been passed) or agreement must, within 30 days after the passing or making thereof, be printed or typewritten and duly certified under the signature of an officer of the company and filed with the Registrar who shall record the same:

- (a) special resolutions;
- (b) resolutions which have been agreed to by all the members of a company, but which if not so agreed to would not have been effected for their purpose unless they had been passed as special resolutions;
- (c) any resolution of the Board of directors of a company or agreement executed by a company relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
- (d) resolutions or agreements which have been agreed to by all the members of any class of shareholders but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by some particular majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind all the members of any class of shareholders though not agreed to by all those members;
- (e) resolutions passed by a company (i) according consent to the exercise by its Board of directors of any of the powers under clause (a), clause (d) and clause (e) of Sub-section (1) of Section 293; (ii) approving the appointment of sole selling agents under Section 294 or Section 294AA;
- (f) resolution requiring a company to be wound up voluntarily passed in pursuance of Sub-section (1) of Section 484; and
- (g) copies of the terms and conditions of appointment of a sole-selling agent appointed under Section 294 or of a sole selling agent or other person appointed under Section 294AA.

Where articles have been registered, a copy of every such resolution which has the effect of altering the articles and a copy of every agreement for the time being in force shall be embodied in or annexed to every copy of the articles issued after the passing of the resolution or the making of the agreement. Where the articles have not been registered, a printed copy of every resolution or agreement shall be forwarded to any member at his request on payment of one rupee.

Ordinarily the Registrar has no authority to enquire into the validity of a meeting and the resolutions passed at it, [See *Golkunda Industries (P) Ltd. v. R.O.C.* (1968)].

But even so his role is not merely that of a mechanical agent to receive documents with one hand and to file them with the other. On occasions he may have to exercise his discretion. Accordingly where the documents like memorandum containing unlawful clauses or a resolution containing matters in violation of law are filed, Registrar may refuse registration. [*Pioneer Mutual Benefit and friendin-Need Society Ltd. v. Asst. Reg. Of Joint Stock Cos.*, (1933)].

13. PASSING OF RESOLUTIONS BY POSTAL BALLOT

Section 192A of the Companies Act, 1956 provides as follows:

- (i) Notwithstanding anything contained in the Companies Act, 1956, a listed public company may, and in the case of resolutions relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company.
- (ii) Accordingly where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor, and requesting them to send their assent or dissent in writing on a postal ballot within a period of 30 days from the date of posting of the letter.
- (iii) The notice shall be sent by registered post acknowledgement due, or by any other method as may be prescribed by the Central Government in this behalf. Also with the notice, there shall be included a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period.
- (iv) (If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.)
- (v) If a shareholder sends his assent or dissent in writing as aforesaid on a postal ballot and thereafter any person fraudulently defaces or destroys the ballot paper or declaration of identity of the shareholder, such person shall be punishable with imprisonment for a term which may extend to 6 months or with fine of with both.
- (vi) If a 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 Rs. 50000 in respect of each such default.

Explanation- For the purpose of Section 192A, "postal ballot" includes voting by electronic mode.

Central Government has introduced Companies (Passing of the Resolution by Postal Ballot) Rules, 2011 (in supersession of earlier rules) vide Notification No. GS.R. 419(E) dated 30.05.2011.

The text of the Rules is reproduced below:

Companies (Passing of the Resolution by Postal Ballot) Rules, 2011

G.S.R. 419(E) dated 30.05.2011 - In exercise of the powers conferred by section 192A read with clauses (a) and (b) of sub-section (1) of section 642 of the Companies Act, 1956 (1 of 1956), the Central Government, hereby makes the following rules, in supercession of Companies (passing of the resolution by postal ballot) Rules, 2001 namely:-

1. Short Title and commencement

- (i) These rules may be called the Companies (passing of the resolution by postal ballot) Rules, 2011.
- (ii) They shall come into force on the date of their publication in the official gazette.

2. Definitions:-

In these rules unless the context otherwise requires –

- (a) "Act" means the Companies Act, 1956.
- (b) "Agency" means agency appointed for providing and supervising electronic platform for voting by electronic platform shall be an agency approved by the Ministry of Corporate Affairs.
- (c) "Postal Ballot" includes voting by share holders by postal or electronic mode instead of voting personally by presenting for transacting businesses in a general meeting of the company;
- (d) "Requisite majority" with regard to Special Resolution means votes cast in favour of the business is three times more than the votes cast against, with regard to ordinary resolution, votes cast in favour is more than the votes cast against.
- (e) "Voting by electronic mode" means a process for recording votes by the members using a computer based machine to display an electronic ballot and to record the vote and also the number of votes polled in favour or against such that the entire voting gets registered and counted in a electronic registry in a centralised server;
- (f) Words and expressions used herein but not defined shall, unless the context otherwise requires, bear the meaning, if any, as assigned to them under the Act and Information Technology Act, 2000.

3. Notice:-

- (a) The company may issue notices either,-
 - (i) Under Registered Post Acknowledgement Due; or
 - (ii) Through any other secured mode of posting provided by Department of Post; or
 - (iii) through electronic mail provided the company has obtained e-mail address of its member for sending the notices through e-mail, after giving an advance opportunity to the member to register his e-mail address and changes therein from time to time with the concerned depository; and

(b) The notice shall clearly mention that whether the company is providing voting through postal ballot or by electronic mode. If the company is opting for providing voting by electronic mode, then the notice shall clearly indicate the process and manner for voting by electronic mode provided by the agency.

(c) The company shall cause an advertisement to be published in a leading English Newspaper and in one vernacular Newspaper circulating in the State in which the registered office of the company is situated, about having dispatched the ballot papers duly specifying therein, inter alia, the following matters:

- (i) The date of completion of despatch of notices;
- (ii) The date of commencement of voting through postal ballot or by electronic mode;
- (iii) The date of end of voting through postal ballot or by electronic mode;
- (iv) The notice shall further state that any postal ballot received from member beyond the said date will not be valid.
- (v) That members, who have not received postal ballot forms may apply to the Company and obtain a duplicate thereof.

4. Applications:-

These Rules shall be applicable to listed companies and in case of resolutions relating to such businesses as are specified under rule 5.

5. List of businesses in which the resolutions shall be passed through Postal Ballot.

- (a) Alteration of the Object Clause of Memorandum;
- (b) Alteration of Articles of Associations in relation to insertion of provisions defining private company;
- (c) Buy-back of own shares by the company under sub-section (1) of section 77A;
- (d) Issue of shares with differential voting rights as to voting or dividend or other wise under sub-clause (ii) of clause (a) of section 86;
- (e) Change in place of Registered Office out side local limits of any city, town or village as specified in sub-section (2) of section 146;
- (f) Sale of whole or substantially the whole of undertaking of a company as specified under sub-clause (a) of sub-section (1) of section 293;
- (g) Giving loans or extending guarantee or providing security in excess of the limit prescribed under sub-section (1) of section 372A;
- (h) Election of a director under proviso to sub-section (1) of section 252 of the Act;
- (i) Variation in the rights attached to a class of shares or debentures or other securities as specified under section 106.

6. Procedure to be followed for conducting business through Postal Ballot:-

- (a) The company may make a note below the notice of General Meeting for understanding of members that the transaction(s) at Sl. No. requires consent of shareholders through postal ballot;

- (b) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner;
- (c) The scrutinizer shall submit his report as soon as possible after the last date of receipt of Postal Ballots;
- (d) The scrutinizer will be willing to be appointed and he is available at the Registered Office of the company for the purpose of ascertaining the requisite majority;
- (e) The scrutinizer shall maintain a register to record the consent or otherwise received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-voting rights and the Scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The Postal Ballot and all other papers relating to postal ballot will be under the safe custody of the Scrutinizer till the Chairman considers, approves and sign the minutes of the meeting. Thereafter, the Scrutinizer shall return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/register safely till the resolution is given effect to;
- (f) The consent or otherwise received after thirty days from the completion of dispatch of notice shall be treated as if reply from the member has not been received;

7. Procedure to be followed for conducting business by electronic mode:-

The company shall follow the procedure for voting by electronic mode as recommended by agency.

XYZ LIMITED

Registered Office

Postal Ballot Form

1. Name(s) of Shareholder(s) _____
(in block letters) _____
(including joint holders, if any) _____
2. Registered address of the sole/first named shareholder
3. Registered folio No./DP ID No./Client ID No.*
(* Applicable to investors holding shares in dematerialized form)
4. Number of shares held
5. I/We hereby exercise my/our vote in respect of the ordinary/special resolution to be passed through postal ballot for the business stated in the notice of the

Company by sending my/our assent or dissent to the said resolution by placing the tick (3) mark at the appropriate box below.

<i>Item No.</i>	<i>No. of shares</i>		
		I/We assent to the resolution	
		I/We dissent to the resolution	

Place:

Date:

(Signature of the shareholder)

INSTRUCTIONS

1. A member desiring to exercise vote by postal ballot may complete this Postal Ballot Form and send it to the company in the attached self-addressed envelope. Postage will be borne and paid by the company. However, envelopes containing postal ballots, if sent by courier at the expenses of the registered shareholder will also be accepted.
2. The self-addressed envelope bears the address of the scrutineer appointed by the Board of Directors of the company.
3. This form should be completed and signed by the shareholder. In case of joint holding, this form should be completed and signed (as per the specimen signature registered with the company) by the first named shareholder and in his absence, by the next named shareholder.
4. Unsigned Postal Ballot Form will be rejected.
5. Duly completed Postal Ballot Form should reach the company not later than the close of working hours on _____ (day) _____ (date). Postal Ballot Form received after this date will be strictly treated as if the reply from the member has not been received.
6. Voting rights shall be reckoned on the paid up value of shares registered in the name of the shareholders on the date of despatch of the notice.

Items to be included in the calendar of events

1. Date of Despatch of notice of Meeting in which the business as notified by the Central Government will also be transacted through Postal Ballot.
2. Date of completion of despatch of notice along with Postal Ballot.
3. Date of appointment of scrutiner.
4. Date on which consent given by the scrutiner to act as scrutiner.
5. Last date for receiving Postal Ballot papers by scrutiner.
6. Date of signing of the minutes book by the Chairman in which the results ballot is recorded.

7. Date of returning the Ballot papers, register required to be maintained by the scrutinizer under rule 5(e) of the Companies (passing of the resolutions by postal ballot) Rules, 2001 and other related papers to the Chairman by the Scrutinizer.
8. Date of Board resolution authorising one of the functional directors and the secretary to be responsible for the entire poll process.
9. Date of handing over the ballot papers to the designated authority.

14. ADJOURNMENT

'Adjournment' literally means an act of putting off or breaking off for resumption at a later date, time and place. In relation to meetings, adjournment connotes a fact of suspending a meeting after it has been duly commenced to be resumed at a later time or date fixed in that meeting itself at the time of such adjournment or to be decided later on. Where a meeting is adjourned without specifying the time after the expiry of which it will be resumed, the meeting is said to have adjourned *sine die*. It is also to be noted that the discussion on a particular business or motion may be adjourned without adjourning the meeting itself.

The power of adjournment vests in the majority of those present at the meeting. If the Chairman vacates his chair or adjourns the meeting ignoring the views of the majority, then those remaining, even if in minority, can appoint a Chairman and transact the business left unfinished. Where the Chairman unlawfully adjourns the meeting realising that he may not be successful in achieving his objectives, the remaining members will have the right to proceed with the meeting and complete the untransacted business.

For the proper conduct of a meeting, power of adjournment is generally conferred upon the Chairman. However such power of adjournment of meeting must be exercised for the proper conduct of the meeting. Unless otherwise expressly provided, the Chairman cannot be compelled to exercise the right of adjournment. At the same time it should be noted that the Chairman cannot adjourn the meeting at his own discretion without there being a good or valid cause for such an adjournment. Where the Chairman, acting *bona fide* within his powers, adjourns the meeting, the dissentient members cannot proceed to continue with such meeting and, if they do, the proceedings thereof will be null and void.

However, the chairman has no power to stop or adjourn a meeting at his will. A meeting of a company cannot be adjourned arbitrarily, for the members are entitled to pursue to a conclusion of the business for which they have met. The articles of a company may provide on the lines of Regulation 53(1) of Table A of the Companies Act, which provides "that the chairman may, with the consent of any meeting at which a quorum is present and shall, if so directed by the meeting, adjourn the meeting from time to time and from place to place". However, there are a number of judicial pronouncements in this regard. A brief appraisal of them is as follows:

- (1) The chairman has no power to stop the meeting and dissolve it before the business of the meeting is over [*Vakil v. Bombay Residency* AIR 1845 Bom. 175].
- (2) Where the articles provide that the chairman may with the consent of any meeting, adjourn the meeting, he may, in his discretion refuse to adjourn

even though the meeting may resolve to do so (*Salisbury Gold Mining Co. v. Hathorn*), but if the articles provide that he shall adjourn, he has no choice but must adjourn if so resolved by the meeting. In the cited case, the articles of the company stated that “the chairman may with the consent of the members present at any meeting adjourn from time to time and from place to place. The chairman declined to put a motion to adjourn the meeting even though it had been proposed and seconded and if put to vote would probably have been carried, as the chairman felt that such adjournment would prejudice the absentee shareholders. It was held that the chairman had acted within the powers given to him by the articles even if the majority required it, so business subsequently conducted was valid.

- (3) The chairman cannot arbitrarily dissolve or adjourn a meeting and if he prematurely closes a meeting or purports to adjourn it, his act will be irregular and it will be open to the meeting to select another chairman and proceed with the business [*Seth Sobha Mal Lodha v. Edward Mills Ltd.* (1972) 42 Comp. Cas. 1 (D.B.) (Raj.)].

Whether Fresh Notice is Required

An adjourned meeting is merely the continuation of the original meeting so a fresh notice is not necessary, if time, date and place for holding the adjourned meeting are decided and declared at the time of adjourning. The rules may provide for notice to be given for adjourned meeting if the interval exceeds a fixed time, e.g., 30 days. If the meeting is adjourned *sine die*, fresh notice of the adjourned meeting is necessary.

Since in law an adjourned meeting is a continuation of the original meeting only the business not finished at the original meeting can be transacted at the adjourned meeting unless proper notice as prescribed in the Act is given for a new proposal.

Whether Fresh Proxies are Required

Where meeting in question was only an adjourned meeting there was nothing improper in using old proxies and it could not be said the meeting was not properly held. [*Kothari Industrial Corpn. Ltd. v. Maxwell Dyes & Chemicals (P) Ltd.* [1995] 5 SCL 82].

While issuing notice for adjourned meeting, calling for fresh proxies is not illegal for the simple reason that fresh proxies ought to be called for as it is a matter of right to the shareholders to change their respective proxies for the adjourned meetings and for the new shareholders to give their own proxies for the adjourned meeting.

Where the notice of the adjourned meeting was issued with the same wording as that of the previous notice, and the fresh proxy form was enclosed therewith, it could not be categorised as an unlawful act on the part of the company. It would suffice if the adjourned meeting transact only the business left untouched in the original meeting and no new business was transacted. [*Maxwell Dyes & Chemical (P) Ltd. v. Kothari Industrial Corpn. Ltd.* (ibid)].

When poll is not demanded, chairman of meeting is not under obligation to order poll and a shareholder who did not demand poll cannot challenge the resolution

subsequently. [*Jetu Jacques Tara Lalwani v. JBA Printing Inks Ltd.* [1996] 20 CLA 12 (Bom.)].

Postponement

Postponement of a meeting is to put off or defer the holding of a meeting before the date originally fixed for the meeting has arrived. The postponement is the act of the convening authority whereas the adjournment is the act of the meeting itself.

There is no general principle relating to postponement having universal application and wide acceptance. Doubts have been expressed as to whether a duly convened meeting can be properly postponed. It is felt that a meeting which has been once duly convened cannot be postponed and if for any reason it is not convenient to hold the meeting on the date originally fixed, the better course, in such cases would be to hold the meeting first and then adjourn it to some other convenient date.

There is another view that the power to convene a meeting also implies the power to postpone the meeting in case such a need arises. But such implied power of postponement must be exercised *bona fide* and in the interest of the association or the body concerned. Unanimity on the issue of postponement of a meeting is desirable. It will, therefore, be worthwhile to make a provision in the relevant rules and regulations of an association to postpone a meeting to take care of any eventuality, which may be beyond the control of the association, in case the postponement of meeting may become necessary for legitimate reasons.

Dissolution

Dissolution of a meeting refers to the situation where the meeting no longer exists as such. Its proceedings are not merely suspended but exhausted.

As per Section 174 of the Companies Act, if within half an hour after the time appointed for holding a general meeting; the quorum is not present, the meeting shall stand dissolved if it was called on requisition.

15. MINUTES OF PROCEEDINGS OF MEETINGS

Every company is required to keep minutes of the proceedings of general meetings and of the meetings of Board of directors and its committees. The minutes are a record of business transacted at a meeting. With a view to ensuring the authenticity of the minutes of proceedings of general meetings and those of Board meetings or those of a Committee of a Board, Section 193 provides that every company must keep minutes containing a fair and correct summary of all proceedings of general meetings and Board and its committee meetings in books kept for that purpose. The minutes books must have their pages consecutively numbered, and the minutes must be recorded therein within 30 days of the meeting. They have to be written directly on the numbered pages.

Sub-section (1A) of Section 193 provides that each page of every such minutes book must be initialled or signed and last page of the record of proceedings of each meeting in such books must be dated and signed—

- (a) in the case of the meeting of the Board of directors or Committee thereof, by

the Chairman of the said meeting or that of the succeeding meeting; and

- (b) in the case of a general meeting, by the chairman of the same meeting within the aforesaid 30 days or in the event of the death or inability of that chairman within the period, by a director duly authorised by the Board of directors for the purpose.

There is no legal requirement of obtaining confirmation of minutes of the Board meeting in the succeeding meeting. The Chairman of the meeting has the full authority to approve the minutes of the Board Meeting. Section 193(1A)(a) gives an option to have the minutes signed by the Chairman of the meeting of the Board of directors or the Chairman of the next succeeding meeting of the Board of directors. Such minutes have to be recorded within 30 days of the date of the Board meeting, however, as the minutes of a Board meeting could be signed by the Chairman of the succeeding meeting, it cannot be insisted upon that the minutes of Board Meeting have to be signed within 30 days.

The Company Law Board, however, may not object if the minutes are maintained in the loose leaf form provided all other procedural requirements are complied with and all possible safeguards against manipulation or interpolation of the minutes are ensured. The loose leaves can be got bound at reasonable interval say, six months. Entering the minutes, in the bound minutes book by a chemical process, which does not amount to attachment to any book by pasting or otherwise is permissible provided on the mechanical impression of the minutes, the original signatures of the Chairman are given on each page.

Section 193 does not provide that minutes should be written up to the last page of minutes book. Thus, where after recording the minutes of a condolence meeting of the Board on the death of one of the directors, a new minute book was started, it was held that, in the absence of allegation that the minutes were not written faithfully or in time, it could not be contended that minutes book could not be relied upon to decide allegation of oppression levelled against director [*Mahrani Yogeshwari Kumari v. Lake Shore Place Hotel* [1996] 21 CLA 107 (Raj.)].

All appointments of officers made at any of the meetings must be included in the minutes of the meeting. In the case of meeting of the Board of directors or its Committee, the minutes must also state the names of directors present at the meeting and the names of directors, if any, dissenting from, or not concurring to a resolution passed at the meeting. The chairman may exclude from the minutes any matter which is defamatory, irrelevant or immaterial or which are detrimental to the interests of the company. The discretion of the chairman with regard to the inclusion or exclusion of any matter is absolute and unfettered.

Section 194 states that the minutes of meetings kept in accordance with the provisions of Section 193, as described above, shall be evidence of the proceedings recorded therein. They are, however, only *prima facie* evidence and as such are refutable. [*Kern. John Mottram Ltd.* (1940) Ch. 657].

Minutes books kept and maintained in the normal course of business is evidence of proceedings at the meeting. The minutes book created the presumption that the meeting of Board of directors was duly called and held and all the proceedings at the

meeting took place duly in accordance with the requirements of the Act. [*M.S. Madhusoodanan v. Kerala Kaumudi P. Ltd.* (2003) 117 Com Cases 19 2004 CLC 117 (SC)].

Section 195 provides to the same effect and states that where minutes of the proceedings of any meeting have been kept in accordance with the provisions of Section 193, they are, unless the contrary is proved, presumed to be correct, and show presumptive evidence that the meeting was duly called and held, and all proceedings thereat to have duly taken place, and in particular, all appointments of directors or liquidators made at the meeting shall be deemed to be valid.

So far as the presumption under Section 195, read with Section 193, in regard to minutes of extraordinary general meetings are concerned, the same is neither applicable nor available to the requisitioned extraordinary general meeting under Section 169. [*Bhankerpur Simbhaoli Beverages P. Ltd. v. Sarabhjit Singh* (1996) 86 Comp. Cas 842 (P&H)].

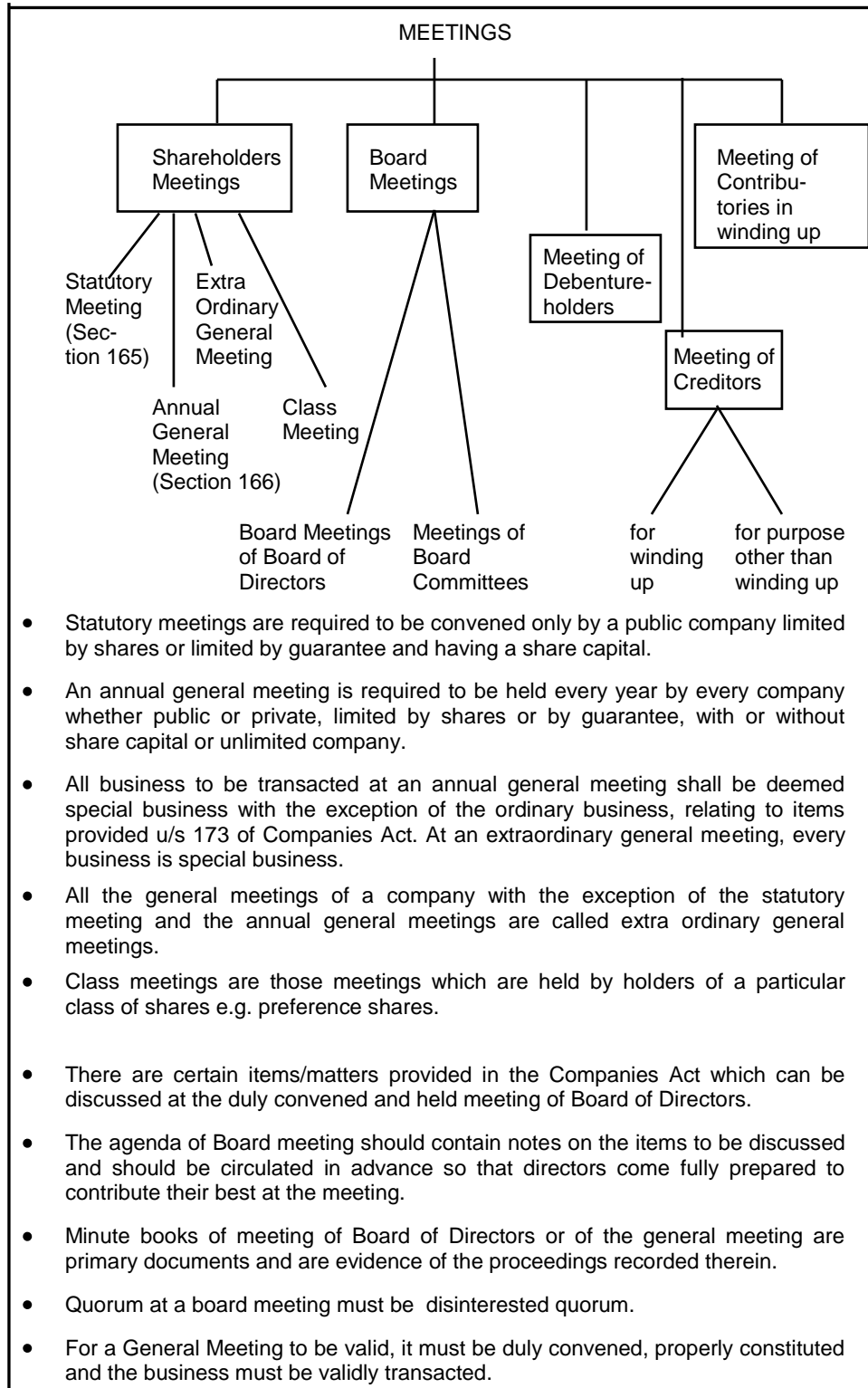
The minutes book must be kept at the registered office of the company. Every member has a right to inspect, free of cost during business hours at the registered office of the company, the minutes book containing the proceedings of the general meetings of the company. Further, any member shall be entitled to be furnished within 7 days after he has made a request to the company, with a copy of any minutes on payment of such sum as may be prescribed for every hundred words or fraction thereof.

If any inspection is refused or a copy requested for is not furnished within the time specified, every officer in default shall be punishable with fine which may extend up to Rs. 500 for each offence. The Company Law Board can also by order compel an immediate inspection or furnishing of a copy forthwith. But the minutes books of the Board meetings are not open for inspection by members.

LESSON ROUND-UP

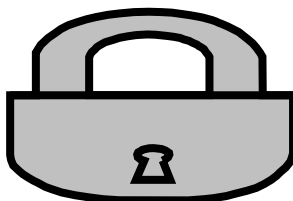


- Decision making powers of a company are vested in the members and the directors and they exercise their respective powers through resolutions passed by them at the duly convened Meetings.
- Company Meetings may be classified as



- Notice of every meeting of Company shall be given to (i) every member, (ii) the persons entitled to shares in consequence of the death or insolvency of a member and (iii) the auditor or auditors for the time being of the Company.
- Proxy appointed to attend and vote at a general meeting need not be a member of the company.
- Proxy can be revoked by the member by attending and voting himself before the proxy has voted.
- Section 183 of the Act regulates voting by members.
- Chairman plays a very important role in a meeting as he is responsible for successful conduct of a meeting.
- Company's whose securities are listed on any stock exchange are also required to comply with the listing agreement in addition to the provisions of the Companies Act. Clause 49 of the listing agreement also deals with Board procedures and its constitution etc.
- A motion becomes a resolution only after the requisite majority of members have adopted it.
- Various methods which may be adopted for taking votes on a motion properly placed before a meeting are by show of hands, by poll, by postal ballot and by electronic voting.
- There are three kinds of resolutions under the Act (a) Ordinary Resolution (S. 189), (b) Special Resolution (S. 189) (c) Resolution requiring special notice (S. 190)
- In accordance with Section 192 of the Act, certain resolutions are required to be filed with the Registrar for its recording within 30 days of its passing at the meeting.
- There are certain businesses, specified under Section 192A of the Act, which are required to be passed through postal ballot.
- Postponement is the act of the convening authority whereas the adjournment is the act of meeting itself.
- Every company is required to keep minutes of the proceedings of general meetings and of the meetings of Board of Directors and its committees.

SELF-TEST QUESTIONS



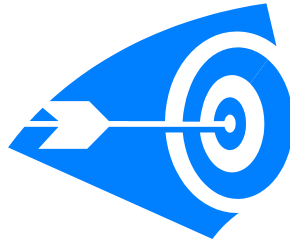
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What are the items that constitute Ordinary Business in an Annual General Meeting of a company?
2. Who shall be chairman of a general meeting of a company? What are the provisions of the Companies Act, 1956 regarding his election?

3. Every Annual General Meeting of a company shall be called on a day which is not a public holiday. Can an adjourned Annual General Meeting of a company be called on a public holiday?
 4. A shareholder having given proxy, personally attends and votes at the meeting. Comment, illustrating a case law.
 5. A valid demand of a poll was received at a general meeting. Thereafter, those who made it, withdraw it. Examine the same in the light of the provisions of the Companies Act.
 6. At a general meeting, two joint holders voted on a resolution. Will the votes of both the joint holders be accepted?
 7. Differentiate between a motion and a resolution.
 8. What are the provision of the Companies Act, in regard to the holding of a Board Meeting?
 9. Write short notes on:
 - (i) Proxy; (ii) Statutory Report; (iii) Special Business; (iv) Quorum;
 - (v) 'Material Facts'.
 10. Can any company pass some resolutions through postal ballot? If yes, what are the Rules in connection to it.
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STUDY XIX
INVESTMENTS AND LOANS

LEARNING OBJECTIVES



This lesson explains provisions of the Companies Act, 1956 in relation to inter-corporate loans and investments. It describes the conditions wherein such loans and investments can be made or not made by the corporates. It also gives provisions for register of loans made, guarantees given, securities provided and investments made as also register of investments not held in company's own funds. The lesson further lists the circumstances wherein companies are not required to keep the investments in its own name.

At the end of the lesson, you should be able to understand:

- Inter-corporate loans and investments.
- Blanket permission from shareholders not admissible.
- Circular of MCA.
- Register of loans made, guarantees given, securities provided and investments made.
- Inspection of register.
- Penalties and exemptions.
- Investments to be held in company's own name and exemptions.
- Register of investments not held in company's own name.
- Penalty for non-compliance.

1. INTRODUCTION

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, for the purpose of this study, the term 'Investments' is used in a limited sense to mean the investing of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 292 of the Act. However, that the Board may not misuse its powers, the Companies Act, 1956 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the

company will have to pay the amount. Thus apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.

Provisions in respect of giving of loans, making investments, giving guarantee or providing securities have been considerably modified w.e.f. 31.10.98 by inserting Section 372A and providing that earlier Sections 370 & 372 shall not apply in respect of loans/investment made or guarantees/securities provided after 31.10.1998. As of now, an overall limit of 60% of paid-up capital plus free reserves or 100% of free reserves, whichever is more has been fixed.

2. INTER-CORPORATE LOANS AND INVESTMENTS

As per Section 372A:

1. No Company shall, directly or indirectly:
 - (a) make any loan to any other body corporate;
 - (b) give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
 - (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;
exceeding 60% of its paid-up share capital and free reserves or 100% of its free reserves, whichever is more.
2. However, a company may make loan, give any guarantee or provide security and/or make investment in aggregate exceeding the aforesaid limits of 60% or 100% if the same is previously authorised by a special resolution passed in a general meeting.
3. The Board of directors may give guarantee without being previously authorised by a special resolution if:
 - (a) a resolution is passed in the meeting of the Board authorising to give guarantee in accordance with the provisions of Section 372A;
 - (b) there exist exceptional circumstances which prevent the company from obtaining previous authorisation by a special resolution passed in a general meeting for giving a guarantee; and
 - (c) the resolution of the Board is confirmed within twelve months, in a general meeting of the company or the annual general meeting held immediately after passing of the Board resolution, whichever is earlier.
4. Notice of such resolution shall indicate:
 - (i) the specific limits;
 - (ii) the particulars of body corporate in which the investment is proposed to be made or loan or security or guarantee to be given;
 - (iii) the purpose of the investment, loan or security or guarantee;
 - (iv) specific sources of funding; and
 - (v) any other detail which is material.

5. No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all directors present at the meeting.
6. The company has to obtain prior approval of the public financial institution referred to in Section 4A, where any term loan is subsisting.
7. However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, alongwith the investments, loans, security or guarantee proposed to be made or given does not exceed the limit of 60% specified above and if there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.
8. Loan given to any body corporate shall carry the rate of interest not lower than the prevailing bank rate being standard rate made public under Section 49 of the Reserve Bank of India Act, 1934.
9. No company, which has defaulted in complying with the provisions of Section 58A shall directly or indirectly:
 - (a) make any loan to any body corporate;
 - (b) give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
 - (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate,till such default is subsisting.

This prohibition will operate in respect of any default under Section 58A and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.
10. The Central Government may prescribe guidelines for the purposes of this Section.

Explanations: For the purpose of this Section:

- (a) "Loan" includes debentures or any deposit of money made by one company with another company, not being a banking company;
- (b) "Free reserves" means those reserves which as per latest audited balance-sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Section 372A compared with Section 295 — It should be noted that the provisions of Section 295 of the Companies Act will be applicable in case a loan is given by a company to another private company in which a director of the first company is a director or member of the private company. As a result, prior approval of the Central Government shall have to be taken for such a loan. Also in cases

where one or more directors of the lending company exercise 25% or more of the total voting power in any other body corporate, approval of the Central Government would be necessary.

Applicability of Section 372A to Section 25 Company or a guarantee Company not having share capital — The provisions of Section 372A shall also apply to these Companies. In such cases where there is no share capital, computation shall be based upon the free reserves of the company if any.

Test your Knowledge

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

Every proposal for making loan to any other body corporate, give any guarantee or provide security, or acquiring the securities of any other body corporate in excess of the limits of 60% or 100% as the case may be, is not liable for approval at the general meeting.

- True
- False

Correct answer: False

Every proposal for making loan to any other body corporate, give any guarantee or provide security, or acquiring the securities of any other body corporate in excess of the limits of 60% or 100% as the case may be, shall be approved at the general meeting by way of an special resolution.

3. NO BLANKET PERMISSION FROM SHAREHOLDERS

We have already mentioned that every proposal in excess of the limits of 60% or 100% as the case may be, shall be specifically approved at the general meeting. A blanket permission of the shareholders empowering the Board to make loan or investments or give guarantee or security upto certain aggregate limit will not be adequate compliance with the provisions.

4. CIRCULAR

The Department of Company Affairs, now Ministry of Corporate Affairs issued a circular regarding the need for companies *inter-alia* to obtain specific approval of shareholders and avoid enblock approval (except in the case of guarantees).

The Department of Company Affairs, now Ministry of Corporate Affairs has vide its Circular No. 8/99-F No. 5/17/99CL.V dated 4.6.1999 cautioned companies on the misuse of the liberalised provisions of Section 372A. The said circular is quoted below:

1. The provisions in the Companies Act, 1956 relating to inter-corporate investments, loans and guarantees have been recently liberalised by the Government through Companies (Amendment) Act, 1999. However, apprehensions have been expressed in some quarters with regard to possible misuse of these provisions by companies. I shall be grateful if the Chamber could draw the attention of their constituents to the following:
 - (i) the companies are expected to obtain the approval for making investments into securities or grant of loan to other companies of

amounts which are limited with the company's available financial measures and the resolution for investment much beyond the networth should not be passed by the companies.

- (ii) the companies should specifically indicate in the explanatory statement to the resolution, the specific securities in which it is proposed to invest the amount. Enblock approval should normally be avoided (except in the case of guarantees where the resolution can indicate an amount on an annual basis).

- 2. If the above parameters are not complied with, the Government will be constrained to take suitable action against those who contravene these.

5. REGISTER OF LOANS MADE, GUARANTEES GIVEN, SECURITIES PROVIDED AND INVESTMENTS MADE

Sub-section (5) of Section 372A provides that:

- (a) Every company shall keep a register showing the following particulars, in respect of every investment or loan made, guarantee given or security provided by it, in relation to any body corporate under Sub-section (1) namely:
 - (i) the name of the body corporate;
 - (ii) the amount, terms and purpose of the investment or loan or security or guarantee;
 - (iii) the date on which the investment or loan has been made; and
 - (iv) the date on which the guarantee has been given or security has been provided in connection with a loan.
- (b) The particulars of investment, loan, guarantee or security referred to above shall be entered chronologically in the register aforesaid within seven days of the making of such investment or loan, or the giving of such guarantee or the provision of such security.

Inspection of Register

The register referred to in Sub-section (5) shall be kept at the registered office of the company concerned and:

- (a) shall be open to inspection at such office; and
- (b) extracts may be taken therefrom and copies thereof may be required;

by any member of the company to the same extent, in the same manner, and on payment of the same fees as in the case of the register of members of the company; and the provisions of Section 163 shall apply accordingly [Sub-section (6) of Section 372A].

Penalties

- (i) If default is made in complying with the provisions of Sub-section (5) relating to maintenance of Register of loans/investments made, guarantees given and securities provided, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and also with a further fine which may extend to five hundred rupees for every day after the first day during which the default continues.

- (ii) If default is made in complying with the provisions of Section 372A except Sub-section (5), the company and every officer of the company who is in default shall be punishable with imprisonment which may extend to two years or with fine which may extend to fifty thousand rupees:

Provided that where any such loan or any loan in connection with which any such guarantee or security has been given, or provided by the company, has been repaid in full, no punishment by way of imprisonment shall be imposed under this sub-section, and where such loan has been repaid in part, the maximum punishment which may be imposed under the sub-section by way of imprisonment shall be appropriately reduced:

Provided further that all persons who are knowingly parties to any such contravention shall be liable, jointly and severally, to the company for the repayment of the loan or for making good the same which the company may have been called upon to pay by virtue of the guarantee given or the securities provided by such company.

Exemptions

Nothing contained in Section 372A shall apply:

- (a) to any loan made, any guarantee given or any security provided or any investment made by —
- (i) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructural facilities;
 - (ii) a company whose principal business is the acquisition of shares, stock, debentures or other securities;
 - (iii) a private company, unless it is a subsidiary of a public company;
- (b) to investment made in shares allotted in pursuance of clause (a) of Sub-section (1) of Section 81.
- (c) to any loan made by a holding company to its wholly-owned subsidiary;
- (d) to any guarantee given or any security provided by a holding company in respect of loan made to its wholly-owned subsidiary; or
- (e) to acquisition by a holding company, by way of subscription, purchases or otherwise, the securities of its wholly-owned subsidiary.

Test your Knowledge

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

If default is made in complying with the provisions of Section 372A(5), the company and every officer of the company who is in default shall be punishable with fine or imprisonment.

- **True**
- **False**

Correct answer: True

6. INVESTMENTS TO BE HELD IN COMPANY'S OWN NAME

According to Sub-section (1) of Section 49, investments made by a company (other than an investment company) on its own behalf shall be made and held by it in its own name.

The requirement that the investment made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. In a case where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. Therefore, the investments by the company as a trustee and held in the name of the beneficiaries is allowed.

Sub-section (2) of Section 49 provides that where a company has right to nominate a director or directors on the Board of another company, it would be open to the appointing or nominating company to hold the shares upto the amount of qualification shares (i) in its own name, (ii) jointly in its own name and the name of appointee or nominee director, or (iii) exclusively in the name of the appointee or nominee. As per Section 49(3), a company may hold any share or shares in its subsidiary through nominee or nominees of the company if it is so required to ensure that the number of members of the subsidiary does not fall below the minimum number prescribed under the Act for public and private companies.

Where the shares of a company were registered in the joint names of the company and one of its directors, it was held that the director was a nominee of the company for that purpose and could only act jointly as he had no rights of his own. [*Exchange Travel (Holdings) Ltd. Re.*, (1991) BCLC 728 (Ch D)].

If company holds shares in dematerialised form, the name of depository is entered in the register of members as member of the company and the name of the investing company as the beneficial owner of the said shares.

Section 49(6) provides that the certificate or letter of allotment relating to the shares or securities in which investments have been made by a company shall, except in two cases covered by Sub-sections (4) and (5) be in the custody of such company or with the State Bank of India or a Scheduled Bank, being the bankers of the company.

Exemptions from applicability of Section 49(1)

1. Sub-section (4) of Section 49 exempts a company from the requirement of holding shares or securities on its own behalf and in its own name if its principal business consists of buying and selling of shares or securities.
2. In terms of the provisions of Section 49(5), Section 49(1) does not prevent a company:
 - (a) from depositing with the bank, being the bankers of the company, any shares or securities for collection of any dividend or interest payable thereon; or
 - (b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the

company, shares or securities, in order to facilitate the transfer thereof. However, if within a period of 6 months from the date from which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities retransferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or

- (c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.
- (d) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

7. SPECIAL COURT (TRIAL OF OFFENCES RELATING TO TRANSACTIONS IN SECURITIES) ACT, 1992

Though not under the Companies Act, but under the aforesaid Act, in *Harshad Shanti Lal Mehta v. Custodian & Ors.* (1998) 231 ITR 71 (SC); it has been held that attached properties (securities) do not vest in the Custodian. In winding up proceeding, the properties vest in the liquidator.

8. REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME

When any shares or securities in which investments have been made by a company are not held by it in its own name pursuant to permissible conditions in Section 49, the company shall forthwith enter in a register maintained by it for the purpose, particulars specified below :

- (a) the nature, value, and such other particulars as may be necessary fully to identify the shares or securities in question; and
- (b) the bank or person in whose name or custody the shares or securities are held.

'Such other particulars' as aforesaid may include particulars relating to date of

investment; kind and number of securities in which investment is made; distinctive number of securities; name of the person in whose name the investment is made; where the company is a part of a group, the date on which it came within the group and names of all companies within the group; the date of disposal; and price and number of securities disposed of.

9. PENALTY

If default is made in complying with any of the requirements of Sub-sections (1) to (8) of Section 49, the company and every officer of the company who is in default, shall be punishable with fine which may extend to 50,000 rupees.

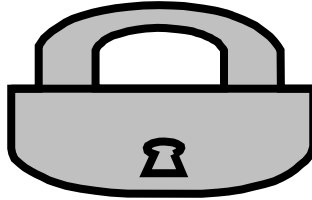
LESSON ROUND-UP



- 'Investments' has been used in a limited sense in the lesson to mean the investing of money in shares, stock, debentures or other securities.
- The power to invest the funds of the company is the prerogative of the Board of Directors. However, the Board must not misuse its powers. The Companies Act, 1956 contains provisions for restrictions on investments that a company can make and loans it can provide. Restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.
- The provisions for restrictions on investments and loans by companies would also apply to Section 25 companies and guarantee companies not having a share capital.
- Approvals for making investments and loans would have to be taken in accordance with the specific provisions of the Companies Act. A blanket approval of the shareholders for the purpose would not suffice.
- The Companies Act provides for the particulars to be provided in the register of loans made, guarantees given, securities provided and investments made and the manner in which it is to be kept.
- Provisions have also been given in relation to inspection of such register and penalties imposable in case of defaults in maintaining the required registers.
- However, there are certain exemptions wherein these provisions would not be applicable.
- As per the Act, investments made by a company (other than an investment company) on its own behalf shall be made and held by it in its own name. This requirement is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. However, in certain circumstances, the Act exempts the companies from complying with the above provisions.

- When any shares or securities in which investments have been made by a company are not held by it in its own name pursuant to permissible conditions given in the Act, the company shall forthwith enter in a register maintained by it for the purpose, particulars as specified in the Act.
- In case of default, the company and every officer of the company who is in default shall be punishable with fine.

SELF-TEST QUESTIONS



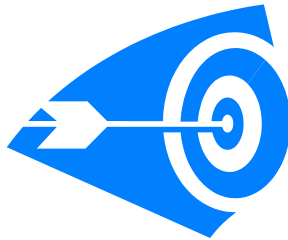
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. Discuss the law relating to inter-corporate loans and investments.
2. Which companies are exempt from the provisions with regard to inter-company investments/loans?
3. What particulars are required to be entered in the Register of Loans and Investments?
4. Your company, which is a public limited company wishes to make investments in shares of a company. The total investment exceeds the statutory limit stipulated by the Act. What are the formalities to be complied with in this regard?
5. ABC Ltd. is a listed company having a shareholder fund of Rs. 60 crore out of which Rs. 24 crore is general reserves. It desires to make a loan of Rs. 10 crore to XYZ Ltd. ABC Ltd. holds 60% of the equity shares in XYZ Ltd. ABC Ltd. has already made investment in and given loans to other companies aggregating to Rs. 30 crore. ABC Ltd. has not committed any default in respect of institutional loans or in repayment of fixed deposits. You are the Company Secretary of ABC Ltd. Advise your Managing Director of the steps to be taken to implement the decision. Would your answer be different if XYZ Ltd. is ABC Ltd.'s wholly-owned subsidiary.

STUDY XX

DEPOSITS

LEARNING OBJECTIVES



Companies prefer to raise finance by accepting deposits from the public instead of taking loans from financial institutions. It is important to learn various provisions governing deposits under the Companies Act.

This chapter covers the following topics:

- Invitation and Acceptance of deposits
- Application of provisions of Section 58A to Guarantee Companies and Section 25 Companies.
- Non Banking Non Financial Companies
- Nomination by Depositors
- Deposits from NRIs
- Companies (Acceptance of Deposits) Rules, 1975
- Constitutional validity of Section 58A of the Act and Rule 3A of Deposit Rules.
- Form and particulars of Advertisement
- Renewal of deposits
- Repayment of Deposits
- Penalties
- Remedy if the company fails to repay on due date.
- Power to grant extension of time and exemption.

1. INVITATION AND ACCEPTANCE OF DEPOSITS

Companies had been accepting deposits from the public offering high rates of interest and varying periods of time to augment their needs for corporate finance after traditional sources of financing like share capital, debentures and institutional loans reached the saturation point. But many such companies failed to refund the deposits so collected, thereby causing untold hardships to the unwary depositors. A need was, therefore, felt to regulate and control the invitation and acceptance of deposits with a view to protect the interest of depositors. The first step in this direction was taken to amend the Reserve Bank of India Act, 1934 by the Banking Laws (Miscellaneous Provisions) Act, 1963 to confer powers on Reserve Bank of India to regulate the quantum of and the manner in which the non-banking companies could accept deposits w.e.f. 1.2.64.

Companies preferred to raise finance by accepting deposits from the public rather than taking loans from financial institutions as :

- (i) the interest payable on deposits is lower than the interest on other loans from banks etc.
- (ii) it is a simple mode of financing.
- (iii) the company has not to provide any security as the deposits from public are unsecured debts.

In exercise of the powers conferred on it, the Reserve Bank of India issued directions regulating the acceptance of deposits by all non-banking companies. For this purpose the non-banking companies were classified into following 3 categories, namely:

- (i) Non-banking non-financial companies.
- (ii) Non-banking financial companies.
- (iii) Miscellaneous non-banking companies.

The invitation and acceptance of deposits by the last two categories of companies as mentioned above is still regulated by the Reserve Bank of India under its directions. The invitation and acceptance of deposits by non-banking non-financial companies is regulated by the Companies Act, 1956 w.e.f. 1.2.75 and the Rules, made thereunder. Two new Sections viz. Section 58A and 58B were inserted by the Companies (Amendment) Act, 1974 in the Companies Act, 1956. Section 58A provides that the Central Government may, in consultation with the Reserve Bank of India, prescribe the limits up to which, the manner in which and the conditions subject to which, the deposits may be invited or accepted by a company either from the public or from its members. In exercise of its powers the Central Government has framed the Companies (Acceptance of Deposits) Rules, 1975. Section 58A further states that no company shall invite or allow any other person to invite or cause to be invited on its behalf any deposits unless deposits are invited in accordance with the Rules framed thereunder and unless the company has not defaulted in repaying deposit or interest thereon. The company is also required to issue an advertisement in the prescribed form including therein a statement showing its financial position for inviting deposits.

Section 291 of the Companies Act, 1956 entitles the Board of directors of a company to exercise all such powers as the company is authorised to exercise but the Board shall not exercise those powers which the company is required, by the Companies Act or any other Act or by its memorandum or by its articles, to exercise in general meeting. According to Section 292(1)(c) of the Act, the Board of directors of a company shall exercise its power to borrow moneys otherwise than on debentures only by means of resolutions passed at meetings of the Board.

Section 293(1)(d) of the Act lays down that the Board of directors of a public company or a private company which is a subsidiary of a public company shall not borrow, except with the consent of such company in general meeting, moneys which together with the moneys already borrowed by the company (except temporary loans obtained from the company's bankers in the ordinary course of its business) exceed the aggregate of the paid-up capital of the company and its free reserves.

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

Companies preferred to raise finance by accepting deposits from the public rather than taking loans from financial institutions because it is a simple mode of financing.

- True
- False

Correct answer: True

2. APPLICATION OF PROVISIONS OF SECTION 58A TO GUARANTEE COMPANIES AND SECTION 25 COMPANIES

The provisions of Sections 58A and 58B of the Companies Act and Companies (Acceptance of Deposits) Rules, 1975 are also applicable to companies limited by guarantee and associations not for profit, viz., Section 25 Companies, having share capital and formed for promoting commerce, art, science, religion, charity, etc. However, guarantee companies which have no share capital have to comply with the requirements of provisions of these sections and the Rules to the extent applicable.

3. NON-BANKING NON-FINANCIAL COMPANIES

Section 58A of the Act provides that the Central Government may, in consultation with the Reserve Bank of India, prescribe the limits up to which, the manner in which and the conditions subject to which, a company may invite or accept deposits from the public or from its members. No company can invite or allow any other person to invite or cause to be invited on its behalf any deposit unless :

- (a) such deposit is invited or is caused to be invited in accordance with the rules made under sub-section (1) of Section 58A;
- (b) an advertisement including therein a statement showing the financial position of the company has been issued by the company in such form and in such manner as may be prescribed; and
- (c) the company is not in default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposit.

It has been clarified by the Department of Company Affairs, now Ministry of Corporate Affairs, that the expression 'public' includes a section of the public also. Therefore, the employees and ex-employees of the companies are to be regarded as those falling in the category of public and the deposits from them would as much attract the provisions of Section 58A of the Companies Act and the Rules framed thereunder as deposits accepted by the companies from public. Therefore, the deposits accepted by the companies from employees and ex-employees of the companies are not outside the scope of the provisions of Section 58A of the Companies Act and the Rules framed thereunder [Clarification No. 8/48/84-CL. X. dated 18.12.1984]. For the purpose of this section 'deposit' means any deposit of money with, and includes any amount borrowed by, a company but shall not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

Exemptions from Applicability of Section 58A

Sub-section (7) of Section 58A of the Companies Act provides that the provisions of this section shall not apply to :

- (a) banking company; or
- (b) such other companies as the Central Government may, after consulting the Reserve Bank of India, specify in this behalf; or
- (c) such classes of financial companies as the Central Government may, after consultation with the Reserve Bank of India specify in this behalf except the provisions relating to advertisement.

The Central Government has specified all classes of financial companies as companies to which the provisions of Section 58A of the Act, except the provisions relating to advertisement, contained in clause (b) of sub-section (2) of that Section shall not apply [vide Notification No. 523 (E) dated 18.9.1975]. "Financial Company" for this purpose means a non-banking company which is a financial institution within the meaning of clause (c) of Section 451 of the Reserve Bank of India Act, 1934. As a result, a non-banking financial company must issue an advertisement for inviting deposits in accordance with the provisions of Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977, although it is exempted from the application of other provisions of this section. In regard to other matters such companies are governed by the directions of Reserve Bank of India.

Exemption for Small Scale Units

In pursuance of the powers conferred by sub-clause (ii) of clause (a) of Section 58A(7) of the Act, the Central Government has, after consultation with the Reserve Bank of India, granted exemption from the applicability of the provisions of Section 58A to certain small scale units, vide Notifications No. GSR 50 (E) dated 1.2.77; GSR No. 655(E) dated 12.9.84 and GSR No. 48 (E) dated 21.1.86 and No. 73(E) dated 2.2.1996.

According to a Notification issued by Department of Company Affairs (now MCA), the exemption from the provisions of Section 58A of the Act is available to Small Scale Industrial Units only if they fulfill all the following conditions, namely:

- (a) The paid-up capital of the company does not exceed ₹ 25 lakhs;
- (b) The company accepts deposits from not more than 100 persons;
- (c) There is no invitation to public for deposits; and
- (d) The amount of deposits accepted by the company does not exceed ₹ 20 lakhs or the amount of its paid up capital, whichever is less.

For the purpose of this notification, a 'Small Scale Industrial Unit' means any industrial undertaking registered with the Directorate of Industries or Small Scale Industries, as the case may be, of the State Government and in respect of which the investment in plant and machinery is not in excess of 300 lakhs of rupees in value.

The exemption of small scale units does not necessarily cover any ancillary industrial unit unless such unit is itself eligible to be treated as a small-scale one. (Circular letter No. 4/13/77 dated 5.5.1977)

A claim for exemption which was rejected without giving opportunity was held to be illegal in *Career Savings and Investments (India) Ltd. v. UOI* 2000 CLC 1665; 2000 39 CLA 92 (Raj.).

'Deposit' has the same meaning as in clause (b) of Rule 2 of the Companies (Acceptance of Deposits) Rules, 1975.

4. NOMINATION BY DEPOSITORS

The Companies (Amendment) Act, 1999 had inserted a new Sub-section (11) in Section 58A which allows depositors to make nomination of deposits. Accordingly, a depositor may, at any time make a nomination and the provisions of Section 109A and 109B shall, as far as may be, apply to the nomination made under this sub-section. Nomination in the case of a deposit-holder in a non-banking non-financial company shall be made in the prescribed Form No. 2B under Rule 4CCC of the Companies (Central Government's) General Rules and Forms, 1956. In case of a Non-Banking Finance Company, a deposit holder may nominate a person in Form DA-1 under Rule 2(1) of the Banking Companies (Nomination) Rules 1985 in terms of Section 45ZA of the Banking Regulation Act, 1949.

The nominee shall on the death of depositor become entitled to all rights in the deposits to the exclusion of all other persons irrespective of anything contained in any other law.

Amendment in Nomination Forms for Investors under Section 109A

Press Release, dated 9.11.2000.—The Government (Department of Company Affairs) has issued a Notification amending Form 2B of nomination form in the Companies (Central Government's) General Rules and Forms, 1956. The amending Notification has been issued under Clauses (a) and (b) of Sub-section (1) of Section 642 read with Sub-section (II) of Section 58A and Section 109A of the Companies Act, 1956. Under the amendment, the nomination can be made by individuals only applying or holding shares or debentures on their own behalf singly or jointly. Non-individuals including society, trust, body corporate, partnership firm, Karta of Hindu Undivided Family, holder of power of attorney cannot nominate. If the shares are held jointly, all joint holders will sign the nomination form. In the amended form, space has been provided as a specimen, if there are more joint holders, more sheets can be added for signatures of holders of shares or debentures and witness.

A minor can be nominated by a holder of shares or debentures or deposits and in that event the name and address of the Guardian shall be given by the holder. The nominee shall not be a trust, society, body corporate, partnership firm, Karta of Hindu Undivided Family or a power of attorney holder. A non-resident Indian can be a nominee on repatriable basis. Nomination will stand rescinded upon transfer of share or debenture or repayment or renewal of deposits made. Transfer of share or debenture in favour of a nominee and repayment of amount of deposits to nominee shall be a valid discharge by a company against the legal heir. The intimation regarding Nomination or Nomination Form shall be filled in duplicate with Company or Registrar and Share Transfer Agents of the Company who will return one copy thereof to the share or debentures or deposits holder.

Multiple choice question

What conditions do the small scale industrial units have to fulfill in order to get exemption from the provisions of Section 58A?

- (a) The paid-up capital of the company does not exceed ₹ 25 lakhs.
- (b) The company accepts deposits from not more than 1000 persons.
- (c) There is no invitation to public for deposits.
- (d) All the above

Correct answer: a and c

Deposit in the name of the Minor

If the deposit is in the name of the minor, the name of the guardian should be stated in the application and the guardian should sign the form for and on behalf of the minor. The date of birth of the minor should also be mentioned in the application form.

Deposit in joint name

In case of deposit in joint names —

- (i) All correspondence should be made in the name of the person whose name appears first in the order of the joint names.
- (ii) Any one of the joint holders may discharge the Fixed Deposit Receipt.
- (iii) Repayment is normally made to the first named depositor only. In the case of the death of the first named depositor, the repayment of the deposit amount and payment of interest may be made to the person first in order of the survivors.

Deposit Receipt Not Transferable

Deposit Receipt and/or the deposit comprised therein and/or any benefit arising out of such deposit is not transferable by assignment, endorsement, transfer or otherwise.

Addition to Names Not Permissible

Addition of one or more name(s), as joint holders, on a Fixed Deposit Receipt during the period of the Fixed Deposit is not permissible.

5. COMPANY'S RIGHT TO REJECT APPLICATION

The company reserves the right to reject an application for deposit without assigning any reasons.

6. DEPOSITS FROM NRIs

- (1) **On Repatriation Basis:** As per Schedule 6 of the Foreign Exchange Management (Deposit) Regulations 2000 a company incorporated in India (including a Non-banking Finance Company registered with the Reserve Bank) may accept deposits from NRIs, on repatriation basis subject to the

following conditions:

- (i) The deposits are received under a public deposit scheme.
- (ii) If the deposit accepting company is a non-banking finance company, it should be registered with the Reserve Bank and should have obtained the required credit rating as stipulated under the guidelines issued by Reserve Bank for such companies.
- (iii) The amount representing the deposit is received by inward remittance from outside India through normal banking channels or by debit to the Non-Resident (External) Account or Foreign Currency (Non-Resident) (Bank) Account maintained with an authorised dealer/authorised bank in India.
- (iv) If the deposit accepting company is a non-banking finance company the rate of interest payable on deposits shall be in conformity with the guidelines/directions issued by Reserve Bank for such companies. In other cases the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under the Companies (Acceptance of Deposit) Rules, 1975.
- (v) The maturity period of deposits shall not exceed 3 years.
- (vi) The company accepting the deposits shall comply with the provisions of any other law, rules, regulations, orders issued by the Government of India or any other competent authority, as are applicable to it in regard to acceptance of deposits.
- (vii) The amount of aggregate deposits accepted by the company shall not exceed 35% of its net owned funds.
- (viii) The payment of interest net of taxes may be made by the company to the depositor by remittance through an authorised dealer or by credit to the depositor's NRE/FCNR(B)/NRNR/NRO/NRSR account as desired by him.
- (ix) The amount of deposits so collected shall not be utilised by the company for re-lending (not applicable to a Non-Banking Finance Company) or for undertaking agriculture/plantation activities or real estate business or for investing in any other concern, firm or a company engaged in or proposing to engage in agricultural/plantation activities or real estate business.
- (x) The repayment of the deposit may be made by the company to the depositor by remittance from India through an authorised dealer or by credit to the depositor's NRE/FCNR(B) account maintained with an authorised dealer in India, provided the depositor continues to be a non-resident at the time of repayment. While applying to the authorised dealer for remittance of maturity proceeds of deposit or credit thereof to NRE/FCNR(B) account, the company should certify that the amount of deposit was received either by inward remittance from outside India through normal banking channels or by debit to the depositor's NRE/FCNR(B) account, as the case may be.
- (xi) The amount representing repayment of deposit may also be credited to the depositor's NRNR/NRO or NRSR account, at the depositor's option.

- (2) **On Non-repatriation Basis:** As per the Schedule 7 of the Foreign Exchange Management (Deposit) Regulations, 2000 a proprietorship concern or a firm in India and a company incorporated in India (including a non-banking finance company registered with Reserve Bank) may accept deposits on non-repatriation basis from NRIs/OCBs, subject to the following conditions :
- (i) In the case of a company, the deposits may be accepted either under private arrangement, or under a public deposit scheme.
 - (ii) If the deposit accepting company is a non-banking finance company, it should be registered with the Reserve Bank and should have obtained the required credit rating as stipulated under the guidelines issued by Reserve Bank for such companies.
 - (iii) The maturity period of deposit shall not exceed 3 years.
 - (iv) If the deposit accepting company is a non-banking finance company the rate of interest payable on deposits shall be in conformity with the guidelines/directions issued by Reserve Bank for such companies. In other cases the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under the Companies (Acceptance of Deposit) Rules, 1975.
 - (v) The amount of deposit shall be received by debit to NRO account only, provided that the amount of the deposit shall not represent inward remittances or transfer of funds from NRE/FCNR(B) accounts into the NRO account.
 - (vi) The proprietorship concern, firm or the company accepting the deposit should comply with the provisions of any other law, rules, regulations or orders made by Government or any other competent authority, as are applicable to it in regard to acceptance of deposits.
 - (vii) The proprietorship concern, firm or the company accepting the deposit shall not utilise the amount of deposits for relending (not applicable to a Non-Banking Finance Company) or for undertaking agricultural/ plantation activities or real estate business or for investing in any other concern or firm or company engaged in or proposing to engage in agricultural/plantation activities or real estate business.
 - (viii) The amount of deposits accepted shall not be allowed to be repatriated outside India.

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

If the deposit is in the name of the minor, the name of the guardian should be stated in the application, and the guardian should sign the form for and on behalf of the minor.

- True
- False

Correct answer: True

Feedback for correct and incorrect answer

If the deposit is in the name of the minor, the name of the guardian should be stated in the application, and the guardian should sign the form for and on behalf of the minor.

7. PROVISIONS RELATING TO PROSPECTUS APPLY TO ISSUE OF ADVERTISEMENT

Section 58B states that the provisions of the Companies Act relating to prospectus shall apply to advertisements to be issued under Section 58A. This obviously means that as in the case of prospectus, an advertisement must also state all the details required by the Act and the Rules. Also, as in the case of prospectus, all statements made in the advertisement must be correct and truthful. Provisions of Sections 62 and 63 as applicable in the case of a mis-statement in prospectus will also apply to mis-statement in advertisement. Any person who makes a deposit on the faith of a mis-statement in an advertisement will have a right to claim compensation under Section 62 of the Act from directors and other person who authorise the issue of advertisement. Criminal liability for untrue statements contained in an advertisement inviting deposits will also be attracted by the person issuing such advertisement as is attracted by persons who authorise the issue of prospectus containing untrue statements under Section 63 of the Act.

Every person who authorises the issue of advertisement containing any untrue statement is punishable with imprisonment up to two years or with fine up to ₹50,000 or with both unless he proves either —

- (i) that the statement was immaterial; or
- (ii) that he had reasonable ground to believe and did upto the time of issue of advertisement believe, that the statement was true.

8. COMPANIES (ACCEPTANCE OF DEPOSITS) RULES, 1975

In exercise of the powers conferred by Sub-section (1) of Section 58A of the Companies Act, 1956 the Central Government has, in consultation with the Reserve Bank of India, framed Companies (Acceptance of Deposits) Rules, 1975. These Rules came into force with effect from 3rd February, 1975 and have been amended several times. These Rules supplement the provisions of Section 58A and provide for the limits up to which, the manner in which and the conditions subject to which the deposits can be invited and/or accepted by non-banking non-financial companies. These Rules do not apply to banking companies and financial companies.

Definition of Deposit

According to explanation to Section 58A of the Act read with Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975, "deposit" means any deposit of money with, and includes any amount borrowed by, a company but does not include:

- (i) Amounts received from the Central or a State Government or any other source and whose repayment is guaranteed by the Central or a State Government, or amounts received from a local authority or a foreign Government, or any other foreign citizen, authority or person [Rule 2(b)(i)].
- (ii) Loans from any banking company or from State Bank of India or its subsidiaries or from any other banking institution notified under Section 51 of the Banking Regulation Act, 1949 or a corresponding new bank as defined in clause (d) of Section 2 of the Banking Companies (Acquisition and Transfer

of Undertakings) Act, 1970 or from a co-operative bank as defined in clause (b)(ii) of Section 2 of the Reserve Bank of India Act, 1934 [Rule 2(b)(ii)].

- (iii) Loans received from the following financial institutions :
- (a) IFCI Limited;
 - (b) State Financial Corporations;
 - (c) Shipping Development Fund Committee;
 - (d) Unit Trust of India;
 - (e) Industrial Development Bank of India;
 - (f) Electricity Boards;
 - (g) Life Insurance Corporation of India;
 - (h) Rehabilitation Industries Corporation of India Ltd;
 - (i) State Trading Corporation of India Ltd;
 - (j) Minerals and Metals Trading Corporation of India Ltd;
 - (k) Rural Electrification Corporation Ltd;
 - (l) Agriculture Finance Corporation Ltd;
 - (m) Industrial Reconstruction Corporation of India Ltd.;
 - (n) ICICI Ltd.;
 - (o) National Industrial Development Corporation of India Ltd.;
 - (p) Tamil Nadu Industrial Investment Corporation Ltd.;
 - (q) State Industrial and Investment Corporation of Maharashtra Ltd.;
 - (r) General Insurance Corporation of India, and its subsidiaries namely, the National Insurance Company Limited, the New India Assurance Company Limited, the Oriental Fire and General Insurance Company Limited and the United Fire and General Insurance Company Limited.
 - (s) Gujarat Industrial Investment Corporation Ltd.;
 - (t) Any financial company wholly owned by the Central or State Government;
 - (u) Oil Industry Development Board;
 - (v) Housing Development Finance Corporation Limited;
 - (w) any other financial company or public financial institution which may be notified by the Central Government in this behalf in consultation with the Reserve Bank of India [Rule 2(b)(iii)];
- (iv) Amounts received by a company from any other company [Rule 2(b)(iv)];
- (v) Amounts received by way of security deposits from the employees of the company [Rule 2(b)(v)].

It is reiterated that the employees and ex-employees are to be regarded as those falling in the category of "public" and the deposit accepted from them would as much attract the provisions of Section 58A and the rules made thereunder as deposits from other categories of "Public".

(Circular : No. 8/48/84-CL-X, dated 18-12-1984)

- (vi) Amounts received as security or as an advance from any purchasing or selling agent or other agents in the course of or for the purposes of the business of the company or any advance received from customers for supply of goods or properties or for rendering of any service [Rule 2(b)(vi)].
- (vii) Amounts received by way of subscriptions to any shares, stock, bonds or debentures, such bonds or debentures as are covered by sub-clause (x) pending allotment of the said shares, stock, bonds or debentures or calls received in advance on shares in accordance with the articles of association so long as such amount is not repayable to the members under the articles of association of the company [Rule 2(b)(vii)].
- (viii) Amounts received in trust or any amount in transit [Rule 2(b)(viii)].
- (ix) Any amount received by a private company from a person who, at the time of the receipt of the amount, was a director, a relative of a director or its member:

Provided that the director, relative of a director or member, as the case may be, from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting from others". [Notification G.S.R. 189 (E) : (12-Mar- 04)]
- (x) Amounts raised by issue of bonds or debentures secured by the mortgage of any immovable property of the company or with an option to convert them into shares in the company provided that in case of such bonds or debentures secured by mortgage of any immovable property, the amount of such bonds or debentures shall not exceed the market value of such immovable property [Rule 2(b)(x)].
- (xi) Any amount brought in by the promoters by way of un-secured loans in pursuance of stipulations of financial institutions subject to the fulfillment of the following conditions, namely :
 - (a) the loans are brought in pursuance of the stipulation imposed by the financial institutions in fulfilment of the obligation of the promoters to contribute such finance;
 - (b) the loans are provided by the promoters themselves and/or by their relatives, and not from their friends and business associates; and
 - (c) the exemption under this sub-clause shall be available only till the loans of financial institutions are repaid and not thereafter.

Explanation: For the purpose of this sub-clause the term 'financial institution' shall mean:

- (a) a public financial institution specified in or under Section 4A of the Companies Act, 1956;
- (b) a State Financial, Industrial or Investment Corporation;
- (c) the State Bank of India or subsidiary bank as defined in the State Bank of India (Subsidiary Bank) Act, 1959, (38 of 1959);
- (d) a nationalised bank, that is to say, a corresponding new bank as defined in Section 2 of:

- (i) the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970); or
- (ii) the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980).
- (e) the General Insurance Corporation of India established in pursuance of the provisions of Section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972);
- (f) the Industrial Reconstruction Corporation of India; or
- (g) any other Institution which the Central Government, may, by notification, specify in this behalf.
- (xii) any amount received as loan from National Dairy Development Board by the companies owned by it directly or through its subsidiary companies.

[Notification GSR 300(E) dated 3.4.2003]

Any amount received by a private company from its shareholders is not regarded as 'deposit' in terms of sub-clause (ix) of clause 2(b) of the Deposit Rules. The expression 'shareholder' has also been used elsewhere in the Deposit Rules. In *Rameshwari Sanwarnal v. CIT*, (1980) 2SCC 377 : AIR 1980 SC 372, the Supreme Court has held that the word 'shareholder' can mean only a registered shareholder, i.e., it is only the person whose name is entered in the register of shareholders of the company as the holder of the shares who can be said to be a shareholder of the company and not the person beneficially entitled to the shares.

If the depositor ceases to be a shareholder or director, the deposits made by him cease to qualify for exemption from the date of such cessation.

It has been clarified by the Department of Company Affairs (now MCA) that the amount received by a company in the joint names of a director and a non-director or in the case of a private company in the joint name of a shareholder and non-shareholder will not be exempted. It has also been clarified that if all the partners of a lending firm are not directors on the Board of directors of the borrowing company, the deposits accepted from such firm would not be exempted and would be treated as deposits (Circular No. 1/1/80 - CLV/7/33/78-CLX, dated 3.5.80).

Blanket exemption to exclude the promoter's contribution (i.e. unsecured loans received by a company in fulfillment of the obligation of the promoters as per stipulation of the financial institutions) from the definition of deposit cannot be accorded. However, the Government can consider giving exemption in individual cases on merit in exercise of powers vested in it under Section 58A(8). (Letter No. 4/6/81-CL-X, dated 20.6.1981).

According to the clarification issued by Department of Company Affairs, vide its letter No. 4/12/81-CL.X dated 10.3.91, unsecured debentures with an option to convert a part of them into shares of company concerned do not fall into category of exempted deposits. Further such unsecured debentures shall not be subject to the discipline of Section 58A of the Companies Act only so long as the option to convert them into shares remains in force.

In a further clarification, Department of Company Affairs (vide their file No. 4/12/81-CL.X dated 20 March, 1984) has stated that in the case of debentures which are partly convertible into shares, only the convertible portion of the debentures is exempt in terms of the provisions of Rule 2(b)(x) of the Companies (Acceptance of Deposits) Rules. Even in regards to the convertible portion of debentures, once the period of conversion is over, the un-converted portion of debentures would acquire a character of loan and would fall within the definition of deposits like other loans, provided they are not secured by mortgage of immovable property of the company in terms of clause (x) of Rule 2(b) of the Deposit Rules. Similarly, where the period for the exercise of option for conversion has expired, the convertible portion of the debentures in respect of which no option has been exercised for conversion by the debentureholders, will acquire the character of loan and will fall within the purview of deposits as defined in the Companies (Acceptance of Deposits) Rules, if these debentures are not secured in the manner mentioned above.

Choose the correct answer

Loans received from which of the following financial institutions are not treated as deposits?

- (a) IFCI Limited
- (b) State Financial Corporations
- (c) Shipping Development Fund Committee
- (d) All the above

Correct answer: d

Deposits and Loan

There have been a number of judicial decisions bringing out distinction between a loan and a deposit. In *Annamalai v. Veerappa*, AIR 1956 S.C. 12, it was held that the term 'deposit' and 'loan' are not synonymous and whether a transaction is a deposit or loan does not merely depend on the terms of document, but has to be judged from the intention of the parties. [Refer also *Ram Janki Devi v. Juggilal Kamlapat*, AIR 1971 SC 2551]. In a sense, deposit is also a loan with this difference that a loan is repayable the minute it is incurred. In the case of deposit the repayment will depend on the maturity date fixed therefor or the terms of agreement relating to the demand on the making of which the deposit becomes payable. In other words, unlike a loan, there is no immediate obligation to repay in the case of deposits (*Abdul Hamid Sahib v. Rahmat Bi*, AIR 1965 Mad. 427).

What must also be borne in mind is that under the Limitation Act, 1963, the periods when limitation would begin in case of loan and in case of deposits are provided for differently. In the former case the limitation commences from the date when the loan is made, whereas in the latter from the date when the demand is made. Therefore, the distinction between a loan and a deposit is fine but appreciable.

Deposit and Debenture

According to Section 2(12) of the Companies Act, 1956, debenture includes debenture stock, bonds and any other securities of a company whether constituting a

charge on the assets of the company or not. A debenture is a document which either creates or acknowledges a debt. A debenture may be secured or unsecured. Where the debenture is unsecured, it will squarely fall within the definition of deposit. It is only the debentures which satisfy the conditions stipulated in Rule 2(b)(x) of the Companies (Acceptance of Deposits) Rules (discussed earlier), which are excluded from the definition of deposits.

Depositor

Depositor includes any person who has given a loan to a company.

Acceptance of Deposits by Companies

Under Rule 3 (1) of the Companies (Acceptance of Deposits) Rules, 1975:-

No company shall accept or renew any deposit which is repayable on demand or on notice or after a period of less than six months or more than thirty six months from the date of acceptance or renewal of such deposits.

However, a company may for meeting short-term requirements of funds, accept or renew short-term deposits for repayment earlier than six months from the date of deposits or renewal provided that such deposits do not exceed 10% of the aggregate of the paid-up share capital and free reserves of the company and such deposits are repayable not earlier than three months from the date of deposits or renewal, as the case may be.

Also, no company with a net owned fund of less than ₹ 1 crore shall invite public deposits. [Inserted by Third Amendment Rules 2001 vide Notification GSR 873(E) dtd. 28.11.2001].

Further, on and from 1.3.1997 no company shall accept or renew any deposits in any form if it is in default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposits.

9. CEILING LIMITS FOR ACCEPTANCE OF DEPOSITS

Under Rule 3(2) of the Companies (Acceptance of Deposits) Rules, 1975, a company other than a Government Company can accept deposits subject to the following ceiling:

- (i) Deposits against unsecured debentures or deposits from shareholders (not being a deposit accepted by a private company from its shareholders) or deposits guaranteed by any person, who, at the time of giving the guarantee, is a director of the company, together with such other deposits referred herein, if any, accepted already and outstanding on the date of acceptance or renewal of such deposit cannot exceed 10 per cent [including any deposit accepted under rule 3 (1)] of the aggregate of paid-up share capital and free reserves.
- (ii) Any other deposit together with such other deposit [other than deposits referred in (i) above] outstanding on the date of acceptance or renewal cannot exceed 25 per cent of the aggregate of paid-up share capital and free reserves of the company.

A Government Company can accept deposits upto 35% of aggregate of its paid-up capital and free reserves [Notification No. GSR 7(E) dated 2.1.1986].

Aggregate of Paid-up Share Capital and Free Reserves

In order to arrive at the aggregate of paid-up share capital and free reserves the company has to deduct from the aggregate of paid-up share capital and free reserves, as appearing in the latest audited balance sheet of the company, amounts of accumulated balance of losses, balance of deferred revenue expenditure and other intangible assets if any, as disclosed in the said balance sheet. [vide Explanation to Rule 3].

While it is obvious that the term “accumulated loss” should also include amount of unprovided depreciation, yet it has come to the notice of the Department that in a couple of cases companies have not deducted the amount of unprovided depreciation while computing the permissible limits of deposits. It is essential to deduct the amount of unprovided depreciation from the aggregate of paid-up share capital and free reserves for determining the limits up to which deposits can be accepted by them (Letter : 4/28/81-CL-X, dated 2-9-1981). The balance shown in ‘share premium account’ will be treated as part of the company’s paid up share capital and not its ‘free reserves’ having regard to provisions of Section 78(1). [Circular Nos. 3/77 (1/1/77-CL.V and 4/5/77-CL-XIV) dated 15.4.77].

The return of deposits required to be filed with the Registrar of Companies in terms of Rule 10 of Companies (Acceptance of Deposits) Rules, should be made with reference to the latest audited balance sheet irrespective of the date of audit, provided it was completed by the time the return was filed on or before June 30. It is prescribed in the explanation to Rule 3 that the latest audited balance sheet means only the balance sheet of the company for a year in relation to which the return is filed [*Malayala Manorama Co. Ltd. v. Registrar of Companies* (1990) 69 Comp. Cas. 339 (Kerala)].

Changes in Paid-Up Capital subsequent to the Close of the Financial Year

The Department of Company Affairs has clarified that any change in the paid-up capital of the company occurring after the close of the financial year of the company is to be disregarded for the purposes of reckoning limits for acceptance of deposits. The reason is that there are several elements other than the paid-up share capital which go into computation of net worth on the basis of which the limits laid down under Rule 3 of the Companies (Acceptance of Deposits) Rules for acceptance of deposits are worked out. By taking into account only the increase in the share capital of the company and at the same time ignoring the other components of net worth, the position would get distorted (Communication No. 4/2/84-CL.X dt. 25.7.84 of the Department of Company Affairs).

Definition of “Free Reserves”

According to Rule 2(d) of the Companies (Acceptance of Deposits) Rules, 1975, “free reserves” include the balance in the share premium account, capital and debenture redemption reserves and any other reserves shown or published in the balance sheet of the company which are created by appropriation out of the profits of the company but excludes any reserve created —

- (i) for repayment of any future liability or for depreciation in assets or for bad debts;
- (ii) by revaluation of any assets of the company.

The Department of Company Affairs has, vide Letter No. 3/1/80-CL.X dated 3.2.82, clarified that the amount of surplus in profit and loss account carried forward under the heading 'Reserves and Surplus' appearing in the balance sheet of a company may form part of the 'Free Reserve' as defined under the Companies (Acceptance of Deposits) Rules, 1975 provided it arises by appropriation out of profits of the company. The amount of depreciation not provided for is treated as part of accumulated loss and required to be deducted from the aggregate of paid-up capital and free reserves while computing permissible limits.

It has now been clarified by the Department of Company Affairs that subsidy received under the Central Government Outright Grant and Subsidies Scheme, 1971, is "free reserve" for the purpose of Companies (Acceptance of Deposits) Rules, 1975 provided the following conditions are fulfilled:

- (i) the subsidy is received in cash;
- (ii) the subsidy is utilised for the purpose for which it is received; and
- (iii) the period of five years from the commencement of production has elapsed and the subsidy has not become recoverable in terms of the conditions of grant (Communication No. 3/5/84-CL.X, dated 5.12.1984).

Capital Redemption Reserve is to be treated as "free reserve" for the purpose of Rule 2(d) if it has been created out of the profits actually realised by the company. (Letter : No. 3/1/80-CL-X, dated 29-12-1976).

10. CEILING ON RATE OF INTEREST

The Companies (Acceptance of Deposits) Amendment Rules, 1987 provided for the rate of interest on deposits at 14% w.e.f. 1.4.1987. The rate of interest has been modified continuously by formulation of Amendment Rules.

The Department of Company Affairs has vide the Third Amendment Rules, 2003, w.e.f. 29.9.03 amended the Rule 3(1)(c) of the said Rules to provide that the maximum rate of interest on the deposits under Section 58A shall be such as may be prescribed by Reserve Bank of India instead of a rate of 12.5% (Prevailing rate as envisaged by Amendment Rules, 2002 w.e.f. 4.2.2002).

The rate as prescribed by the RBI vide Notification No. DNBS 165/CGM (CSM) – 2003 dated 3.3.2003 is 11%.

The payment of compound interest in the case of cumulative deposits does not contravene the ceiling on rate of interest prescribed in the Rules as the rules do not specify whether the interest should be simple or compound. The only restriction is that at the time of acceptance of deposits, no company should offer interest at a higher rate than the prescribed rate.

11. RATE OF BROKERAGE

Rules 3(1) provides for payment of brokerage on deposits collected by or through a broker and prescribes the limit upto which brokerage may be paid. The payment of brokerage should be only on one time basis.

The rates of brokerage payable by the company on deposits collected by or through brokers have been revised w.e.f. 2.1.86 vide Notification No. GSR 7(E) dated 2.1.86. The revised maximum rate of brokerage that can be paid by the company on one time basis are as under:

- | | |
|--|---|
| (i) Deposits up to one year | 1% of the deposits collected by or through brokers. |
| (ii) Deposits for a period of more than one year but up to 2 years | 1-1.5% of the deposits collected by or through brokers. |
| (iii) Deposits for a period exceeding 2 years. | 2% of the deposits collected by or through brokers. |

The Department of Company Affairs has clarified vide their circular letter dated 18.9.88 that management charges, managers' fees, service charges and such other charges paid to agents would amount to brokerage and such brokerage in excess of the rates specified in Rule 3(1)(d), would amount to contravention of the said Rule. However, reimbursement of advertising or printing charges incurred by the agents or managers would not tantamount to payment of brokerage.

The following Explanation has been inserted in Rule 3(1)(d) vide Notification No GSR 551(E) dated 7.6.1990 w.e.f. 7.6.1990, namely:

“Explanation: Any person who is authorised by a company, in writing, to solicit deposits on its behalf and through whom deposits are procured will only be entitled to brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be not in conformity with the Rules”.

12. MAINTENANCE OF LIQUID ASSETS

As per Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975, companies are required to deposit or invest, as the case may be, a sum which shall not be less than 15 per cent of the amount of its deposits maturing during the year commencing from 1st day of April and ending on 31st day of March of the following year in any one or more of the following methods, namely:

- (i) in a current or other deposit account with any scheduled bank, free from charge or lien;
- (ii) in unencumbered securities of the Central Government or any State Government;
- (iii) in unencumbered securities mentioned in clause (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882 :
 - (a) promissory notes, debentures, stock or other securities of any State Government or of the Central Government;
 - (b) securities both the principal whereof and the interest whereon have been fully and unconditionally guaranteed by any State Government;
 - (c) stocks or debentures or shares of corporations, interest whereon has been guaranteed by the Central Government or in debentures of the

Bombay Provincial Corporation Bank Ltd., the interest whereon has been guaranteed by the State Government of Bombay;

- (d) debentures or other securities for money issued under the authority of any Central or Provincial Act or State Act or on behalf of any municipal body, port or trust or city improvement trusts; and
 - (e) units issued by the Unit Trust of India under any unit scheme made under Section 21 of the Unit Trust of India Act, 1963.
- (iv) in unencumbered bonds issued by the Housing Development Finance Corporation Ltd., Mumbai, a company incorporated under the Companies Act, 1956 (1 of 1956) and notified under clause (f) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).

This deposit of investment, as the case may be, is required to be made by the 30th day of April each year. The securities referred to in (ii) and (iii) above purchased for the purpose of compliance with this requirement will be reckoned at market value. The amount deposited, or invested as the case may be as per this requirement, cannot be utilized for any purpose other than for the repayment of deposits maturing during the year. It should, however be ensured that the amount remaining deposited or invested, as the case may be, shall, not any time during the year fall below 15 per cent of the amount of deposits maturing and remaining to be paid until, the 31st day of March of that year.

13. CONSTITUTIONAL VALIDITY OF SECTION 58A OF THE ACT AND RULE 3A OF DEPOSIT RULES

The vires of Section 58A read with Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975 was challenged before the High Courts, and the Supreme Court of India.

In *Calico and Ahmedabad Manufacturing and Printing Co. Ltd. and Others v. Union of India* (1983) 53 Comp Cases 904 it was contended before the Gujarat High Court that Section 58A of the Act was *ultra vires* of the Articles 245 and 246 of the Constitution and Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975 was *ultra vires* of Section 58A of the Act, in as much as it transgresses the scope and ambit of Section 58A and Rule 3A was violative of Articles 14 and was arbitrary.

The Gujarat High Court dismissed the above contentions and held that Section 58A fell squarely within Entries 43 and 44 of the Union List and, therefore, it was within the legislative competence of Parliament to enact it. It was also held that Rule 3A did not transgress the ambit of Section 58A of the Act and Rule 3A was not *ultra vires* Section 58A and, therefore, was valid in so far as it was applicable to deposits which a company received or might receive after 1st April, 1978.

In *Modi Spinning and Weaving Mills Co. Ltd. v. Union of India* AIR, 1979 ALL 211 the vires of Rule 3A was questioned before the Allahabad High Court more or less on the same grounds mentioned in Calico Ltd's case. While upholding the vires of Rule 3A the Allahabad High Court observed that the principle on which the Rule had been framed appeared to be in the larger public interest as well as in the broad interest of the companies accepting deposits. It was a part of the measure to preserve the credit structure on which the national economy was based and such a measure could not be characterised as unjust or capricious or that it involved an oppressive interference with the right of those to whom it applied.

Supreme Court in *Delhi Cloth and General Mills Co. Ltd. and Others v. Union of India and other*, (1983), 2 Comp. LJ, 281 (SC) upheld Constitutional validity of Section 58A and Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975. It is not outside the legislative competence of Parliament to enact such a provision as it falls within the scope of Entries 43 and 44 of List I of Seventh Schedule to the Constitution. Supreme Court observed, while upholding the vires of Section 58A and Rule 3A, that no regulatory or protective measure could be rejected as arbitrary on the short ground that it failed to protect fully the person for whose benefit it was enacted. One has to keep in view the cumulative effect of protective and regulatory measures. Requiring the company to invest 15 % of its deposits maturing in a year with prescribed institutions or in trust securities could not be termed deprivation of the funds of a company. It was measure to ensure that part of the funds of a company was kept as liquid assets available for use for specified purpose. Such regulatory measures ensuring availability of liquid assets could not be termed as deprivation of property. In a welfare State, it was a constitutional obligation of the State to protect socially and economically weaker segments of the society from exploitation by corporations. Therefore, it could not be contended that conditions prescribed had no relevance to object or the purpose for which the power was conferred under Section 58A on the Central Government. Supreme Court further observed by applying the doctrine of pith and substance, that as Section 58A was referable to Entries 43 and 44 in the Union List and the enactment viewed as a whole, could not be said to be legislation on money lenders and money lending referred to Entry 30 in the State List. It was also noted that Companies (Acceptance of Deposits) Rules, 1975 have been framed in the exercise of powers conferred by Section 58A and Section 642. Section 642 provides for placing before Parliament any rules framed in exercise of those powers. Parliament, while considering such rules is empowered to suggest modifications. There is therefore, no excessive delegation of essential legislative functions. The Court also declared that there was no violation of Articles 14 and 19(1)(g) and hence Rule 3A and Section 58A were constitutionally valid.

Choose the correct answer

What percent of the amount of its deposit maturing during the financial year are the companies required to deposit or invest?

- (a) Not less than 10%
- (b) Not less than 12%
- (c) Not less than 15%
- (d) Not less than 20%

Correct answer: c

Companies are required to deposit or invest a sum which shall not be less than 15% of the amount of its deposits maturing during the financial year (commencing from 1st day of April and ending on 31st day of March).

14. FORM AND PARTICULARS OF ADVERTISEMENT

Every company intending to invite, allowing or causing any other person to invite, deposits, shall issue an advertisement for the purpose in a leading English

newspaper and one vernacular newspaper circulating in the State in which the registered office of the company is situated [Rule 4, sub-rule (1)].

As per Rule 4 (2), such advertisement must be issued only on the authority and in the name of the Board of directors of the company, and must contain a reference to the conditions subject to which deposits shall be accepted by the company. The advertisement must state the date on which the Board of directors approved the text of the advertisement and the following information namely:

- (a) name of the company;
- (b) date of incorporation of the company;
- (c) business carried on by the company and its subsidiaries with the details of branches or units, if any;
- (d) brief particulars of the management of the company;
- (e) names, addresses and occupations of the directors;
- (f) profits of the company, before and after making provision for tax, for the three financial years, immediately proceeding the date of advertisement.
- (g) dividends declared by the company in respect of the said years;
- (h) a summarised financial position of the company as in the two audited balance sheets immediately preceding the date of advertisement in the following form namely:

Summarised financial position of the company as appearing in the two latest audited balance sheets.

<i>Liabilities</i>	<i>Figures for the latest financial year for which audited accounts are available</i>	<i>Figures for the financial year previous to the year referred to in column 2</i>	<i>Assets</i>	<i>Figures for the latest financial year for which audited accounts are available</i>	<i>Figures for the financial year previous to the year referred to in column 5</i>
1	2	3	4	5	6
Share Capital Reserve and Surplus Secured loans Unsecured loans Current Liabilities and provisions			Fixed assets Investments Current assets, Loans and Advances Miscellaneous expenditure Profit and Loss account		
Total			Total		

Note: Brief particulars of Contingent Liabilities may be added by way of a footnote.

- (i) the amount which the company can raise by way of deposits under these rules and the aggregate of deposits actually held on the last day of the immediately preceding financial year;
- (j) a statement to the effect that on the day of the advertisement, the company has no overdue deposits other than unclaimed deposits or a statement showing the amount of such overdue deposits, as the case may be;
 - (ja) the total number of small depositors and amount due to them in respect of which default has been made.
 - (jb) the fact of waiver of interest accrued on deposits of small depositors.
- (k) a declaration to the effect :
 - (i) that the company has complied with the provisions of the Companies (Acceptance of Deposits) Rules, 1975;
 - (ii) that compliance with these rules does not imply the repayment of deposits is guaranteed by the Central Government; and
 - (iii) that the deposits accepted by the company (other than secured deposits, if any, accepted under the provisions of these rules, the aggregate amount of which may be indicated) are unsecured and ranking *pari passu* with other unsecured liabilities.
 - (iv) that the company is not in default in repayment of any deposit or part thereof and any interest thereupon in accordance with terms and conditions of such deposits.

An advertisement issued in accordance with this rule is valid until the expiry of six months from the date of the closure of the financial year in which it is issued or until the date on which the balance sheet is laid before the company in general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier, and a fresh advertisement has to be made in each succeeding financial year for inviting deposits during that financial year[Rule 4, Sub-rule (3)].

Notice/advertisement notifying merely alterations in the terms and conditions of deposits including change in the rates of interest from a particular date is an amendment to the statutory advertisement issued earlier and does not require to be in form prescribed in Rule 4(2). While making announcement about alteration in the terms and conditions including the change in the rates of interest on deposits, if the company, *inter alia*, invites deposits by indicating, for example, that deposits were continued to be accepted, that the higher rates would be applicable in case the existing deposits were renewed or in case fresh deposits were made, that necessary application forms for accepting deposits were available with the company and/or its agents and so on, such announcement tantamounts to invitation of deposits and require advertisement in the form prescribed in Rule 4(2), failing which the advertisement is construed to be not in conformity with the provisions of Section 58A(2) and penal provisions of Section 58A(6)(a)(ii) read with Section 58A(6)(b) become attracted.

Delivery of the Text of Advertisement to the Registrar

No advertisement shall be issued by or on behalf of a company unless, on or before the date of its issue, there has been delivered to the Registrar a copy thereof signed by a majority of the directors on the Board as constituted at the time of approval of the advertisement by the Board or their agents duly authorised in writing [Sub-rule (4) of Rule 4].

The date of issue of an advertisement is the date on which it appears in the newspaper, [vide Explanation to Sub-rule (4) of Rule 4].

Statement in Lieu of Advertisement (Rule 4A)

Every company intending to accept deposits without inviting or allowing or causing any other person to invite deposits is required to file with the Registrar a statement in lieu of advertisement containing the same particulars as in the case of advertisement referred above and signed in the same manner as advertisement before accepting any deposits. The period of validity of this statement is the same as in the case of advertisement and a fresh statement has to be filed if it is intended thereafter to accept deposits without inviting.

Signing of Advertisement

Prior to the commencement of the Amendment Rules, 1978, the rules required that the advertisement should be signed by all the directors of the company, which created operational difficulties. Therefore, the rule was amended to provide that on or before the date of issue, the advertisement should be signed by a majority of the directors of the company as constituted at the time the Board approved the advertisement or their duly authorised agent in writing and a copy of the same should be delivered to the Registrar for registration. Even a letter of authority is sufficient for this purpose and power of attorney is not necessary [Circular No. 23/75 (91/14/75-CL.XIV) dated 25.9.1975 of the Department of Company Affairs].

State whether the following is 'True' or 'False'

It is optional for a company intending to invite deposits to issue an advertisement in a leading English newspaper and a vernacular one.

- **True**
- **False**

Correct answer: False

Every company intending to invite, allowing or causing any other person to invite, deposits, shall issue an advertisement for the purpose in a leading English newspaper and one vernacular newspaper.

15. FORM OF APPLICATION FOR DEPOSITS (RULE 5)

No company shall accept or renew any deposit unless an application is made by the intending depositor for the acceptance of such deposit and such application contains a declaration by such person to the effect that the amount is not being deposited out of the funds acquired by him by borrowing or accepting deposits from any other person.

The application shall be made in the form supplied by the company and such form shall be accompanied by a statement containing all the particulars specified in the advertisement issued by the company incorporating all changes in such particulars that may have been made upto the date on which the application form is issued by the company.

16. FURNISHING OF RECEIPTS TO DEPOSITORS (RULE 6)

Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent, a receipt for the amount received by the company within a period of eight weeks from the date of receipt of money or realisation of cheques. This deposit receipt shall be signed by an officer of the company duly authorised by the company in this behalf and shall state the date of deposit, the name and address of depositor, the amount received by the company as deposit, the rate of interest payable thereon and the date on which the deposit is repayable.

The terms and conditions of the deposits cannot, after acceptance of deposits, be altered to the prejudice or disadvantage of the depositor and the company cannot reserve to itself any right to do so either directly or indirectly.

The Company Law Board dismissed the application for recovery of deposit (with interest) from the company, where while accepting the money, none of the requirements of Rules 3, 4, 5 and 6 pertaining to interest rate, issuance of advertisement, furnishing of receipt, were satisfied by the applicant as well as the company. Therefore, it was held not amounting to 'deposit' for the purposes of Section 58A. [*Gopal K. Maheshwari v. Hawk Multimedia P. Ltd.* (2005)].

17. REGISTERS OF DEPOSITS (RULE 7)

Every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely—

- (a) name and address of the depositor;
- (b) date and amount of each deposit;
- (c) duration of the deposit and the date on which each deposit is repayable;
- (d) rate of interest;
- (e) date or dates on which payment of interest will be made;
- (f) any other particulars relating to the deposit.

The register or registers must be preserved in good order for a period of not less than 8 calendar years from the financial year in which the latest entry is made in the register. This register or registers is/are part of the books of a company and hence not normally open for inspection by members of the company.

18. GENERAL PROVISIONS REGARDING PREMATURE REPAYMENT OF DEPOSITS (RULE 8)

Where a company makes repayment of a deposit after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted by the company, the rate of interest payable by the

company on such deposit shall be reduced by 1 per cent from the rate which the company would have paid, had the deposit been accepted for the period for which such deposit had run, and the company shall not pay interest at any rate higher than the rate so reduced.

The Government has notified that where a company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of the higher rate of interest, the company shall pay interest to such depositor at higher rate if:

- (i) such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit, and
- (ii) the rate of interest as stipulated at the time of the acceptance or renewal of deposit is reduced by one per cent for the expired portion of the deposit and is paid or adjusted or recovered accordingly.

Where the period for which the deposit had run contains any part of a year, then, if such part is less than six months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year for this purpose.

Exemption from Applicability of Rule 8 regarding Premature Payment of Deposit Tax

The provisions of Rule 8 regarding the reduction in the rate of interest on premature deposits is not applicable where the deposits are repaid prematurely solely for the following purposes :

- (a) complying with the provisions of the Non-banking Non-financial Companies (Reserve Bank) Directions, 1966; or
- (b) complying with the provisions of Rule 3; or
- (c) converting, with the consent of the depositors into secured debentures in accordance with the guidelines, issued by the Government of India from time to time, regarding the issue of "rights" debentures; or
- (d) providing war risk or other related benefits to the personnel of the naval, military or air forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under Article 352 of the Constitution.

Rule 8 of the Companies (Acceptance of Deposit) Rules has been amended with effect from 10.1.1992, vide Notification No. GSR 39(E) dated 10.1.1992, to provide for acceptance of deposits in joint names. Sub-Rule (2) of Rule 8 provides that where the depositor so desires, deposits may be accepted in joint names not exceeding three with or without any of the clauses, namely, "Either or Survivor", "Number one or Survivor" or "Any one or Survivor".

Penal Rate of Interest (Rule 8A)

For any public deposit matured and claimed but remaining unpaid, the company should pay a penal interest of 18% for overdue period. In case of deposit made by a small depositor, this penal interest shall be 20% compounded on an annual basis.

19. POWER OF THE CENTRAL GOVERNMENT (RULE 9)

Rule 9 provides that if any question arises as to whether these Rules are

applicable or not to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

20. RETURN OF DEPOSITS (RULE 10)

Rule 10 requires the company to which these rules apply to file with the Registrar on or before the 30th day of June, every year, a return in the prescribed form and, furnishing the information contained therein as on the 31st March of that year duly certified by the auditor of the company. A copy of the return shall also be simultaneously furnished to the Reserve Bank of India.

'Nil Return' not necessary

Unless a company accepts a deposit within the meaning of the Rules, the Rules do not become applicable to that particular company and consequently there is no need to submit a nil return under Rule 10 (Department's Letter No. 4/1/76-CL-XIV, dated 5th February 1976).

21. RENEWAL OF DEPOSITS

The word 'renew' also amounts to 'acquire again'. The renewal amounts to receiving or acquiring fresh deposits within the meaning of Section 58-A [*Sujani Textiles Pvt. Ltd. v. Assistant Registrar of Companies* (1980) 50 Com Cases 276 (Mad)].

Need for advertisement in case of renewal of existing deposits

Rule 4 of the Companies (Acceptance of Deposits) Rules 1975 requires every company intending to invite or allowing or causing any other person to invite deposits to issue an advertisement for the purpose. A question has been raised as to whether an intimation to a depositor on the eve of maturity of his deposit indicating the date of maturity coupled with a statement that the depositor may renew his deposit if deemed necessary would amount to an invitation, and hence call for issue of an advertisement. This Department has considered the matter and is of the view that such an intimation would amount to an invitation, and hence the company should comply with requirements of sub-rule (1) of Rule 4 of the said Rules. In short, there must be a valid advertisement in force which would permit such an invitation (Circular No. 5 of 1976 dated the 10th March, 1976 on File No. 4/3/76-CL.XIV).

22. REPAYMENT OF DEPOSITS

Sub-section (9) of Section 58A provides that where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board may, if it is satisfied, either on its own motion or on the application of the depositor, that it is necessary so to do to safeguard the interests of the company, the depositors, or in public interest, direct, by order, the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order :

Provided that the Company Law Board may, before making any order under this sub-section give a reasonable opportunity of being heard to the company and the other persons interested in the matter. Under the provisions of Sub-sections (3A), (9)

and (10) of Section 58A inserted by Amendment Act of 1988, the Company Law Board may take cognizance of any case of non-repayment of deposits. Depositors may also seek relief from the Company Law Board on the company's failure to make repayment.

In *Edpuganti Bapanaiah v. K.S. Raju*, [(2007) 79 SCL 468 (AP)] decided on 03.08.2007, during pendency of the petition seeking approval of a scheme for the repayment of deposits, Respondent No. 1, along with group companies, filed affidavits giving undertaking to the CLB that they would abide by the scheme and pay off the depositors in accordance with scheme. On that assurance, the CLB approved the scheme.

Thereafter, Respondent No. 1 claimed that there was a change in the management of respondent No. 3 company and so he had no control over that company. Also, he sought for relieving him as well as the group companies from the undertaking.

CLB declined for the same and further ordered that the undertaking given by them would continue till the repayment.

Since no amount was paid, therefore, the petitioner filed contempt petition before the High Court, seeking to punish the respondents for deliberate violation of the orders of the CLB as well as the undertaking. The Respondents contested the petition.

The decision of the case was that the Petition was allowed. Reason behind the decision was that when Respondent No. 1 availed the benefit from the CLB, by representing as well as filing affidavits, undertaking that they would see that the order of the CLB was implemented, once scheme was approved. Order of approval of the scheme was binding on all the parties to it. Now rescheduling the payments to depositors was clearly not only in violation of the orders of the CLB as well as the undertaking, but also a deliberate attempt to circumvent the proceedings of the CLB.

If respondent No. 1 was permitted to transfer his obligations to some third party and then claiming that had no control over respondent No. 3 and, therefore, he could not be held responsible for non-compliance, then there would not be any sanctity to the judicial proceedings and the orders passed by the judicial authorities, especially when an undertaking has been filed before the authority for obtaining an order. Further, an attempt was also made to get out of the proceedings, by seeking permission to withdraw the affidavits. Under the above circumstances, the liability of respondent No. 1 would continue and failure to comply with the order would amount to deliberate attempt to circumvent the orders of the CLB by his own action, which was not approved by the competent authority which passed the order against him. The CLB is not vested with powers to deal with cases under the provisions of the Contempt of Courts Act. Therefore, such powers are to be exercised only by the High Court for any alleged contempt of CLB similar to the civil courts. Further, as the orders of the CLB are appealable under Section 10F before the High Court, the CLB should be treated as subordinate to the High Court and, therefore, the High Court is well within its powers in entertaining the contempt proceedings, and the contentions to the contra were devoid of merit.

Respondent No. 1 was liable for punishment, as by his actions, he tried to overreach the CLB as well as the Court, having collected huge amounts from the public and failed to repay the same to them.

Therefore, respondent No. 1 was liable for severe punishment, which could be shown as an example for such persons not to indulge in such activities by deliberate, false representations before the CLB as well as before the Court.

The sub-section does not refer to interest on deposits. In *Re : Ambalal Sarabhai Enterprises Ltd.* (1991) 2 Comp LJ 447, the Company Law Board has ordered the company to pay unpaid interest within the time specified in the order. In *Re : Pure Drinks Ltd.* (1991) CLA 188, payment of interest at an enhanced rate has been ordered by the Company Law Board.

Where a company had defaulted in repayments on maturity, the CLB invoked *suo motu* power under Section 58A(9). The company accepted its liability and contended that while it was financially sound and stable, it suffered from liquidity problem and that brought about the default. The company prayed for sanction of scheme for clearance of all matured deposits in a phased manner over a period of time. The CLB sanctioned the scheme having regard to the interest of the company, interest of depositors and also public interest at large [*Morpen Laboratories Ltd. Re.*, (2003) 48 SCC 720 (CLB)].

Power of the Consumer Protection to order repayment of deposit

In *Neela Raje v. Amogh Industries* [RP No. 409 of the 1992 dated 26.8.93 (1993) 840 (1993) 12 CLA 90 (NCDRC)], the National Consumer Disputes Redressal Commission was faced with a query as to whether a complaint lodged in regard to the failure to pay interest on repayment of the principal amount on the maturity of a deposit by a company could be entertained by a consumer forum. The commission pointed out that after the Amendment Act, 1993, a consumer forum can direct payment of amounts due to a depositor under the provisions of Section 14 of the Consumer Protection Act, 1986. An order directing payment of the outstanding amount to the depositor can now be made under the provisions of the said Section 14.

The power of the Company Law Board (CLB) under Section 58A read with Section 45 QA of the RBI Act does not have the effect of debaring a depositor from approaching to a Consumer Redressal Forum even after exercising a remedy under the above sections. When the CLB has ordered re-scheduling, even then the depositor can approach a Consumer Forum for any defaults by the company in complying in implementing orders. [*Prudential Capital Market P. Ltd. v. State of A.P.* (2000) 27 SCL 482 (A.P.)].

Whoever fails to comply with any order made by the Company Law Board under Sub-section (9) shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than rupees five hundred for every day during which such non-compliance continues [Sub-section (10)].

Repayment before maturity

Deposits are not repayable before maturity. However, in the event of the company agreeing in any exceptional circumstances at its absolute discretion to premature

repayment, the rate of interest payable by the company on such deposits agreed to be repaid before maturity shall be reduced by such rate as may from time to time be specified in the Companies (Acceptance of Deposits) Rules, 1975 as amended.

Repayment before the period of maturity was offered at reduced rate of interest in exercise of the power under Clause 11 of the rules framed by the company. The depositor accepted the same. He was estopped from challenging the reduction saying subsequently that his consent was not taken in advance [*Umanath Baliga v. S.R.P. Tools Ltd.*, 2003 CLC 1139: (2003) 47 SCL 146 (CLB)].

23. PENALTIES

Penalty (Rule 11)

Rule 11 provides that any contravention of the Rules for which no punishment is provided in the Act is punishable with fine up to ₹ 500 and for continued contravention, ₹ 50 per day during the continuance of the contravention.

Penalties for Contravention of Section 58

Under Section 58A (4) of the Act, any deposit received in contravention of the provisions of the Rules must be paid back by the company within 30 days from the date of acceptance of such deposit, or within such extended time, not exceeding 30 days, as the Central Government may, on sufficient cause being shown by the company, allow.

Section 58A(6) provides that where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposits in excess of the limits prescribed by the Rules or in contravention of the manner or conditions prescribed by the Rules or sub-section (2) of section 58 —

- (a) the company shall be punishable :
 - (i) where such contravention relates to the acceptance of any deposit, with fine which shall not be less than an amount equal to the amount of deposit so accepted;
 - (ii) where such contravention relates to the invitation of any deposit, with fine which may extend to ₹ ten lakh, but not less than ₹ 50,000.
- (b) every officer of the company who is in default shall be punishable with imprisonment upto 5 years and shall also be liable to fine.

In both these cases of acceptance or invitation of deposit in contravention of the requirements of Section 58A and the rules made thereunder, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 5 years and shall also be liable to fine [*H.H. Marthanda Varma & H.H. Bhupendra Narayana Singh v. Registrar of Companies* [1988] 64 Comp. Cas. 125.]

Defaults in Repayment of Deposits to Small Deposit holders

Section 58AA had been introduced by the Companies (Amendment) Act, 2000 to protect the interest of small deposit holders. A small depositor has been defined to mean a depositor who has deposited in a financial year a sum not exceeding

₹20,000 in a company and includes his successors, nominees and legal representatives. Under this section the Company Law Board has been empowered to deal with defaults on part of companies in repayment of deposits of small deposit holders. In case of default of repayment of small deposits or interest thereon the company is required to inform the Company Law Board within 60 days of such default. The Company Law Board shall, on receipt of intimation of such default in payment, either on its own motion direct the company to make repayment of deposit and interest thereon forthwith or within such time and subject to such conditions as may be specified in the order or it may, pass any appropriate order within a period of 30 days.

Sub-section (4) prohibits companies from accepting further deposits from small depositors till they repay the matured deposits of each small depositor including interest accrued thereon. Further, as per sub-section (5), every defaulting company shall state in every future advertisement and application form inviting deposits from public, not only the total number of small depositor and amount due to them in respect of which such default has been made but also of any waiver of interest on the deposit of small depositors.

Sub-section (7) of the section provides that where a company has accepted deposits from small depositors and subsequently obtains funds by taking a loan for purposes of its working capital from any bank, it is required to first utilise the funds to repay any deposits or part thereof or any interest thereon to the small depositors before applying such funds to any other purpose.

Sub-section (8) provides that every application form issued by a company to a small depositor for accepting deposits from him, shall contain a statement to the effect that the applicant had been apprised of (a) every past default by the company in the repayment of deposit or interest thereon, if any. Such default has occurred; and (b) the waiver of interest under Sub-section (6), if any, and reasons therefor.

Sub-section (9) provides that whoever knowingly fails to comply with the provisions of this section or fails to comply with any order of the Company Law Board¹/Tribunal² shall be punishable with imprisonment which may extend to three years and shall also be liable to fine for not less than rupees five hundred for every day during which such non-compliance continues. Further Sub-section (10) provides that if a company or any other person contravenes any provision of this section, every person, who at the time of such contravention, was a director of the company, as well as the company, shall be deemed guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Section 58AAA was also inserted by the Companies (Amendment) Act, 2000. Sub-section (1) of this section makes every offence connected with or arising out of acceptance of deposits under Section 58A or Section 58AA a cognizable offence under the Code of Criminal Procedure, 1973. This provision was inserted to provide for a strict and immediate action against companies that accept deposits and do not repay the same on maturity.

¹ Existing

² Proposed

As such, the offence is not compoundable under Section 621A of the Act. However, under sub-section (2) of section 58AAA, it has been provided that no court shall take cognizance of the offence except on a complaint made by the Central Government or any officer authorised by it in this behalf.

24. REMEDY IF THE COMPANY FAILS TO REPAY ON DUE DATE

Earlier, there was no provision in the Companies Act, 1956 or the Companies (Acceptance of Deposits) Rules 1975 empowering the Government to compel repayment of public deposits in case of default, by non-banking non-financial companies to the depositors on maturity. However, the Companies (Amendment) Act, 1988 has included such a provision by inserting two new Sub-sections (9) and (10) to Section 58A.

As stated earlier Section 58A(9) provides that where a company has failed to repay any deposit as per the terms and conditions of such deposit, the Company Law Board may direct the company, if it deems necessary to safeguard the interests of the company, its depositors or public interest, either on its motion or on the application of the depositor, to repay such deposit forthwith or within such time and subject to such conditions as the Company Law Board may specify. Where a depositor wishes to make an application, it should be submitted in duplicate in Form No. 4 of Annexure II to the Company Law Board Regulations, 1991 with a fee of ₹50. It may be noted that no affidavit is required to be filed with this application. However, the application should be accompanied by the following documents:

- (i) copy of the deposit receipt;
- (ii) copy of the correspondence exchanged with the company;
- (iii) bank draft evidencing payment of application fee.

It would be necessary for a complainant to furnish afterwards the terms and conditions of the deposits and the dates of maturity because without such particulars it would be very difficult for Company Law Board to come to a positive conclusion as to the alleged violation [*Kanak Vinod Mehta (Mrs.) v. Jyoti Wire Industries Ltd.*, (1991) 72 Com Cases 366 : (1991) 2 Comp LJ 428 (CLB)].

In this regard, the students are advised to refer to a Press Release dated 18.6.2001, as provided in Annexure I to this chapter.

According to the proviso to Section 58A(9), the CLB before making any order give the company and other interested persons a reasonable opportunity of being heard.

Where the company was able to convince the CLB as to the reasons for its inability to refund deposits as they mature, the company was ordered to pay the principal amount at once and the interest as directed. [*Ambalal Sarabhai Enterprises Ltd.*, (ibid)]. But where a company was not able to give a proof as neither its application for relief was accepted by BIFR nor it had filed a schedule for repayment as promised, the company was ordered to pay back within a period specified in the order [*Genlec Ltd. Re* (1991) 2 Comp LJ 450 (CLB)].

Where reference to BIFR was made because the company has become potentially sick, Company Law Board held that since the rehabilitation proposals were under consideration, the repayment of the deposits should be justifiably

postponed for a period of 2 years from the date of maturity. However, the deposits of those persons who were in financial stringency or facing situations like sickness, etc., could be paid. Besides company agreed to pay the current interest on deposits, the arrears of accumulated interest, if any, within one month from the date of receipt of copy of the Order [*Savita Jain v. Vinnyoga Clothex Ltd.* (1998) 17 SCL 309 (Company Law Board - New Delhi)].

It may be clarified that in the following circumstances, application under Section 58A(9) of the Act will not lie :

- (i) Deposit made for booking/purchase of scooter, car, etc.
- (ii) Deposits accepted by financial companies like hire-purchase, finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, an equipment leasing company, a chit fund company or a company, which receives deposits under any scheme or arrangement by way of contributions/subscriptions or by sale of units/certificates.
- (iii) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985, in respect of which the Board for Industrial and Financial Reconstruction, has specifically, by order, suspended the operation of any contract, agreement, settlement, etc. under Section 22(3) of the said Act.
- (iv) Deposits accepted by relief undertakings which are notified as such under the State laws. (Letter : No 1/6/88CL-V dated 8.3.1990)

In *A Karishma v. Premier Nitrates & Chemicals (P) Ltd. Bidar* (1997) 90 Com Cases 285 an unsecured loan of ₹ 10 lakhs was raised by a company on the condition that the lender will be made a director. Rupees Five lacs was meant to be appropriated towards share capital and the balance as deposits. The company contended that since allotment of shares was made, the balance of ₹ 5 lakhs is not a deposit under rule 2(b)(ix) of the Companies (Acceptance of Deposits) Rules, 1975, the Company Law Board held that Section 58A(9) of the Companies Act does not contain anything that the provision would cover the deposits received under Section 58A only. Since, the amount was held by the company as a deposit (may not be a deposit under Section 58A), the provisions of Section 58A(9) will be attracted and the company is bound to repay the deposit.

25. POWERS TO GRANT EXTENSION OF TIME AND EXEMPTION

Sub-section (8) of Section 58A of the Act, which was inserted by the Companies (Amendment) Act, 1977, enables the Central Government to grant extension of time to a company or a class of companies either prospectively or retrospectively from a date not earlier than 1.2.1975, to comply with, or exempt any company or class of companies from all or any of the provisions of Section 58A, for any specified period. In relation to a class of companies an order granting exemption can be issued by the Central Government only after consultation with the Reserve Bank of India. The exemption or extension of time may be with reference to particular provisions of Section 58A or all the provisions of that section. The Central Government may impose such conditions as it may think fit while granting exemption of time. These provisions have been made to grant relaxation for removing hardships in repayment of deposits by companies.

The Central Government has promulgated the Companies [Application for Extension of Time or Exemption under Sub-section (8) of Section 58A] Rules, 1979, laying down the procedure for making application seeking exemption or extension of time. In terms of these Rules, every company seeking extension of time or exemption is required to make an application in a prescribed form (Form I) of the Rules referred to above, furnishing the particulars specified therein. Along with the application the company has to attach the following documents:

- (i) one copy of the Memorandum and Articles of Association of the company;
- (ii) one copy of each of the latest audited accounts of the company together with directors' reports and auditors' reports;
- (iii) a copy of the resolution of the Board of directors in support of the proposal;
- (iv) one copy of each quarterly, half-yearly or other proforma accounts of the company subsequent to the latest audited accounts;
- (v) one copy each of the advertisement issued in newspapers pursuant to Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975;
- (vi) copy of previous approval/order, if any obtained by the company from the Central Government granting exemption/extension of time during last 10 years;
- (vii) certificates from the Statutory Auditors that:
 - (a) there was no contravention of any provision or rules for acceptance of deposits.
 - (b) deposits have been accepted which were within the specified limits.
- (viii) deposit position of the company as at 31st March during the current year and the past two years showing the specified details.
- (ix) original newspaper clippings of the public notices published in English and vernacular language of the region in which registered office of the company is situated in the manner specified in Form 2 appended to the rules.
- (x) Application fee as per details given below:

<i>Companies with authorised capital</i>	<i>Amount of fee</i>
(a) Less than ₹ 25 lacs	₹ 500/-
(b) ₹ 25 lacs or more but less than ₹ 5 crores	₹ 1,000/-
(c) ₹ 5 crores or more	₹ 2,000/-

The application is also required to be accompanied by a demand draft drawn in favour of Pay and Accounts officer, Department of Company Affairs (Now Ministry of Corporate Affairs), New Delhi, towards payment of the requisite fees specified.

Under Rule 4 of these Rules, a company intending to make an application is required to publish a general notice to the members of the general public at least once in an English daily newspaper and at least once in a newspaper published in the language of the region having wide circulation in the region in which the registered office of the company is situated. The advertisement is to be published in the prescribed form (Form II of the aforesaid Rules). The Central Government after considering the application may exempt a company from the application of the provisions of section or grant extension of time, as the case may be.

Some Relevant Notifications

1. Payment for penal interest @18% p.a. shall be made by the company for deposits, which have matured and are claimed as well but they have remained unpaid. However, in case of deposits made by small depositors the penal interest rate shall be @20% p.a. which shall be compoundable with annual rests. [Notification No. GSR 873(E) dated 28.11.01].
2. The fee to be enclosed with the application to seeking exemption from Central Government under Section 58A(8) shall be accompanied with fees as per the following scale:-

<i>Authorised capital of the company</i>	<i>Fee (₹)</i>
1. Less than ₹ 25 lakhs	500
2. From ₹ 25 lakhs to ₹ 500 lakhs	1,000
3. ₹ 500 lakhs and above	2,000

[Notification No. GSR 501 dated 6th July, 1999].

Guidelines for filing statutory applications under Section 58A(8) of the Companies Act, 1956

An application submitted under Section 58A(8) of the Companies Act, 1956 should be in accordance with the Companies (Application for Extension of Time or Exemption under sub-section (8) of Section 58A) Rules, 1979 and be accompanied by the following:

- Original newspaper clippings of the public Notices published in English and vernacular language of the region in which registered office of the company is situated in the manner specified in Form 2 appended to the Rules.
- Certified copy of Resolution of the Board of Directors approving the proposal of the company.
- Copy of previous approval/order, if any, obtained under Section 58(A) from the Central Government granting exemption/extension of time during last ten years.
- Certificates from the statutory Auditors:
 - to the effect that the company has not contravened any other provisions of Section 58A of the Companies Act, 1956 and the Companies (Acceptance of Deposits) Rules, 1975 except those for which the application is submitted.
 - to the effect that the deposits held by the company are within limits and that no contravention of the provisions of Section 58A of the Companies Act, 1956 and the Companies (Acceptance of Deposits) Rules, 1975 exists at present.
- Deposit position of the company as at 31st March during the current year and the past two years showing the details as under:
- One copy each of the advertisement issued in newspapers pursuant to Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975.

*ANNEXURE I***Non-payment of Matured Deposits — Remedies available to Investors*****Press Release - dt. 18.6.2001***

The procedure of filing an application for non-payment of matured deposits or investments by a Company before the Company Law Board (CLB) provides for filing Form No. 4 prescribed under the CLB Regulations, 1991 in duplicate along with photocopy of deposit receipts accompanied by a demand draft of ₹ 50 drawn in favour of Pay and Accounts Officer, Department of Company Affairs (DCA) payable at New Delhi, Mumbai, Kolkata and Chennai as the case may be. Each depositor is required to file separate Form No. 4. Those having more than one deposits in the same company may file only one Form No. 4 application. Jurisdiction of the Bench is as per the location of registered company.

There are four CLB Benches located at New Delhi, Mumbai, Kolkata and Chennai with the Principal Bench in Delhi.

In case of non-compliance of CLB orders by Non-Banking Financial Company (NBFC), depositors are required to lodge a complaint with the Reserve Bank of India in area of registered office of the company.

For non-compliance of CLB orders by other companies, complaints are to be filed with the Registrar of Company (ROC) of a State wherein registered office of the company is situated. Besides, there are procedures under Sections 397 and 398 of the Companies Act, 1956. Requisite fee towards a petition is ₹ 5,000 and ₹ 50 towards application by way of demand draft favourable to Pay and Accounts Officer, DCA, involving large depositors or investors at Delhi or Chennai. Petition accompanied by affidavits verifying application from all the petitioners drawn on non-judicial stamp paper of requisite value duly attested by Notary Public or Oath Commissioner may be filed. [*Press Release issued by PIB on 18.6.2001*].

*ANNEXURE II***Investors Grievances Relating to Deposits, Mutual Funds, Collective Investment Scheme, Companies in Liquidation and other Investor Complaints*****Press Note 3/2001, dt. 2.7.2001***

The Department of Company Affairs receives from general public a number of complaints relating to Deposits, Mutual Funds, Collective Investment Schemes, companies in liquidation and also other investor complaints.

2. The complaints relating to deposits in Banking Companies and Non-Banking Financial Companies are dealt with RBI. Investors complaints relating to Non-Banking Non-Financial Companies (Listed) are dealt with by the Securities and Exchange Board of India (SEBI). The complaints in respect of Non-Banking Non-Financial Companies (Unlisted) are dealt with by the Department of Company Affairs. The public are advised to approach these regulatory bodies for redressal of their grievances in the first instance itself. Similarly, complaints against companies in liquidation should be addressed to the concerned Official Liquidators attached to the High Courts.

3. In the case of deposits from Non-Banking Non-Financial Companies, the

depositors should, in the first instance, approach the Company Law Board and if the orders passed by the above Board are not honoured then they should approach the concerned Registrar of Companies with a certified copy of the order of CLB.

4. Investors complaints of Unlisted companies are dealt with by the Department of Company Affairs. These may be, in the nature of non-registration of transfer of shares, non-refund of share application money, non-receipt of dividends, non-receipt of duplicate shares, non-issue of share certificates, non-receipt of debenture certificates, bonus shares, share certificates on conversion, after endorsement etc. On receipt of a complaint, the same is registered and number is given. The Department pursues the matter with the company and in the case of non-settlement of the complaint, the matter is referred to Registrar of Companies for prosecution. The status of the complaint is also displayed in the Website of the Department at <http://www.nic.in/dca>. [No. 5/13/2001-CL.V, issued by DCA].

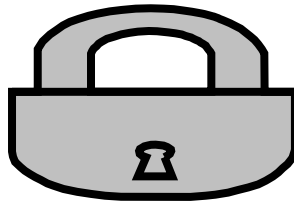
LESSON ROUND-UP



- The invitation and acceptance of deposits by non-banking non-financial companies is regulated by the Companies Act, 1956 and the rules framed thereunder.
- Central Government has framed the Companies (Acceptance of Deposits) Rules, 1975.
- Section 58A of Companies Act states that no Company shall invite or allow any other person to invite any deposits unless deposits are invited in accordance with the Rules framed thereunder, an advertisement has been issued by the company in such form and manner as may be prescribed and unless the company has not defaulted in repaying deposit or interest thereon.
- Governing sections empowering the company to accept deposits are Sections 58A, 58AA, 58AAA, 58B, 291, 292(1)(c), 293(1)(d) of the Companies Act.
- Section 58A(7) provides that section 58A will not be applicable to a banking company, or such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.
- Depositor may make a nomination and provisions of Sections 109A and 109B shall apply to the nomination of deposits.
- A minor, non-resident can be nominated by holder of deposits.
- The nominee shall not be trust, society, body corporate, partnership firm, Karta of HUF or a power of Attorney holder.
- Foreign Exchange Management (Deposit) Regulations 2000 regulates acceptance of deposits from NRIs.
- The provisions of the Companies Act relating to prospectus shall apply to advertisements to be issued under Section 58A.

- Companies (Acceptance of Deposits) Rules, 1975 provides for the limits upto which, the manner in which and the conditions subject to which the deposits can be invited and/or accepted by the non banking non-financial companies.
- Rule 2(b) of the said rules, defines the term 'deposit'.
- Rule 3(2) of the rules provides the ceiling upto which deposits can be accepted by the company. It provides that the limit of deposits against unsecured debentures or deposits from shareholders or deposits guaranteed by any person, who, at the time of giving the guarantee, is a director of the company, together with such deposits, if any, accepted already and outstanding on the date of acceptance or renewal of such deposit cannot exceed 10 per cent of the aggregate of paid-up share capital and free reserves. Any other deposit together with such other outstanding deposits (other than deposits referred aforesaid) on date of acceptance or renewal cannot exceed 25 per cent of the aggregate of paid-up share capital and free reserves of the company. A Government Company can accept deposits from shareholders and others upto 35% of aggregate of its paid-up capital and free reserves [Notification No. GSR 7(E) dated 2.1.1986].
- Ceiling on rate of interest is provided in Rule 3(1)(c) of the Rules.
- Rule 3A deals with maintenance of liquid assets. According to this rule, companies are required to deposit or invest, as the case may be, a sum which shall not be less than 15 per cent of the amount of its deposits maturing during the year commencing from 1st day of April and ending on 31st day of March of the following year.
- Supreme Court in Delhi Cloth and General Mills Co. Ltd. and Others vs. Union of India and other upheld the Constitutional validity of Section 58A and Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975.
- Company Law Board may direct the company to make repayment of deposits or part thereof subject to such conditions as may be prescribed in the order.

SELF TEST QUESTIONS



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

1. Explain the manner in which the Companies Act, 1956 regulates and controls the invitation for and acceptance of deposits by the companies from their members and the public at large.
2. Discuss the limits of accepting 'deposits' as prescribed under the Companies (Acceptance of Deposits) Rules, 1975 as amended up-to-date.
3. What are the legal requirements if a company wants to invite deposits from the public?

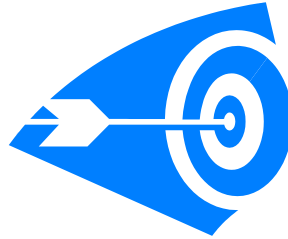
4. What transactions are not deemed to be deposits?
 5. What are the particulars to be included in an advertisement inviting deposits by a company?
 6. What is the validity period of such an advertisement inviting deposits by a company?
 7. What kind of deposits are not deposits as per the definition of 'deposits' under the Companies (Acceptance of Deposits) Rules, 1975?
 8. Explain:
 - (a) Non-financial companies can accept deposits.
 - (b) Advertisement in the context of public deposits.
 9. Write short notes on :
 - (i) Statement in lieu of advertisement
 - (ii) Return of deposits.
 - (iii) Small deposit holder
 10. Insertion of Section 58AAA is intended to take a strict view against companies that accept deposits and do not repay the same on maturity. Comment.
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STUDY XXI

CORPORATE ACCOUNTABILITY - I

ACCOUNTS AND AUDIT

LEARNING OBJECTIVES



This lesson explains the provisions for keeping books of accounts, inspection of books of accounts and other provisions for balance sheet and profit and loss account under the Companies Act. It also discusses provisions for audit and auditors, their appointment, qualifications, resignation, removal, duties and liabilities.

At the end of the lesson, you should be able to understand:

- Requirement of keeping books of accounts.
- Inspection of costing records and stock records.
- Maintenance of costing records and stock records.
- Statutory books and statistical books.
- Annual accounts: Balance Sheet and profit and loss account.
- Authentication of annual accounts.
- Directors' report and Directors' responsibility statement.
- Liability of statements in the board's report.
- Accounts of holding and subsidiary company.
- Audit and its need.
- Appointment of auditor.
- Qualifications and disqualifications of audit.
- Method of appointment of auditor.
- Remuneration of auditor and their term of office.
- Resignation and removal of auditors.
- Auditors of government companies.
- Rights, powers, duties and liabilities of auditors.
- Audit of branch accounts.
- Special audit and cost audit.
- Cost audit report.
- Social audit.
- Notes on accounts and its contents.

ACCOUNTS

The shareholders provide capital to the company for running the business. They are in a way, the owners of the company. But, all of them cannot take part in managing the affairs of the company as their number is usually much more. But they have every right to know as to how their money has been dealt with by the directors in a particular period. This is why perhaps compulsory disclosure through annual information to the shareholders by the directors about the working and financial position of the company enables them to exercise a more intelligent and purposeful control over the affairs of the company. For preparation of annual accounts the maintenance of proper books of account is a must. Section 209 of the Companies Act, 1956 contains the provisions for maintenance of proper books of accounts.

The requirement of maintenance of proper books of accounts has been further amplified through the provisions of Section 541 of the Companies Act. Though the provisions of this section relate to a situation involving winding up of a company, as a general rule, they are relevant.

In terms of Section 541(2) of the Companies Act, 1956, proper books of accounts shall be deemed to have been kept by a company if (i) such books exhibit and explain the transactions and financial position of the business of the company, including books containing detailed entries of daily cash receipts and payments; and (ii) where the business of the company has involved dealings in goods, statements of the annual stock takings (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and the sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified have been maintained.

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

To prepare annual accounts, the maintenance of proper books of account isn't a necessity.

- **True**
- **False**

Correct Answer: False

For preparation of annual accounts, the maintenance of proper books of account is a must.

1. REQUIREMENT OF KEEPING BOOKS OF ACCOUNT

Section 209 of the Companies Act requires every company to keep at its registered office proper books of account with respect to the following transactions:

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure took place;
- (b) all sales and purchases of goods by the company;
- (c) the assets and liabilities of the company;

- (d) in the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or other items of cost as may be prescribed relating to certain class of companies as the Central Government may require.

From the above it can be seen that this section does not name the books of accounts which a company should keep. They may keep whatever books they like, provided all the aforesaid transactions are recorded therein. Sub-section (3) of Section 209 provides that proper books of account shall not be deemed to have been kept with respect to aforesaid matters — (i) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or the branch office, if any, and to explain its transactions; and (ii) if such books are not kept on accrual basis and according to double-entry system of accounting.

Apart from the aforesaid books of account Sub-section (1)(d) of Section 209 provides that in case a company is engaged in production, processing, manufacturing or mining activities, the Central Government may prescribe the maintenance of cost accounting records for recording the utilisation of materials or labour or other items of cost. So far, the Government has issued Cost Accounting Records Rules for about forty-seven different classes of companies engaged in the manufacture of Cement, Sugar, Vanaspati, Fans etc. The aforesaid provisions of maintaining proper books as in Sub-section (3) also applies to Cost Records.

Place of Keeping Books of Account

Section 209 requires every company to keep the aforesaid books of account at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place in e-Form No. 23AA alongwith requisite filing fee.

Books of Accounts in Respect of Branch Office

Where a company has a branch office whether in India or outside, the books of account relating to transactions effected at the branch office may be kept at that office. However, proper summarised returns, made up to dates at intervals of not more than three months must be sent by the branch office to the registered office or to such other place where the books are kept [Section 209(2)].

True and Fair View

The books of account should be kept on accrual basis and according to double entry system of accounting. Further, they must give a true and fair view of the affairs of the company or branch office and explain its transactions. The books of account should not suppress any transaction nor should they contain any fictitious transaction. These and other books and papers shall be open to inspection by any director during business hours, as also by the Registrar or an officer authorised by the Central Government/SEBI.

Preservation of Books of Account

Section 209(4A) casts an obligation upon a company to preserve in good order

the books of account together with the vouchers relevant to the entry in such books, relating to the period of at least 8 years immediately preceding the current year, or if the company has not been in existence for 8 years, then for the whole period of its existence. As per Section 2(8) of Act, 'book' includes a voucher also. Therefore, the related vouchers and documents for 8 years have also to be preserved. It has been clarified by the Department of Company Affairs in its Circular No. 2/83 dated 2/3/1983 that the books of account should be prepared and maintained in indelible ink (and not in pencil) for giving a proper and adequate meaning to the words, "proper books of account" in Section 209.

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

The books of account are open to inspection by the company director, Registrar or a Government/SEBI officer.

- True
- False

Correct Answer: True

2. INSPECTION OF BOOKS OF ACCOUNT

Director's right of inspection

Sub-section (4) of Section 209 provides that books of account and other books and papers should be available for inspection by any director on working days during business hours. "Book and Paper" and "Book or Paper" have been defined in Section 2(8) to include accounts, deeds, vouchers, writings and documents.

Though generally the director should personally exercise this right of inspection, the right is not so restricted that it can only be exercised personally by the director.

In *Vakharia v. Supreme General Film Exchange Co. Ltd.* (1948) 18 Com Cases 34 : AIR 1948 Bom 301 it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilise the information obtained by him for any purpose other than the purpose of his principal. The judgement was also endorsed in the case of *Sugrabai Alibhai v. Amtee Properties (P) Ltd.*, (1984) 55 Com Cases 734: (1982) 3 Comp LJ 159 (Bom).

In *M.L. Thukral v. Krone Communications Ltd.*, (1996) 86 Com Cases 643 (CLB-New Delhi), the petitioners (directors) wanted to exercise their right of inspection of books of account accompanied by a chartered accountant. The Board (CLB) allowed it subject to the undertaking being given by the Chartered Accountant that he would disclose the information obtained through inspection only to the petitioners and not to others.

The right of inspection can however, be refused if it is found that the inspection is being sought to pass on the information to a rival business of the company.

Inspection by the Registrar/Officers of SEBI

Section 209A empowers the Registrar and any other officer authorised by the Central Government to carry out inspection of books of account.

In *BM Bajoria v. Union of India*, (1972) 42 Com Cases 338 (Del) : 1971 ILR (Del) 715, the court held that the power of inspection under Section 209A is different from an investigation under Section 235 and 237 and that it is not necessary for the Registrar filing a complaint on the basis of inspection of accounts to give to the company before hand a copy of the inspection report. In *Indian Express (Madurai) P. Ltd. v. Chief Presidency Magistrate*, (1974) 44 Com Cases 106 (Mad): it was held that these powers may be overlapping but there is nothing to show that the power under this section cannot be exercised when an inspection and investigation of affairs is going on under any other provision.

The books of account can also be inspected by such officers of the SEBI as may be authorised by it, in respect of matters covered under sections referred to in Section 55A i.e. Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207.

Members' right of inspection of accounting records

Members of a company do not have a right of inspection of its accounting records [*Latika Rajya Lakshmi v. Indian Motor Co. Ltd. AIR 1962 (Cal) 129*]. Table A, Article 95(2) also provides that no members (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by law or authorised by the Board or the company in general meeting.

Where books of account of the company are with the managing director in his official capacity, the third parties in a suit, which is not against the company, cannot ask for the production of books of accounts [*A.K. Chinnathambi Chettiar v. G.S. Murugan*, (1968) 2 Comp LJ 260 (Mad)]. The right of inspection of documents and books of a company is not limited to the Board of Directors. In order to prove allegations made in a petition under Sections 397 and 398, the shareholders are also entitled to be allowed inspections of the books of account and other relevant papers of the company.

Auditor's right of inspection of accounts — Section 227(1) empowers an auditor with the right of access at all times to the company's accounts, whether kept at the head office of the company or elsewhere.

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

Section 227(1) of the Companies Act, 1956, does not allow an auditor the right to access the company's accounts.

- True
- False

Correct Answer: False

Section 227(1) empowers an auditor with the right of access at all times to the company's accounts, whether kept at the head office of the company or elsewhere.

3. MAINTENANCE OF COSTING RECORDS AND STOCK RECORDS

Section 209(1) read with Section 541(2) provides for the maintenance of proper books of account and they obviously include the cost accounting records [Section 209(1)(d)] and stock records [Section 541(2)], apart from normal books of account. Section 209(1)(d) was included in the Act in 1965 to ensure that companies engaged in production, processing, manufacturing or mining activities, if specifically required by the Central Government, maintain detailed cost records in the manner specified by the Central Government. Similarly, proper maintenance of stock records is also a necessity as in the absence of proper stock record the truth and fairness of the annual statement of accounts cannot be properly understood.

Choose the correct answer

What type of records does Sub-section (1)(d) of Section 209 of the Companies Act, 1956, deal with?

- (a) Cost accounting records
- (b) Stock records
- (c) Annual report
- (d) None of the above

Correct Answer: a

4. PERSONS RESPONSIBLE FOR KEEPING THE BOOKS OF ACCOUNT

Sub-section (6) of Section 209 specifies the persons who have been made responsible for keeping the books of account and securing compliance by the company with the requirements of Section 209 of the Act, they are:

- (i) managing director or manager and all officers and other employees of the company, and
- (ii) where the company has neither a managing director nor manager then every director of the company.

If any of the persons referred to above fails to take all reasonable steps to secure compliance by the company with the requirements for keeping books of account or has by his own wilful act been the cause of any default by the company in this respect, he shall be punishable with imprisonment up to six months or with fine which may extend to ₹ 10,000 or with both.

However, in any proceedings against a person in respect of an offence under this section consisting of a failure to take reasonable steps to secure compliance by the company with the requirements of this section, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty. It is also provided that no person shall be sentenced to imprisonment for any such offence unless it was committed wilfully.

If any person other than those mentioned above, having been charged by the

managing director, manager or Board of directors, as the case may be, with the duty of seeing that the requirements of this section are complied with, makes default in doing so, he shall in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees or with both.

5. STATUTORY BOOKS

In addition to the books of account mentioned earlier, the Companies Act, 1956, specifically requires certain other books to be kept by a company for maintaining a record of its different activities in order to safeguard the interests of the shareholders and creditors. These books are known as Statutory Books. According to the Companies Act, 1956 the following books must be maintained by the company:

1. Register of investments in securities made by the company but not held by it in its own name [Section 49(7)].
2. Register of fixed deposits.
3. Register of Securities bought back [Section 77A(9)].
4. Register of charges [Section 143(1)].
5. Register of Members [Section 150(1)].
6. Index of Members where the number is more than fifty unless the Register of Members itself affords an index [Section 151(1)].
7. Register of Debentureholders [Section 152(1)].
8. Index of Debentureholders where the number is more than fifty unless the Register of Debentureholders itself affords an index [Section 152(2)].
9. Register and Index of Beneficial Owners [Section 152A].
10. Foreign Registers of Members and Debentureholders and their duplicates [Sections 157(1) and 158(4)].
11. Books for recording minutes of proceedings of general meetings [Section 193(1)].
12. Books for recording minutes of Board Meetings [Section 193(1)] and of Committees of Directors.
13. Dividend Register.
14. Books of account [under Section 209(1)(a) to (c)].
15. Cost account records [under Section 209(1)(d) for companies engaged in industries so specified by the Central Government].
16. Register of contracts, companies and firms in which directors are interested directly or indirectly [Section 301(5)].
17. Register of directors, managing directors, manager and secretary [Section 303(1)].
18. Register of directors' shareholdings [Section 307(1)].
19. Register of investments or loans made, guarantee given or security provided under Section 372A (5) [w.e.f. 31.10.1998].

20. Register of renewed and duplicate share certificates [Rule 7 of the Companies (Issue of Share Certificates) Rules, 1960].
21. Register of Postal Ballot.

Further, all the above books except books at Serial Nos. 12, 18, 19, 20 and 21 can be inspected by the members of the company; however, the register of directors shareholding would be available for inspection only for 14 days before the Annual General Meeting and 3 days after that. Copies can be obtained by the members, debenture holders, creditors or public as the case may be except of Registers at Serial Nos. 1, 4, 13 and 14, on the prescribed payment.

6. STATISTICAL BOOKS

In addition to the books of account and statutory books mentioned earlier, a company usually maintains a number of statistical books in order to keep complete records of the numerous details connected with the business operations. The keeping of such books has become a necessity although there is no legal compulsion for the same. The following is a list of such important books:

1. Share Application and Allotment Book
2. Share Call Book
3. Share Certificate Book
4. Share Transfer Book
5. Debenture Interest Book
6. Director's Attendance Book
7. Agenda Book
8. Dividend Mandate Register
9. Share Warrants Register
10. Register of certified transfers
11. Register of lost share certificates
12. Register of powers of attorney
13. Register of probates
14. Register of declaration under Section 187C
15. Register of documents sealed
16. Register of proxies
17. Register of inspection
18. Register of records and documents destroyed
19. Register of investors' complaints
20. Register of transmission of shares
21. Register of transfer of debentures
22. Register of transmission of debentures
23. Register of employee stock options

24. Register of Sweat Equity Shares
25. Register in respect of SEBI (Prohibition of Insider Trading) Regulations, 1992
26. Annual Return.

7. ANNUAL ACCOUNTS : BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

In fact, the expression annual accounts embraces both balance sheet and profit and loss account. In a wider sense, it also covers cash and fund flow statements, director's report etc.

Section 210 (1) of the Companies Act provides for laying of annual accounts before Annual General Meeting and Section 211 relates to form and contents of balance sheet and profit and loss account.

Meaning of Balance Sheet

The term "Balance Sheet" means a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date. It is also described as a classified summary of the debit and credit balance existing in the ledger after the Profit and Loss Account has been constructed, because a balance sheet often contains items which cannot, strictly speaking, be characterised either as assets or as liabilities. The balance sheet is arranged in such a way as to show the assets and debit balances on the right hand side and liabilities and credit balances on the left hand side and it represents the culmination of the system of book-keeping and it should be a document setting forth the true position of the business on the date as on which it is drawn up. It was stated in *Legal Remembrance v. Aktul Bandhu Gupta*, ILR (1937) 1 Cal 328 –A balance sheet is a pictorial representation of the trading position of a company, easily appreciated not by the ignorant people, but persons who are reasonably able to understand commercial expressions and commercial conditions". The balance sheet is a shareholders' quick guide to ascertain the financial position of the company. A properly drawn up Balance Sheet should give the following:

- (i) the nature and the cost of assets of the company on the date of the balance sheet;
- (ii) the nature, extent and the type of liabilities on that date;
- (iii) whether the company is solvent and whether it is over trading.

If the total assets exceed the total liabilities, the company is said to be solvent i.e. it is able to pay its debts in full. On the other hand, if the total liabilities of a company exceeds its total assets the company is said to be financially unsound.

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

Section 210 of the Companies Act makes provisions for presenting the annual accounts of a company before the annual general meeting.

- True
- False

Correct Answer: True

Balance sheet when final

The provisions of Sections 205, 210, 215, 216 and 220 (2) of the Companies Act make it clear that it is only after the balance sheet and profit and loss account have been placed before and considered by the general body of the shareholders of the company that they are finally accepted. It would, therefore, be correct to say that the balance sheet and the accounts of the company are finalised only after the seal of approval of the shareholders is obtained [*Commissioner of Income Tax v. National Industrial Corporation*, (1982) 52 Com Cases 535 : (1983) 1 Comp LJ 100 (Del)].

Balance sheet as acknowledgement of debt

The balance sheet of a company wherein the company admits its indebtedness in a certain sum, to any person, is sufficient acknowledgement of the debt. The approval of the balance sheet in Board meeting and signing of it by two directors, as required by the Companies Act, is sufficient acknowledgement for purpose of the Limitation Act [*Jones v. Bellegroves Properties Ltd.*, (1949) 2 All ER 198 (CA)].

It must, however, be noted that, though the balance sheet is signed by the directors on behalf of the company several months after the balance sheet date, the acknowledgement of debt relates to the date of the balance sheet and not the date on which the directors sign it. [*Re Gee & Co. (Woolwich) Ltd.*, (1974) 1 All ER 1149 (Ch D)].

Preparation of Balance Sheet and Profit and Loss Account

From the books of account as mentioned above every company has to prepare a balance sheet and profit and loss account for each financial year. According to Section 211, every Balance Sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and shall be in the form set out in Part I of Schedule VI or as near thereto as circumstances permit. This requirement is not applicable to a Banking or an Insurance Company or to any other class of companies for which a form of balance sheet has been specified in the separate Acts governing such companies. Every profit and loss account and balance sheet of the company shall comply with the accounting standards recommended by the Institute of Chartered Accountants of India and as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards. It has been also provided that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the Accounting Standards are prescribed by the Central Government. Where the profit and loss account and the balance sheet of the company do not comply with accounting standards, it shall disclose in its profit and loss account and balance sheet the deviation from accounting standards, reasons for such deviation and the financial effect, if any, arising due to such deviation. The Central Government may exempt any class of companies from compliance with any of the requirements of Schedule VI relating to the form and contents of the balance sheet if in its opinion it is necessary to grant exemption in the public interest. The Central Government may modify on the application or with the consent of the Board, in relation to that company, any of the requirements of Schedule VI as to the matters to be stated in the balance sheet for the purpose of adapting it to the circumstances of the company.

If any person who is responsible for keeping proper books of account fails to take all reasonable steps to secure compliance by the company with the requirement of law relating to the form and contents of the balance sheet, he is liable for each offence to imprisonment for term extending up to six months or to a fine up to ₹ 10,000 or with both.

Form of Balance Sheet

As per section 211(1), balance sheet of a company shall be in the form set out in Part I of Schedule VI to the Act. Central Government vide Notification No. G.S.R 447(E) dated 28.02.2011 has revised the Schedule VI of the Companies Act, 1956 (Please refer Annexure III). Further the Central Government vide notification no. S. O. 653(E) dated 30.03.2011 has also notified that the Balance Sheet and Profit and Loss Account for the financial year commencing on or after 1-04-2011 shall be prepared in accordance with the revised Schedule VI. The revised schedule VI has been divided into following two parts:

Part-I Form of Balance Sheet

Part-II Form of Statement of Profit and Loss

PART I – Form of BALANCE SHEET

Name of the Company.....

Balance Sheet as at

(Rupees in.....)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1	2	3	4
I	EQUITY AND LIABILITIES			
(1)	Shareholders' funds (a) Share capital (b) Reserves and surplus (c) Money received against share warrants			
(2)	Share application money pending allotment			
(3)	Non-current liabilities (a) Long-term borrowings (b) Deferred tax liabilities (Net) (c) Other Long term liabilities (d) Long-term provisions			
(4)	Current liabilities (a) Short-term borrowings (b) Trade payables (c) Other current liabilities (d) Short-term provisions			
	TOTAL			

II	ASSETS			
(1)	Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets			
	(ii) Intangible assets			
	(iii) Capital work-in-progress			
	(iv) Intangible assets under development			
	(b) Non-current investments			
	(c) Deferred tax assets (net)			
	(d) Long-term loans and advances			
	(e) Other non-current assets			
(2)	Current assets			
	(a) Current investments			
	(b) Inventories			
	(c) Trade receivables			
	(d) Cash and cash equivalents			
	(e) Short-term loans and advances			
	(f) Other current assets			
	TOTAL			

Rounding off the figures in Balance Sheet

Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as below:

	Turnover in a Financial year (₹)	Level of Rounding off permitted (₹)
(i)	Less than 100 crores	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(ii)	100 crores or more	To the nearest lakhs, millions or crores, or decimals thereof.

Once a Unit of measurement is used, it should be used uniformly in the Financial Statements.

Meaning of Profit and Loss Account

Profit and loss account is the account by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation, to its capital, and enables them to judge about the administration and management of the affairs of the company. Many people pay too much attention to a company's balance sheet and too little attention to its Profit and Loss Account. It is true that a company's balance sheet exhibits a position which is the result of transactions that have taken place during the whole of its life, whereas the profit and loss account only shows what the profits are for the year. It may also be true that owing to special circumstances the profits for that particular year are abnormally high or abnormally low and therefore afford little guide as to future profitability; but a comparison of the result with that of preceding years, coupled with such information

as is given in the Directors Report should furnish a reliable guide to the earning capacity of the business. By making the publication of the annual profit and loss account compulsory, the law has recognised its importance for the purpose of assessing the value of a company's business.

Form of Profit & Loss Account

As per section 211(2), profit and loss account of a company shall comply with the requirements of Part II of Schedule VI, so far as they are applicable thereto. Central Government vide Notification No. G.S.R 447(E) dated 28.02.2011 has revised the Schedule VI of the Companies Act, 1956 (Please refer Annexure III). Part II of revised schedule VI which provides the format of Statement of Profit & Loss Account is given below:

PART II – Form of Statement of Profit and Loss

Name of the Company.....

Profit and Loss Statement for the year ended

(Rupees in)

Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period
I. Revenue from operations		xxx	xxx
II. Other income		xxx	xxx
III. Total Revenue (I+II)		xxx	xxx
IV. Expenses:			
Cost of materials consumed		xxx	xxx
Purchases of Stock-in-Trade		xxx	xxx
Changes in inventories of finished goods work-in-progress and Stock-in-Trade		xxx	xxx
Employee benefits expenses			
Finance costs			
Depreciation and amortization expenses			
Other expenses			
Total expenses		xxx	xxx
V. Profit before exceptional and extraordinary items and tax (III-IV)		xxx	xxx
VI. Exceptional items		xxx	xxx
VII. Profit before extraordinary items and tax (V-VI)		xxx	xxx
VIII. Extraordinary Items		xxx	xxx
IX. Profit before tax (VII-VIII)		xxx	xxx

X.	Tax expense:		
	(1) Current tax	xxx	xxx
	(2) Deferred tax	xxx	xxx
XI.	Profit (Loss)for the period from continuing operations (VII-VIII)	xxx	xxx
XII.	Profit/(loss) from discontinuing operations	xxx	xxx
XIII	Tax expense of discontinuing operations	xxx	xxx
XIV	Profit/(loss) form Discontinuing operations (after tax)(XII – XIII)	xxx	xxx
XV.	Profit (Loss) for the period (XI+XIV)	xxx	xxx
XVI.	Earnings per equity share:		
	(1) Basic	xxx	xxx
	(2) Diluted	xxx	xxx

Filing of Balance Sheet and Profit And Loss Account etc. in XBRL Format

In exercise of the powers conferred by sub-section (1) of section 642 read with section 610B of the Companies Act, 1956, the Central Government has notified Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011 w.e.f. 06.10 2011.

The following class of companies have to file their Balance Sheet, Profit and Loss Account and other documents as required under section 220 of the Companies Act, 1956 with the Registrar using the Extensible Business Reporting Language (XBRL) taxonomy given in Annexure enclosed to the rules for the financial year ending on or after 31st March, 2011 with e-Form no. 23AC-XBRL and 23ACA-XBRL specified under the Companies (Central Government) General Rules and Forms, 1956, namely:-

- (i) All Companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or
- (ii) All Companies having paid up capital of rupees five crore or above; or
- (iii) All companies having turnover of rupees hundred crore or above.

Companies in Banking, Insurance, Power Sectors and Non-Banking Financial companies are exempted for Extensible Business Reporting Language (XBRL) filing for the financial year 2010-11.

8. ANNUAL ACCOUNTS TO COMPLY WITH ACCOUNTING STANDARDS

Sub-section (3A) of Section 211 of Companies Act 1956 inserted by the Companies (Amendment) Act, 1999 provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.

Sub-section (3B) of the said section provides that where the profit and loss account and the balance sheet of the company do not comply with the accounting standards such companies shall disclose in their profit and loss account and balance sheet, the following namely:-

- (a) the deviations from the accounting standards;
- (b) the reasons for such deviations; and
- (c) the financial effect, if any, arising due to such deviations.

Sub-section (3C) of the said section lays down the meaning of the expression "accounting standards" as the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949), as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under Sub-section (1) of Section 210A.

IND AS

International Financial Reporting Standards (IFRS) are now becoming universal reporting language. In tune with the global trend the Government of India decided to facilitate the convergence of the Indian Accounting Standards with IFRS by 1st April, 2011. In this direction all the existing Indian Accounting Standards are being revised and converged with corresponding to International Accounting Standards/ International Financial Reporting Standards. These converged accounting standards shall be known as Ind AS.

According to the Press Release dated 25 February 2011, the process of convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS) has been carried out in Ministry of Corporate Affairs through wide ranging consultative exercise with all the stakeholders. Thirty five Indian Accounting Standards converged with International Financial Reporting Standards (henceforth called IND AS) are being placed by the Ministry on their website. These are: IND ASs 1, 2, 7, 8, 10, 11, 12, 16, 17, 18, 19, 20, 21, 23, 24, 27, 28, 29, 31, 32, 33, 34, 36, 37, 38, 39, 40, 101, 102, 103, 104, 105, 106, 107 and 108.

The Ministry of Corporate Affairs will implement the IFRS converged Indian Accounting Standards in a phased manner after various issues including tax related issues are resolved with the concerned Departments. The date of implementation of the IND AS will be notified by the Ministry at a later date.

9. NATIONAL ADVISORY COMMITTEE ON ACCOUNTING STANDARDS (NACAS)

The Companies (Amendment) Act, 1999 had inserted a new Section 210A in the Companies Act, 1956 which provides for constitution of a National Advisory Committee on Accounting Standards (hereinafter referred to as the 'Advisory Committee') to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies or class of companies. According to Section 210A, the Central Government may, by notification in the Official Gazette constitute such 'Advisory Committee'. The Advisory Committee shall consist of the following members, namely:

- (a) a chairperson who shall be a person of eminence well-versed in accountancy, finance, business administration, business law, economics or similar discipline;

- (b) one member each nominated by the Institute of Chartered Accountants of India, the Institute of Cost & Works Accountants of India and the Institute of Company Secretaries of India.
- (c) one member each nominated by Central Government, Reserve Bank of India, Comptroller and Auditor General of India and SEBI;
- (d) the chairman of the Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963 or his nominee;
- (e) a person who holds or has held the office of professor in accountancy, finance or business management in any University or deemed University; and
- (f) two members to represent the Chambers of Commerce and Industry to be nominated by the Central Government.

The Advisory Committee gives its recommendations to the Central Government on such matters of accounting polices and standards and auditing as may be referred to it for advice from time to time.

The members of the Advisory Committee hold office for such term as may be determined by the Central Government at the time of their appointment and any vacancy in the membership in the Committee shall be filled by the Central Government in the same manner as the member whose vacancy occurred was filled.

The non-official members of the Advisory Committee shall be entitled to such fees, travelling, conveyance and other, allowances as are admissible to the officers of the Central Government of the highest rank.

In exercise of the powers conferred by clause (a) of sub-section (1) of Section 642 of the Companies Act, 1956, read with sub-section (3C) of Section 211 and sub-section (1) of section 210A of the said Act, the Central Government, in consultation with National Advisory Committee on Accounting Standards, issued, the Companies (Accounting Standards) Rules, 2006.

Rules 3 specifies that the Central Government prescribes Accounting Standards 1 to 7 and 9 to 29 as recommended by the Institute of Chartered Accountants of India. These Accounting Standards have been given as Annexure to these rules. Every company and its auditor(s) shall comply with the Accounting Standards in the manner specified in Annexure to these rules.

The Accounting Standards shall be applied in the preparation of General Purpose Financial Statements. Accounting Standards, which are prescribed, are intended to be in conformity with the provisions of applicable laws. However, if due to subsequent amendments in the law, a particular accounting standard is found to be not in conformity with such law, the provisions of the said law will prevail and the financial statements shall be prepared in conformity with such law. Accounting Standards are intended to apply only to items which are material.

The Central Government, in consultation with National Advisory Committee on Accounting Standards has made the rules to be called the Companies (Accounting Standards) Rules, 2006 vide notification No. G.S.R. 739(E) dated 07.12.06.

Choose the correct answer

Which body/authority receives recommendations from the Advisory Committee on matters of accounting policies and standards and auditing, as may be referred to it for advice from time to time?

- (a) Tax Committee
- (b) State Government
- (c) Central Government
- (d) None of the above

Correct Answer: c

10. LAYING OF ACCOUNTS

Section 210 requires that at every annual general meeting of the company, the Board of directors must lay before the shareholders of the company a balance sheet and a profit and loss account for the period specified in Sub-section (3); and in the case of non profit companies, an income and expenditure account. The following provisions of the Act are required to be kept in mind:

- (1) Balance Sheet and Profit and Loss Account are to be prepared as per provisions of Section 211 as discussed above.
- (2) Auditors Report and Directors Report should be attached to the balance sheet as required under Section 216 and 217 of the Act.
- (3) The profit and loss account to be placed in the first annual general meeting should relate to the period beginning with the incorporation of the company and ending with a day, the interval between which and the date of the meeting does not exceed nine months. [Section 210(3)(a)].
- (4) In the case of subsequent annual general meetings, the profit and loss account should relate to a period beginning with the day immediately after the period for which the preceding profit and loss account was made and ending with a day, the interval between which and the date of the meeting should not exceed six months. Where the Registrar has granted extension of time for holding the AGM under second proviso to sub- section (1) of Section 166, such interval should not exceed six months and the extended period [Section 210(3)(b)].
- (5) The period to which the profit and loss account relates is known as the financial year. It may be more or less than a calendar year, but it must not exceed 15 months or with the special permission of the Registrar, 18 months [210(4)].

Default in Laying of Accounts

According to Sub-section (5) of Section 210 of the Act, if any director fails to take all reasonable steps to comply with the aforesaid requirements of Section 210 he is, in respect of each offence liable to be punished with imprisonment upto six months or with fine up to ₹ 10,000/- or with both. Further, as per sub-section (6) of section 210, if some other competent person had been charged with the duty of ensuring the compliance with the requirements then he would be liable for such non-compliance in the same manner as provided in sub-section (5). The legal position in this issue as

laid down through various case laws is as follows:

- (i) The directors of a company cannot evade liability for failure to lay the accounts and balance sheet before the Annual General Meeting merely by stating that the auditor had not sent his report.
- (ii) The directors must prove that some other competent and reliable person was charged with the duty of seeing that the provisions of this section were complied with [*State of Bihar v. Linkers Pvt. Ltd.*, (1970) 40 Com Cases 17 (Pat)].
- (iii) That the Managing Director was looking after the accounts is also not a defence unless the directors prove that he was charged with the duty. [*State of Bihar v. Linkers (Private) Ltd.*, AIR 1969 Pat 445].
- (iv) Where the accounts were not placed before the company in annual general meeting pending the disposal of a petition for amalgamation, but, relying upon a circular of the Company Law Board, the directors adjourned the annual general meeting, it was held that the directors could not be prosecuted under Section 210(5). [*M.D Mundhra. v. Assistant Registrar of Companies* (1980) 50 Comp Cas 346 (Cal)].
- (v) Where the default was due to reasons beyond the control of the persons concerned, it is hard to fasten criminal liability on them. [*Public Prosecutor v. H.R. Basavaraj*, (1963) 1 Comp LJ 130 (AP)].
- (vi) In the case of default under this section no question as to whether such default is wilful or not will arise. [*Registrar of Companies, Orissa v. Radhika Prasad Nanda* (1978) 48 Com Cases 102 (Ori)].
- (vii) The directors cannot be made liable for a default which took place long before they became directors or officers of the company or after they ceased to be directors by resignation. [*Krishna Kumar Khemka v. R.O.C. West Bengal* (1986) 2 Crimes 604, 608 (Cal)].
- (viii) The offence under Section 210 is not a continuing offence. [*Dhanalaxmi Chemical Industries (P) Ltd. v. Asstt. Registrar*, 1988 LW (Cri) 180, 184 (Mad)].
- (ix) The Asstt. Registrar of Companies is a "person aggrieved" and may file a complaint under Section 210(5). [*Bhagabati Prasad Tantia v. Asstt. Registrar of Cos*, (1983) 53 Com Cases 56 (Cal)].
- (x) The Department of Company Affairs (Now Ministry of Corporate Affairs) in its Circular no. 4/74 dated 2.2.1974 has clarified that in case where accounts are not ready up to the holding of the annual general meeting, the same can be adopted at the adjourned annual general meeting. The Division Bench of Calcutta High Court in *Bejoy Kumar Karnani and others v. Asstt. Registrar of Companies*, (88 CWNP 1073) has held that if the Department Circular No. 4/74 dated 2.2.1974 is to be literally construed, the adjournment may go *ad infinitum* and in such an event not only the provisions of Section 166 but also the provision of Sections 168 and 210 would be rendered negatory leading to chaos and confusion in the matter of enforcement of the relevant provisions of the Act by the Registrar of Companies.

Consequently, the Department of Company Affairs, further clarified vide its circular No 2/85 dated 20.3.85 that no doubt, it is open to the company to adjourn the annual general meeting to a subsequent date for laying the accounts but then, the adjourned meeting must itself be held within the statutory period [including the period of extension thereof if any allowed as provided in Section 166(1)]. Thus, if the accounts are not placed at the Annual General Meeting in either case within the statutory period laid down in Sub-section (3) of Section 210 the delinquent directors are liable for prosecution under Sub-section (5) thereof.

11. APPROVAL AND SIGNING OF BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report (Section 215). In the case of a banking company the balance sheet and profit and loss account shall be signed by the person mentioned in clause (a) or clause (b) of Section 29(2) of the Banking Regulation Act, 1949. In the case of other companies, the balance sheet and profit and loss account of a company must be signed on behalf of the Board of directors by not less than two directors and the manager, or secretary, if any. If the company has a managing director, he should be one of the signing directors.

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

As per Section 215 of the Companies Act, 1956, the Company Secretary of the company should not sign the Balance Sheet and Profit & Loss Account of the company.

- True
- False

Correct Answer: False

In terms of the provisions of Section 215 of the Companies Act, 1956, the Balance Sheet and Profit & Loss Account must be signed on behalf of the Board of directors by not less than two directors and the manager, or secretary, if any. If the company has a managing director, he should be one of the signing directors.

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

In the absence of any specific provision in Section 215, the power of the directors to approve the annual accounts can be delegated to a committee of directors.

- True
- False

Correct Answer: False

In the absence of any specific provision in Section 215, the power of the directors to approve the annual accounts cannot be delegated to a committee of directors or some of the directors

12. PENALTY

Section 218 provides for penalty for non compliance with the provisions of Sections 212, 215, 216 and 217. Thus, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 5,000/- if:

- (i) any copy of balance sheet and profit and loss account is, without being signed as required by Section 215, issued, circulated or published; or
- (ii) any copy of a balance sheet is issued, circulated or published without there being annexed or attached thereto, as the case may be, a copy each of,
 - (a) the profit and loss account;
 - (b) any accounts, reports or statements which, by virtue of Section 212, are required to be attached to the balance sheet;
 - (c) the auditors' report; and
 - (d) the Board's report referred to in section 217.

It may be noted that the proviso to Sub-section (1) of Section 383A requires that company shall attach with the Board's report a copy of compliance certificate obtained from secretary in whole time practice.

13. AUTHENTICATION OF ANNUAL ACCOUNTS BY SECRETARY

In terms of the provisions of Section 215, the signature by the secretary, if the company has one, is mandatory. However, there may be companies who have, in spite of legal obligation, not appointed a Managing Director and/or secretary. Where the company has not appointed a secretary, despite the legal obligation in this regard, the accounts would be deemed to have been properly authenticated if they have been signed by two directors, including the managing director, if any. Likewise, where the annual accounts of such a company, which does not at the relevant time appointed a Managing Director would be deemed to have been properly authenticated if they have been authenticated by the secretary/manager, if any and two directors.

As the authentication by the secretary is "on behalf of the Board of directors" and not in his personal capacity the secretary can be held responsible regarding errors, etc. only as an "officer" of the company within the meaning of Section 628 and not because of authentication by him under Section 215 as such. Where however, the secretary is charged with the responsibility of maintaining the accounts and also assisting the auditor at the time of auditing, he cannot conceivably escape consequence of any wrong statement in the account (DCA's Circular No. 7 of 1972, dated 12.5.1972).

Authentication, however, does not mean that the facts and figures or truth or accuracy of the transactions in the accounts are all certified as true. Authentication only implies that the documents authenticated are genuine and not fake. The secretary or an ordinary director, for instance, who signs the balance sheet or profit and loss account cannot be expected to guarantee the truth and accuracy of the transactions and figures in the accounts presented, as it is not part of the duty of the secretary or ordinary directors to vouch the truth or correctness of the items in the accounts as the duty lies in those in management and/or responsible for maintaining the accounts.

14. AUTHENTICATION OF ANNUAL ACCOUNTS WHEN ONLY ONE DIRECTOR IS AVAILABLE

As stated earlier, the balance sheet and the profit and loss account shall be signed on behalf of the Board by (a) the manager or secretary if any and by (b) at least two directors one of whom shall be a managing director where there is one. If there is no managing director, then by (a) the manager or secretary, if any and (b) any two director, shall sign the same. If only one director or managing director is, for the time being in India, he can sign the balance sheet and the profit and loss account. However, in such a case he is required to file with the Registrar of Companies, along with the balance sheet and the profit and loss account, a signed statement explaining the reason as to why compliance with the provisions of Sub-section (1) of Section 215 was not possible.

15. TIME GAP BETWEEN AUTHENTICATION OF ACCOUNTS AND SIGNING BY AUDITOR

Ministry's views — Responsibility for the preparation of the accounts of a company belongs to the directors who have to approve them before the auditors make their report thereon. The Act is apparently silent on when the auditors may commence their work of audit. In other words, it does not clarify whether they have simply to await the directors' report on the accounts or proceed with the audit work in the meantime immediately after their appointment at the last annual general meeting. The auditor's report comes at the end of the audit process and Section 215 mentions nothing of the process preceding the preparation of the audit report by the auditors. Section 227 of the Companies Act, 1956, gives the auditors access at all times to the books of account and vouchers of the company, which amply suggests that they do not have to remain idle at any time after their appointment as auditors. Subject to the convenience of the company, he may actually commence the checking up of vouchers, etc., and the company may prepare Trial balances, balance sheets etc, which will save time for the auditors in the preparation of their report in due course. Thus, if the auditor signs the balance sheet on the same date on which the directors have approved it, it may not be inferred from this circumstances that the auditor has not performed the audit efficiently (Circular No. 7 of 1974 dated 26th April, 1974). There is no violation of Section 215 where the audit is completed before approval of the balance sheet by the Board of directors (Letter No. 8/13 (215)/5 CLV, dated 29.9.1965).

It appears that the Act contemplates two Board Meetings, one for the approval of the accounts and another to answer any reservation, qualification or adverse, remark in the auditor's report, including the report under the CARO, pursuant to provisions of Section 217(4). It is, however, a common practice of practically all the companies to hold only one Board Meeting for this purpose, after the auditor's draft report is made available for Board's consideration. This practice of submitting draft report by the auditor is to avoid any discrepancy in the facts on which the auditor's conclusions and Board's replies thereto are based.

16. APPROVAL OF ANNUAL ACCOUNTS BY DELEGATION

The Department of Company Affairs (Now Ministry of Corporate Affairs) vide its letter dated 27.10.1976 has clarified that in the absence of any specific provision in Section 215, the power of the directors to approve the annual accounts cannot be delegated to a committee of directors or some of the directors. It, *inter alia*, states

that the approval of annual accounts which are to be ultimately placed before the shareholders of the company is not to be treated as a routine or part of day to day work. Hence the Board of Directors must themselves consider the annual accounts and approve them before the accounts are handed over to the statutory auditor of the company.

However, the Audit Committee should review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems. Further, the recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board. Also, if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor and communicate such reasons to the shareholders.

17. CIRCULATION OF BALANCE SHEET AND AUDITOR'S REPORT

Section 219 (1) of the Companies Act requires that a copy of every balance sheet, profit and loss account, auditor's report and every other document required to be annexed or attached to the balance sheet must be sent not less than twenty-one days before the annual general meeting at which they are to be laid, to:

- (i) every member of the company;
- (ii) every trustee for debenture holders whether such member or trustee is entitled to have notice of general meeting to be sent to him or not; and
- (iii) all other persons who are entitled to have notice of general meetings.

In the case of a company not having a share capital, the above documents need not be sent to a member, or debenture holder who is not entitled to have notice of general meetings sent to him.

Section 219(1)(b)(iv) provides that in case of listed companies, the company may keep the aforesaid documents available for inspection at its registered office during working hours for a period of twenty-one days before the date of the meeting and send to every member and trustee for debentureholders only a statement containing the salient features of these documents in the prescribed form.

Rule 7A has been inserted in the Companies (Central Government's) General Rules and Forms, 1956 which prescribes Form 23AB for sending statement containing salient features to members.

It is also provided that if the copies of documents are sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by all the members entitled to vote at the meeting.

If any default is made in complying with Sub-section (1), of Section 219 the company and every officer of the company who is in default, shall be punishable with fine which may extend to ₹ 5,000/-.

Any member or holder of debentures of a company and any person from whom the company has accepted a sum of money by way of deposit shall, on demand, be entitled to be furnished free of cost, with a copy of the last balance sheet of the

company and of every document required by law to be annexed or attached thereto, including the profit and loss account and the auditor's report [Section 219(2)].

If any person makes a demand for a copy of any document with which he is entitled to be furnished by virtue of Sub-section (2), and if default is made in complying with the demand within seven days after the making thereof, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees, unless it is proved that person had already made a demand for and been furnished with a copy of the document [Section 219 (4)].

Sending Annual Reports through e-mail – Green Initiative by Ministry of Corporate Affairs

The Ministry of Corporate Affairs vide its Circular No. 18/2011 dated 29.04.2011 has clarified that a company would be in compliance of sections 219(1) of Companies Act, 1956, in case, a copy of Balance Sheet etc., is sent by electronic mail to its member provided the following conditions are complied with –

- (a) The company has obtained e-mail address of its member for sending Notice with Balance Sheet, Profit and Loss Account, Auditor's Report, Directors' Report and Explanatory Statement etc. through e-mail after giving an advance opportunity to the member to register his e-mail address and changes therein from time to time with the company or concerned depository.
- (b) The company's website display full text of the documents i.e. notice with Balance Sheet, Profit & Loss A/c, Auditor's Report, Director's Report, and explanatory statements etc well in advance prior to mandatory period and an advertisement is issued in prominent newspapers both in English and Vernacular stating that the documents are available in website and for inspection at the registered office of the company.
- (c) In cases where any member(s) has not registered his e-mail address for receiving the Balance Sheet etc through e-mail, it will be sent by other modes of services as provided under section 53 of the Companies Act, 1956.
- (d) In case any member(s) insist for physical copies of above documents, the same should be sent to him physically, by post free of cost.

The Ministry of Corporate Affairs vide its General Circular No. 72/2011 dated 27.12.2011 has clarified that for e-voting in general meetings, any agency providing electronic platform for e-voting is required to obtain certificate from Standardization Testing and Quality Certification (STQC), Directorate, Department of Information Technology, Ministry of Communication and IT, Government of India, New Delhi.

Amendment in listing agreement — submission of complete balance sheet

SEBI had in 1994, directed all Stock Exchanges to amend the relevant clause of their listing agreement to provide that the companies shall supply a copy of the complete and full Balance Sheet, Profit and Loss Account and the Director's Report to each shareholder. However, in view of the various representations received, according to which, the directions resulted in waste of paper, cost and time etc.,

particularity when shareholders reside in one household, SEBI has now advised all stock exchanges to amend clause 32 (vide SM DRP/policy/Cir-98 dated 28.5.99) as under:

Clause 32

The Company will supply a copy of the complete and full Balance Sheet, Profit and Loss Account and the Director's Report, to each Shareholder and upon application to any member of the Exchange.

However, the company may supply a single copy of complete and full Balance Sheet and Profit and Loss Account and Directors' Report to the shareholders residing in one household (i.e., having same address in the Books of Company/Registrars/Share transfer agents). Provided that, the company on receipt of request shall supply the complete and full Balance Sheet and Profit and Loss Account and Directors Report also to any shareholder residing in such household. Further, the company will supply abridged Balance sheet to all the shareholders in the same household.

In case the company has changed its name suggesting any new line of business (including software business), after 1st January, 1998 or it changes the name hereafter, then the company will disclose the net sales or income or expenditure and net profit or loss after tax, from such new activities separately in the annual results for a period of 3 years from the date of change in the name of the company.

In addition to the above provisions, listed companies which decide to change their names would be required to comply with the following conditions:

1. a time period of at least 1 year should have elapsed from the last name change
2. at least 50% of the total revenue in the preceding 1 year period should have been accounted for by the new activity suggested by the new name.

The new name along with the old name shall be disclosed through the web sites of the respective stock exchange/s where the company is listed.

The Company will also give a Cash Flow Statement along with Balance Sheet and Profit and Loss Account. The Cash Flow Statement will be prepared in accordance with the Accounting Standard on Cash Flow Statement (AS-3) issued by the Institute of Chartered Accountants of India, and the Cash Flow Statement shall be presented only under the Indirect Method as given in AS-3.

The company will mandatorily publish Consolidated Financial Statements in its Annual Report in addition to the individual financial statements. The company will have to get its Consolidated Financial Statements audited by the statutory auditors of the company and file the same with the Stock Exchange.

The company will make disclosures in compliance with the Accounting Standard on ~~Related Party Disclosures~~ in its Annual Report.

Disclosure of loans/advances and investments in its own shares by the listed companies, their subsidiaries, associates etc.

The following disclosure requirements shall be complied by the companies in the Annual Accounts:

Sr. No.	In the accounts of	Disclosures of amounts at the year end and the maximum amount of loans/advances/investments outstanding during the year.
1.	Parent	Loans and advances in the nature of loans to subsidiaries by name and amount. Loans and advances in the nature of loans to associates by name and amount. Loans and advances in the nature of loans where there is (i) no repayment schedule or repayment beyond seven years or (ii) no interest or interest below section 372A of Companies Act by name and amount. Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount.
2.	Subsidiary	Same disclosures as applicable to the parent company in the accounts of subsidiary company.
3.	Parent	Investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.

Note: (1) For the purpose of the above disclosures the terms ~~parent~~ and ~~subsidiary~~ shall have the same meaning as defined in the Accounting Standard on Consolidated Financial Statement (AS-21) issued by ICAI.

(2) For the purpose of the above disclosures the terms ~~Associate~~ and Related Party shall have the same meaning as defined in the Accounting Standard on ~~Related Party Disclosures~~ (AS-18) issued by ICAI.

(3) For the purpose of above disclosures directors interest shall have the same meaning as given in Sec. 299 of Companies Act.

The above disclosures shall be applicable to all listed companies except for listed banks.

Petition before CLB

An aggrieved person may make an application to the Company Law Board for a direction to a company to make available to him the necessary balance sheet etc. The petition should be made in Form No. 1 of Annexure II to the Company Law Board Regulations, 1991 [Regulation 14]. A fee of ₹ 50/- is required to be paid for every such petition.

Copy of balance-sheet etc., to be delivered to Reserve Bank

As per the Reserve Bank's directions issued to all non-banking companies receiving deposits (which term includes borrowings) ~~an~~ audited balance-sheet as on

the last date of each financial year and an audited profit and loss account in respect of that year as passed by the company in general meeting within fifteen days of such meeting” should be furnished by such companies to the Department of Non-Banking Companies of the Reserve Bank (See Notifications Nos. DNBC./ 1 & 2/ED (S)-66 both, 29th October, 1966 and DNBC 21/DG/(S)-73, 23rd August, 1973).

18. ADOPTION OF ACCOUNTS AT ANNUAL GENERAL MEETING

An important business to be transacted at an annual general meeting is adoption of the accounts including the balance sheet, profit and loss account and the director's report thereon.

It may be noted that the balance sheet and profit and loss account are required to be placed only at an annual general meeting and not at any other general meeting. In case the annual accounts are not ready for laying at the appropriate annual general meeting, the company may adjourn the said annual general meeting to a subsequent date when the annual accounts are expected to be ready for laying. This may be done by adopting a suitable resolution adjourning the said annual general meeting to a specified date, or to a date to be specified later.

However, the adjourned annual general meeting should, *inter alia*, be held within the time frame laid down in Sections 166 and 210 [Department's Circulars No. 4/47 dated 22.2.1974 and No. 2/85 dated 25.3.1985].

19. FILING OF ANNUAL ACCOUNTS WITH THE REGISTRAR

Section 220 requires every company to file with the Registrar within 30 days from the day on which the balance sheet and profit and loss account were laid before the company at the annual general meeting, a copy of balance sheet and profit and loss account signed by the managing director, manager or secretary of the company or if there be none of these, by a director of the company together with a copy of all documents which are required by the Act to be annexed or attached thereto.

While requiring a private company also to file three copies of the balance sheet and profit and loss account, Section 220 safeguards its privacy. Consequently, a private company can file copies of balance sheet and profit and loss account separately.

Where the annual general meeting of a company for any year has not been held, there shall be filed with the Registrar, three copies of the balance sheet and profit and loss account, duly signed, within thirty days from the latest day on or before which that meeting should have been held in accordance with the provisions of the Act. Section 220(2) provides that if for any reason, the annual general meeting before which a balance sheet is laid does not adopt it, or is adjourned without adopting the balance sheet or if the annual general meeting of a company for any year has not been held, a statement of that fact and of reasons therefor must also be annexed to the balance sheet and to the copies thereof to be filed with the Registrar.

If default is made in complying with the requirements of Section 220 regarding the filing of copies of balance sheet and profit and loss account, then the company and every officer of the company who is in default shall be punishable with fine which may extend ₹ 500 for every day during the period the default continues.

Kishan Prasad Palaypu v. Registrar of Companies [(2008) 83 SCL 376 (AP)]. A director of the company along with another director were prosecuted under section 220 for their failure to file return, annual accounts and audited balance sheet required to be laid before the annual general meeting. The director moved the Court under Section 482 of the Code of criminal procedure for quashing the proceedings contending that the complaints filed were barred by limitation. Dismissing the petition, the Court held that Section 162(1) provides for penalty at the rate of ₹50 for every day till the default continues, it must be held that default in complying with the provisions of Section 220(1) is a continuing default covered by Section 472 of the Code of Criminal Procedure. The contravention of Section 220(1) made punishable under Section 220(3) is a continuing offence and the period of limitation prescribed under Section 468 of the Code does not apply to the prosecution launched against the company.

Where the default was due to reasons beyond the control of the company and the officers concerned, it is hard to fasten criminal liability on them. But whether the circumstances in any case were beyond control or not will be a question of fact. [*Great Indian Steam Navigation Co. Ltd. v. State*, (1967) 37 Com Cases 135 (Cal)]. The prosecution has to prove that the person in question was a director at the material time and also an officer in default, otherwise the case would fail. Notwithstanding the fact that a director who had sent in his resignation prior to the due date of filing the copies of balance sheet he could still be held responsible for the offence [*Bipin Behari Nayak v. Registrar of Cos.*, (1988) 63 Com Cases 271 (Orissa)]. A director must be shown to be guilty of default [*Ramacast Ltd. v. Asst. Registrar of Cos.*, (1987) 3 Comp LJ 242].

As per Sub-section (1) of Section 220, a company is liable to file balance sheet etc. whether the annual general meeting has been held in time or not, or whether the balance sheet etc. is laid thereat or not; or, whether the annual general meeting is adjourned, without the balance sheet etc. being laid or adopted thereat. The company becomes punishable for its failure to do so *per se* because there is no excuse even on the ground of "sufficient reasons". [*Asst. Registrar of Cos. v. Sudarsan Linkers Ltd.*, (1988) 1 Comp LJ 107 (Mad)]. The Court will not quash a complaint for default in filing balance sheets merely because a director claims to have retired from the post.

The fact that the company did not function is no excuse. So long as a company is in existence and not wound-up, nothing stood in the way of holding a meeting or preparing a balance sheet and profit and loss account and submitting the annual return [*Madan Gopal Dey v. State of W.B.*, AIR 1968 Cal 79].

The Ministry of Corporate Affairs (MCA) vide its General Circular No. 37/2011 dated 07.06.2011 has mandated the following class of companies to file balance sheet and Profit and Loss Account along with Director's and Auditor's Report in XBRL form only from the year 2010-11:

- All companies listed in India and their Indian subsidiaries,
- All companies with paid capital of Rs. 5 Crore and above
- All companies with turnover of Rs. 100 Crore or above.

However banking Companies, insurance companies, power companies and Non Banking Financial Companies (NBFCs) are exempted, till further orders.

The Central Government has also issued The Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011. (See *Annexure II*)

(Students are advised to visit MCA-XBRL website for further knowledge on XBRL at the link <http://www.mca.gov.in/XBRL/index.html>.)

20. CLARIFICATIONS ISSUED BY THE DEPARTMENT OF COMPANY AFFAIRS WITH RESPECT TO FILING OF ANNUAL ACCOUNTS:

1. *Whether Registrar can take balance sheet and profit and loss account on record if not laid before annual general meeting?*

It has come to the notice of this Department that a company has sent to the Registrar of Companies, for filing under Section 220, its balance sheet and profit and loss account which had been laid before a general meeting and not an annual general meeting. In this context the question arose for consideration as to whether the Registrar could take the document on record in view of the clear provisions of Sub-section (1) of Section 210 read with Sub-section (1) of Section 220 requiring the balance sheet and profit and loss account to be laid before a company at an annual general meeting before sending it to the Registrar for filing. The Department has been advised that the balance sheet and profit and loss account are required to be placed only at an annual general meeting and not at any other general meeting. In case the annual accounts are not ready for laying at the appropriate annual general meeting, it is open for the company concerned to adjourn the said annual general meeting to a subsequent date when the annual accounts are expected to be ready for laying. This may be done by adopting a suitable resolution adjourning the said annual general meeting to a specified date or to a date to be specified later on.

In future balance sheets and profit and loss accounts which are not laid before an annual general meeting of the company but submitted to the Registrar of Companies for filing under Section 220 would not be taken on record. The question of launching prosecution in such cases would be considered.

2. *Whether Board's report is to be filed along with the balance sheet and profit and loss account with the Registrar?*

Section 220(1)(a) provides that three copies of the balance sheet and the profit and loss account, together with three copies of all documents which are required to be annexed or attached to the balance sheet and profit and loss account, shall be filed with the Registrar of Companies. Since by virtue of Section 217(1), the Board's report is a document required to be attached to the balance sheet, copies of said report have also necessarily to be filed with the Registrar in terms of Section 220(1)(a). [*Letter No. 44(69)-CL-IV/61, dated 11.12.1961*].

3. *Whether Registrar should call for separate report by auditors on profit and loss account?*

A private company is not required to attach to its profit and loss account, filed with the Registrar of Companies, separate auditors' report signed by the auditors. Unless a private company has on its own volition reproduced the auditors' report in full on the balance sheet as well as on the profit and loss account, all that the company should be able to do is to adopt either of the following two alternatives:

- (a) to attach to the profit and loss account a copy, authenticated in the manner

specified in Section 220(1)(a), of the full auditors' report as attached to the balance sheet;

- (b) to attach to the balance sheet a copy of the relevant extracts from the auditors' report pertaining to the balance sheet only and to attach to the profit and loss account a copy of the full auditors' report — the copy of the auditors' report in each case to be authenticated in the manner specified in Section 220(1)(a).

The Registrar should put to the company concerned both the alternatives and leave it to the choice of adopting either of the alternatives. In no case should they call for a separate report by the auditors on the profit and loss account of a private company [*Letter No. 15(62)-CL-VI/61, dated 2.3.1962.*].

4. *Whether separate filing fee is required for profit and loss account and whether only members are to be permitted to inspect profit and loss account?*

No separate filing fee in respect of the profit and loss accounts of private companies filed under Section 220 need be charged, if filed at the same time as the balance sheet is filed.

If a person seeks inspection of the profit and loss accounts of a private company, the Registrar should make sure that he is a member of the company by referring to the list of members and demanding to see share scrip duly endorsed in his favour. [*Letter No. 8/16(1)(61)-PR, dated 25.2.1961.*].

5. *Reopening/Revision of Annual Accounts after adoption in Annual General Meeting*

It has been clarified that a company could reopen and revise its accounts even after their adoption in the annual general meeting and filing with the Registrar of Companies in order to comply with technical requirements of any other law to achieve the object of exhibiting true and fair view. The revised Annual Accounts would be required to be adopted either in the extraordinary general meeting or in the subsequent annual general meeting and filed with the Registrar of Companies.

[Circular No. 1/2003 dated 13th January, 2003].

21. INVESTOR EDUCATION AND PROTECTION FUND

An item named as 'Investor Education and Protection Fund' has been added to the current liabilities and provisions in part I of Schedule VI of the Act through a Notification No. GSR 762(E) dated 13.11.2000 and effective from that date, so as to make it mandatory for the companies to credit the following amounts to this fund:

- (a) unpaid dividend;
- (b) unpaid application money received by the companies for allotment of securities and which are due for refund;
- (c) unpaid matured deposits;
- (d) unpaid matured debentures;
- (e) interest accrued on (a) to (d) above.

- (f) grants and donations given to the fund by the Central Govt., State Govts., Companies or any other institutions for the purposes of the fund.
- (g) the interest or other income received out of the investments made from the fund.

The MCA vide its Circular No. 5/2010 dt. 22nd November, 2010 has directed that ROCs should keep a watch on repeat filings of annual accounts by companies for a particular financial year.

The MCA has concluded that keeping in view the provisions of section 220 of the Act read with Ministry's General Circular 1/2003, a company cannot lay more than one set of annual accounts for a particular financial year unless it has reopened/revised such annual accounts after their adoption in the Annual General Meeting in order to comply with technical requirements of any other law to achieve the object of exhibiting true and fair view as specified in Ministry's Circular No. 1/2003 dated 13th January, 2003.

22. INSPECTION OF ANNUAL ACCOUNTS IN CASE OF PRIVATE COMPANIES

No person other than a member of the company is entitled to inspect, or obtain copies, of the profit and loss account under Section 610 of the Act, in the case of:

- (i) a private company which is not a subsidiary of public company;
- (ii) a private company whose entire paid-up capital is held by one or more bodies corporate incorporated outside India.

23. DUTY OF OFFICER TO MAKE DISCLOSURE OF PAYMENTS, ETC.

Section 221 provides that where any particulars or information is required to be given in the balance sheet or profit and loss account of a company or in any document required to be annexed or attached thereto, it shall be the duty of the concerned officer of the company to furnish without delay to the company, and also to the company's auditor whenever he so requires, those particulars or that information in as full manner as possible.

The particulars or information referred to herein may relate to payments made to any director or other person by any other company, body corporate, firm or person.

If any person knowingly makes default in performing the duty cast on him by the foregoing provisions of this section, he shall be punishable with imprisonment which may extend to six months, or with fine which may extend to fifty thousand rupees, or with both.

24. CONSTRUCTION OF REFERENCES TO DOCUMENTS ANNEXED TO ACCOUNTS (SECTION 222)

References in this Act to documents annexed or required to be annexed to the company's accounts or any of them shall not include the Board's report, the auditor's report or any document attached or required to be attached to those accounts.

It is however provided that any information which is required by this Act to be given in the accounts and is allowed by it to be given in a statement annexed to the accounts, may be given in the Board's report instead of in the accounts, and if any

such information is so given, the report shall be annexed to the accounts and this Act shall apply in relation thereto accordingly, except that the auditors shall report thereon only in so far as it gives the said information.

AUDIT

25. WHAT IS AUDIT?

Audit is an examination of accounting records undertaken with a view to establishing the correctness or otherwise of the transactions reflected therein. It involves the intelligent scrutiny of the books of account of a company with reference to documents, vouchers and other relevant records to ensure that the entries made therein give a true picture of the business conducted during the period under review, that every transaction has been properly authorised by the appropriate authority and that effect of all the entries in the books of account has been duly reflected in the final accounts.

The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company.

Need for Audit

Audit of accounts is a *sine qua non* of any business however, big or small it may be. During the course of business, proprietor, creditor, purchaser or a seller has to deal with various financial statements. Nobody would rely on an audited financial statements prepared by the management because this would be just like having a judge for hearing a case in which he himself is a litigant. When a business is run by a proprietor himself, the need for audit may be limited because the business is under his direct control. But where the business is run by persons other than the owners in a company, an independent review of the books of account becomes absolutely necessary in order to safeguard the interest of the shareholders who with the help of the audited accounts are enabled to know how their funds have been utilised during the financial year, whether proper books of account have been maintained, whether profit and loss account discloses true affairs of the company, profit earned or loss suffered by the company and whether the balance sheet gives a true and fair view of the state of affairs of the company on the date on which it is drawn. Another reason for making audit compulsory in a company is the fact that the shareholders and the directors who are shareholders enjoy the benefit of limited liability. Audit is also a tool to safeguard the interest of the creditors.

An audit of accounts is conducted with two-fold purpose: (i) detection and prevention of errors; (ii) detection and prevention of fraud.

Audit is useful only if it is conducted by some independent and qualified authority. The auditor must possess requisite qualifications and must act in an independent capacity. He should not be an employee of the company and his action should not be subject to the supervision of the management of the company. The provisions relating to audit and auditors including their qualifications, rights and powers are contained in Sections 216, 218 and from 224 to 233B of the Act. Section 216 lays down that auditors report should be attached with the balance sheet. Circulation of any balance sheet and profit and loss account without auditor's report is an offence punishable with a fine of ₹ 5000/- under Section 218 of the Act.

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

Audit is a careful scrutinising of accounting records undertaken to establish a true and fair view of the company's state of affairs.

- True
- False

Correct Answer: True

26. APPOINTMENT OF AUDITOR

Section 224 of the Companies Act provides for compulsory appointment of an auditor by every company whether public or private. It provides that every company shall, at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next annual general meeting.

The auditors are appointed at the annual general meeting by an ordinary resolution. However, special resolution may become necessary in certain situations as are specified under Section 224A. First auditors are to be appointed by the Board of directors within one month of the date of registration of the company and auditor or auditors so appointed are to hold office until the conclusion of first annual general meeting.

27. QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS

Section 226 contains provision as regards qualifications and disqualifications of auditors. These apply to all companies whether public or private or Section 25 companies or a Government company.

Qualification of Auditors

Section 226 provides that only a Chartered Accountant within the meaning of Chartered Accountants Act, 1949 can act as an auditor of a limited company. Though the auditor should be a Chartered Accountant, only Chartered Accountants in practice can act as auditors of companies. It may be pointed out that Section 6 of the Chartered Accountants Act, 1949 lays down that no Chartered Accountant can practice in India, or elsewhere unless he obtains a certificate of practice from the Institute of Chartered Accountants of India. Thus, only those Chartered Accountants, who have obtained a certificate of practice from the said Institute, can act as an auditor of a company. As soon as the certificate of practice is suspended or withdrawn by the said Institute he becomes ineligible to continue or to act as auditor.

A firm whereof all the partners are practising Chartered Accountants can be appointed by its firm's name as auditor. In that case any partner may act in the name of the firm. Further, the Department of Company Affairs has expressed its view vide Circular No. 29/76, dated 27.8.1976 amended by 5/77, dated 8.4.1977 that the auditor of a company should not accept the job of an internal auditor of the company because he would thereby become an employee and his independent position will be undermined and he will also not be able to perform his duty under the CARO, to report whether there is adequate internal control procedure commensurate with the size of the company, the nature of its business, etc. and in the case of companies having more than rupees twenty-five lakhs paid-up share capital, to report whether there is any internal audit system commensurate with the size and nature of business.

Appointment of a firm as auditors shall be made in the name of the firm whereas the appointment of a proprietary concern as auditor shall be made in the name of the individual i.e., the proprietor [vide Circular No. 8/229/56-PR, dated 20.3.1957].

A Statutory auditor of a subsidiary company is a director of its holding company. It was held that such appointments will not be considered as professional misconduct. [Yogeshwari Kumari V. Institute Of Chartered Accountants Of India & Anr. (Del)]

Disqualification of Auditors

Under Section 226(3), none of the following shall be qualified for appointment as auditor of a company:

1. A body corporate;
2. An officer or employee of the company (officer includes director, manager or secretary);
3. A person who is a partner or who is in the employment of an officer or employee of the company;
4. A person who is indebted to the company for more than ₹ 1,000/- or who has guaranteed the repayment of any debt of more than ₹ 1,000/- due to the company by a third person;
5. A person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000 i.e. 13 December, 2000 [Section 226(4)].
6. A person who is disqualified for appointment as auditor of the company's subsidiary or holding company, or a subsidiary of its holding company.

The Department of Company Affairs, vide Circular No. 5/77 dated 8.4.1977 has clarified that a statutory auditor cannot act also as internal auditor of the company.

Where the Chartered Accountant is employed whole-time, he is an employee of the company. In other cases, there would appear to be only a contract for service and not a contract of service between the company and the Chartered Accountant [In *Dharangdhara Chemical Works v. State of Saurashtra*, AIR 1957 SC 264]. Therefore, the Chartered Accountant who is in whole-time employment of the company cannot be appointed as its auditor. If an auditor becomes disqualified in any of the above ways after his appointment as auditor, then he shall be deemed to have vacated his office.

The Ministry of Corporate Affairs (MCA) vide its notification S.O. 1152(E) dated 23.05.2011, has notified that LLP, which is a Body Corporate as per the Limited Liability Partnership Act 2008, shall not be treated as Body Corporate, for the purpose of section 226(3)(a) of the Companies Act 1956, in exercise of its powers under 2(7)(c) of the Companies Act 1956.

As section 2(7)(c) of the Companies Act 1956, the Central Government may by notification, notify that a Body Corporate, will not be recognized as Body Corporate for the purpose of the Companies Act 1956.

The MCA by its aforesaid notification has taken LLP out of the purview of the Body Corporate under this sub section and therefore, LLP can be appointed as the Auditor of the company.

28. METHOD OF APPOINTMENT OF AUDITORS

Provisions relating to the appointment of auditor are contained in Sections 224 and 224A of the Companies Act, 1956. The provisions with regard to the appointment of an auditor can be divided into three categories:

- (a) First auditor
- (b) Subsequent auditor
- (c) Filling of casual vacancy

Appointment of First Auditors

Section 224(5) provides that the first auditor or auditors are to be appointed by the Board of directors within one month of the date of the registration of the company.

It is further provided that if the Board of directors fails to appoint the first auditors within one month of its incorporation, the company in general meeting, may appoint the first auditors. Further, the appointment of auditor is mandatory in the annual general meeting for the ensuing year. [*Institute of Chartered Accountants v. Jhanendranath Saikia* (1955) 25 Com Cases 53, 55 (Assam)].

Period of Office

The first auditor or auditors so appointed are to hold office until the conclusion of the first annual general meeting of the company. However, the auditor or auditors so appointed may be removed earlier, if the company at a general meeting appoints another auditor, of whose nomination, notice has been given by any member to the members not less than 14 days before the meeting. This means, that the first auditor can be removed at any general meeting prior to the first annual general meeting. Special notice is not required for the removal of the first auditor or auditors.

Subsequent Appointment of Auditors

Section 224(1) provides that every company must appoint an auditor or auditors at each annual general meeting to hold office from the conclusion of that annual general meeting until the conclusion of the next annual general meeting, and must, within 7 days of the appointment, give intimation thereof to the auditors so appointed. As per Section 224(1A), every auditor so appointed must, within 30 days of the receipt from the company of the intimation of his appointment, inform the Registrar in writing in Form No. 23B that he has accepted the appointment or refused it.

It is, however, necessary for every company, before making an appointment or reappointment at any general meeting of an auditor or auditors, to obtain from the auditor or auditors proposed to be appointed a certificate to the effect that the appointment or re-appointment, if made, will be in accordance with the limits on the number of audits specified in Sub-section (1B) of Section 224.

Ceiling on appointment as auditor

Sub-section (1B) of Section 224 provides that no company or its Board of directors shall appoint or reappoint any person who is in full-time employment

elsewhere, or if he is at the date of such appointment or re-appointment holding appointment as an auditor of specified number of companies i.e. 20 companies, out of which not more than 10 shall be companies each of which has a paid-up share capital of ₹ 25 lakhs or more.

Where a firm is appointed auditor, the ceiling of 20 will be per partner who is not in full time employment elsewhere. Where any partner of a firm of auditors is also a partner in any other firm or firms of auditors, the overall ceiling in relation to such partner will also be 20 companies. It is also provided that where any partner of firm of auditors is also holding office, in his individual capacity, as the auditor of one or more companies, the number of companies which may be taken into account in his case shall not exceed the specified number in aggregate.

While calculating the specified limit, branch audits of Indian companies and the audit of Indian business accounts of foreign companies are to be excluded. [Vide Department of Company Affairs' Circular No. 21/75 dated 24.9.1975].

It is provided that the provisions of Sub-section (1B) of Section 224 shall not apply, on and after the commencement of the Companies (Amendment) Act, 2000, to a private company. Thus, private companies shall also be excluded in reckoning the aforesaid number of companies which an auditor can audit.

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

The maximum limit allowed for audit to an auditor is 15 companies per partner who is not employed whole-time, if the whole firm is appointed as an auditor for a company.

- True
- False

Correct Answer: False

Where a firm is appointed as auditor, the ceiling will be 20 companies per partner who is not in whole-time employment elsewhere.

Appointment of auditor — An ordinary business

Under Section 173(1)(a)(iv), the appointment of, and the fixing of the remuneration of the auditors is an ordinary business to be transacted at an Annual General Meeting of a company. Only an ordinary resolution is to be passed for this purpose except in the circumstances stated under Section 224A which require passing of a special resolution.

Auditors signing Form 23B in firm's name without disclosing identity of signatory

It is necessary that the identity of person who signs Form 23B, whether he is a partner or a clerk of the firm, must be disclosed as such, as it will not be enough if the form is signed only in the firm's name, without disclosing the identity of the signatory since the firm has no *locus standi* of its own in the eyes of law. Further, since Form 23B is a statutory document, it is all the more necessary that a person duly authorised by the concerned firm should be the signatory and his name must be

disclosed therein, in addition to the name of the firm. (Department's Letter No. 7/26/76, IGC-dated 31.10.1977). This will help to fix responsibility of any wrong or false statement made in such a document.

The Department of Company Affairs (Now Ministry of Corporate Affairs) has further clarified that the intimation to the Registrar regarding acceptance of appointment by a firm of auditors, i.e. Form 23B should be signed by the partner of the firm or any other authorised person but not in the name of the firm (Letter No. 7/26/76-IGC dated 31.10.1977).

Re-appointment of Auditors

Section 224(2) states that subject to Sub-section (1B), with regard to the ceiling of 20 companies, and Section 224A, regarding appointment of auditors by special resolution in certain cases, at any annual general meeting, a retiring auditor, by whatsoever authority appointed shall be re-appointed unless:

- (a) he is not qualified for re-appointment;
- (b) he has given to the company notice in writing of his unwillingness to be re-appointed;
- (c) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
- (d) where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, but owing to that person's death, incapacity or disqualification, the resolution cannot be proceeded with.

Appointment of Auditor Other Than a Retiring Auditor

Sub-section (2) of Section 224 provides that the retiring auditor shall be re-appointed unless any of the circumstances specified in clauses (a) to (d) thereof exists. Neither the Board of directors nor the company in general meeting has the power to refuse re-appointment of the retiring auditor. But if any of the circumstances mentioned in clauses (a) to (d) of Sub-section (2) intervenes, there is no obligation on the part of the company to re-appoint the retiring auditor and the company may proceed to appoint as auditor any person other than the retiring auditor having the requisite qualifications. It is, however, to be noted that the re-appointment of the existing auditor is not automatic as there must be an act of the company re-appointing him by passing a resolution. Where the retiring auditor is re-appointed and a person other than him is proposed to be appointed as an auditor, a special notice has to be given proposing that such a resolution would be moved at the next annual general meeting [Section 225(1)]. On receipt of the special notice, the company should send a copy thereof to the retiring auditor. The Department has advised to send the notice by registered post acknowledgement due. (Circular No. 2/81, dated 17.10.1981).

The Department has clarified that in view of Section 225 special notice shall be required for a resolution appointing as an auditor a person other than the retiring auditor. Non-compliance with the provisions of the said section would render such a resolution illegal and ineffective. (Circular No. 2/72 dated 21.2.1972).

Rights of retiring auditor [Section 225(2) & (3)]

A retiring auditor, for whom it has been proposed that he shall not be reappointed

or that a person other than him be appointed, has been given certain rights under the provisions of Section 225(2) and (3) of the Companies Act. These rights, which follow the principles of natural justice are:

- (1) right to receive notice of the resolution.
- (2) right to make a written representation to the company and request its notification to members of the company.
- (3) right to get his representation circulated among the members. (The fact that the representation has been received must be mentioned in any notice of the resolution given to members).

The company or any other aggrieved person may make an application to the Company Law Board alleging that by his written representation, the auditor is abusing the rights conferred by this section to secure needless publicity for defamatory matters. The Company Law Board may, on such an application, direct that the representation need not be circulated or read out at the meeting and award costs against the auditor notwithstanding that the auditor is not a party to the application.

- (4) right to get his representation read out at the meeting, if it has not been sent to the members because they were received too late or because of default on the part of the company.
- (5) right to be heard at the meeting.

Filling Casual Vacancy

Sub-section (6) of Section 224 provides that the casual vacancy in the office of auditor may be filled by the Board. But where the vacancy is caused by resignation of auditor, such vacancy shall only be filled by the company in general meeting. The remaining auditor or auditors may act notwithstanding the casual vacancy. The auditor appointed in the casual vacancy holds office till the conclusion of the next annual general meeting.

Power of the Central Government to Appoint Auditors

If no auditors are appointed or re-appointed at the annual general meeting, the Central Government may appoint a person to fill the vacancy [Section 224(3)]. The company is required to give within one week notice to the Central Government that the power has become exercisable. If a company fails to give such notice, then the company and every officer of the company who is in default shall be punishable with fine upto ₹ 5000/-.

Appointment of Auditors by Special Resolution

Section 224A provides that in the case of company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination by:

- (a) a public financial institution or Government company or Central Government or any State Government; or
- (b) any financial, or other institution established by any Provincial or State Act in which State Government holds not less than 51 per cent of the subscribed share capital; or
- (c) a nationalised bank or an insurance company carrying on general insurance business;

the appointment or re-appointment at each annual general meeting of an auditor or auditors shall be made by a special resolution.

Where any such company as mentioned above fails to pass at its annual general meeting any special resolution appointing an auditor or auditors it shall be deemed that no auditor or auditors had been appointed by the company at its annual general meeting and thereupon the Central Government may appoint an auditor or auditors to fill the vacancy.

This provision is significant as it implies that, in reality, a company in which 25% or more of the subscribed share capital is held by any of the aforesaid institutions, can appoint or re-appoint auditors only with the concurrence of such institutions.

The Department of Company Affairs has clarified vide General Circular No. 14/2001 dated 16.7.2001 that three clauses - (a) to (c) to Sub-section (1) of Section 224A are not mutually exclusive. The provisions of Sub-section (1) would, therefore apply to all cases of shareholdings in any combination by any of the institutions mentioned in the three clauses.

Changes in percentage of holding after notice of meeting

Material date for 25% holding of subscribed share capital: If, after the notice of the annual general meeting is issued in the usual course and before the holding of the meeting, it happens that the holdings of the public financial institutions have reached 25% of the total subscribed share capital, the proper course to follow will be to adjourn the meeting and after issuing notice under this section, pass the necessary special resolution appointing the auditor or auditors.

If no such procedure is adopted, Sub-section (3) of Section 224 will take effect. The text of the DCA Circular in this respect is reproduced hereunder:

-A doubt has been expressed as to the material date, i.e. whether the date of the notice of the meeting, or the date of passing the special resolution shall be taken into consideration. The matter has since been examined in the Department, and it is to be clarified that the material date is the date of the Annual General Meeting at which the special resolution is required to be passed. Moreover, since generally, Articles of Association of Companies provide for closure of the Register of Members before general meeting during a period not exceeding thirty days at any one time, it is unlikely that the position regarding shareholding in the company will be different between the date of issue of notice and the date of the general meeting.

In exceptional cases, however, where a change in the shareholding pattern in the company has taken place, between the date of issue of notice of the annual general meeting and the date of actual passing of this resolution regarding appointment of auditor, the company may either—

- (i) adjourn the meeting to another date, and later issue the required notice in accordance with law and thereafter pass the special resolution required to be passed under Section 224A of the Companies Act, 1956, or
- (ii) omit or pass over the item on the agenda regarding appointment of auditor.

In the event of the company adopting the procedure at (ii) above, the situation would be then covered by Sub-section (2) of Section 224A of the Companies Act, 1956. (Circular No. 2/76 dated the 5th June, 1976 on File No. 35/4/75-CL. III).

29. REMUNERATION OF AUDITORS [Section 224 (8)]

The Board fixes the remuneration of the first auditor, where the Central Government makes an appointment as per Sub-section (3) of Section 224, it may fix the remuneration. Where the auditor is appointed or re-appointed by the general meeting, the remuneration is fixed by the general meeting. In practice, the remuneration is recommended by the Board which is approved by the general meeting or the general meeting authorises the Board to fix the remuneration. Where the Central Government appoints the auditors but does not fix their remuneration, remuneration shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine. In case of an auditor appointed under Section 619 by the Comptroller and Auditor General of India, it shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Connotation of 'remuneration'

For the purposes of Section 224(8), any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression, "remuneration".

The remuneration which has been fixed for an auditor is considered to be inclusive of all expenses allowable to him and consequently, he cannot claim any amount in addition to the fixed remuneration. The expenses of the auditors are included in the remuneration. If these are to be paid separately it has to be sanctioned specifically by the sanctioning authority i.e. the company, Board of directors or the Central Government, as the case may be.

Where expert advice is sought by an auditor in respect of any legal or technical matter for the proper discharge of his duties, the cost of such advice is permissible as an extra expenditure which can properly be claimed from the company.

Besides remuneration for audit work, as per para 4-B of Part II of Schedule VI, the auditor may also be paid extra remuneration as for services rendered in any other capacity. It is necessary to disclose in the Profit and Loss account of detailed information in regard to amounts paid to the auditor whether as fees, expenses or otherwise for services rendered (a) as auditor, and (b) in any other capacity'.

The point to be noted here is that the profit and loss account should contain detailed information as regards all amounts paid to the auditor and not merely a bare mention of the amounts paid.

30. TERM OF OFFICE OF AUDITORS

Section 224(1) provides that an auditor is appointed for a particular period, i.e., from the conclusion of one annual general meeting until the conclusion of the next annual general meeting. In case where an annual general meeting is not held within the period prescribed by Section 166, the auditor will continue in office until the next annual general meeting is held and concluded. If the next annual general meeting for any reason, happens to get adjourned, the auditor will continue to hold office until the conclusion of the adjourned meeting.

Section 224(5) requires that the first auditors of a company shall be appointed by the Board of directors within one month of the company's registration and the

auditors so appointed shall hold office until the conclusion of the first annual general meeting of the company. If the board fails to appoint such auditors, the company in general meeting may appoint them, and where they are appointed by the Board, the company at a general meeting, may remove them and appoint other auditors in their place who have been nominated by a member of the company and of whose nomination notice has been given to the members of the company not less than 14 days before the date of the meeting. Further, any auditor appointed in casual vacancy shall hold office until the conclusion of the next annual general meeting.

31. RESIGNATION BY AN AUDITOR

The auditor may vacate his office by tendering a resignation. Where the auditor resigns his office, the vacancy arising therefrom can be filled only by the company at a general meeting. The board has no power to fill casual vacancy caused by resignation. The auditor appointed to fill the casual vacancy caused by the resignation holds office until the conclusion of the next annual general meeting of the company. Besides the remaining auditor or auditors, if any, may act while any such casual vacancy continues.

32. REMOVAL OF AUDITORS

The proviso to Section 224(5) states that the first auditor appointed by the Board of directors may be removed at a general meeting by the company and other appointed in his place.

Section 224(7) states that except as provided in the proviso to Sub-section (5) any auditor appointed under this section may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval of the Central Government in that behalf.

In *Fortune Stones Ltd. v. Registrar of Companies* [(2008) 84 SCL 479(DEL)], the company had appointed 'T' as its first statutory auditor. Subsequently, 'T' expressed its inability to audit the accounts and, therefore, the petitioner appointed a new auditor in the EGM. 'T' filed a complaint before the Regional Director, Department of Company Affairs against the company as well as the new auditor alleging violation of Section 224(7). The company filed the instant petition seeking quashing of the complaint and the proceedings before the trial court. Allowing the Petition, the court held that a perusal of the complaint would show that the offence was for the contravention of Section 224(7) which required a company to obtain the previous approval of the Central Government for removal of the auditor at a general meeting. Admittedly, the prior approval of the Central Government was not obtained when 'T' was removed as an auditor at the EGM. The subsequent obtaining of the permission of the Central Government cannot rectify the contravention of section 224(7) which mandates a prior approval. By the very nature of the statutory requirement, the contravention can constitute only a one time offence and not a continuing one. The contention that the contravention in the instant case was a continuing one was to, accordingly, rejected. The punishment for contravention of section 224(7) is only a fine as is evident from a reading of Section 629A. In terms of section 468(2) (a) of the Code of Criminal Procedure the Trial Court was required to take cognizance within a period of six months. In the present case the complaint was filed more than four years after the commission of the offence. For the aforesaid reasons, the Trial court ought not to have taken cognizance of the offence under section 224(7) as it was beyond the period of limitation stipulated under section 468(2)(a) of the Code of Criminal Procedure. Therefore, the petition is allowed and the complaint filed in the Court of the Chief Metropolitan Magistrate and all proceedings consequent thereto are quashed.

At the expiry of his term, the company may in general meeting appoint another person in his place; but a special notice of any such resolution will be necessary. A copy of the resolution is required to be sent immediately to the auditor as he has the right to make a representation. A copy of his representation, if any, and if so desired by the auditor, should be sent to every member to whom notice of the meeting has been sent, and if this is not practicable the representation should be read out at the meeting [Section 225(3)]. But the representation need not be sent to the members or read out at the meeting if, on the application of the company or of any aggrieved person, the Company Law Board is satisfied that the right of representation is being abused to secure needless publicity for defamatory matter. The Company Law Board may also direct that the company's costs on such application to be paid by the auditor notwithstanding that he is not a party to the application. The same procedure has to be followed in regard to a resolution for removal of an auditor.

33. STATUS OF THE AUDITOR

(i) **An agent of the members** — An auditor is an agent of the shareholders. He is expected to safeguard their interests. In *Spackman v. Evans* 2 H.L. 236 Lord Cranworth said. —The auditors may be agents of the shareholders, so far as relates to the audit of the accounts. For the purposes of the audit, the auditors will bind the shareholders.”

An auditor is specifically mentioned as an agent of the company for the purposes of Section 240 dealing with the production of documents and the giving of evidence on investigation and as an agent of the company he may be examined on oath by an inspector. However, his signature in the statutory report or the balance sheet will not amount to an acknowledgement on behalf of the company of a debt referred to in that report.

(ii) **As an officer of the Company** — An auditor is not an officer of the company within the meaning of Section 2(30) of the Companies Act, 1956.

In *London and General Bank* case, an auditor was held to be an officer of the Company. Lord Lindely said:

—It seems impossible to deny that for some purpose, and to some extent, an auditor is an officer of the company. He is appointed by the company and his position is described in the section as that of an officer of the company. He is not a servant of the directors. On the contrary, he is appointed by the company to check the directors and for some purposes and to some extent, it seems to me quite impossible to say that he is not an officer of the company.”

Similarly, in *Kingston Cotton Mill Co. Ltd.* (1896) 2 Ch. 279, it was decided that the auditors are officers of the company.

In India, in *Connell v. Himalaya Bank Ltd.* (1895) 18 All. 12, it was held auditors, if appointed at a general meeting of the company and if also paid by the company were officers of the company.

34. AUDITORS OF GOVERNMENT COMPANIES

Section 619 of the Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor-General of India. Further, the limits specified in Sub-section (1B) and (1C) of Section 224 apply to such auditor.

In *Comptroller and Auditor General of India v. Kamlesh Vadilal Mehta* (2003)(1) Scale 351, a question was raised whether the Comptroller and Auditor General (CAG) can sub-classify the eligibility qualification by inviting applications for empanelment of firms of Chartered Accountants for the purposes of auditing the accounts of the Government companies and PSUs by way of debarring the proprietary firms even to submit their application. Supreme Court held that the CAG can not create a sub-classification from the general class of eligible Chartered Accountants and also observed that once a person is qualified, experienced and efficient then there is no ground of discrimination against him.

In the case of Government Companies, practically there is no difference in the procedure of appointment of first auditor and the subsequent auditor as in all the cases the auditor is to be appointed by the Comptroller and Auditor General of India. However, under Section 619 read with Sub-section (5) of Section 224 of the Act, the first auditors of Government company should be appointed by the Comptroller and Auditor General of India (C. & A.G.) within one month of the date of registration of the company. Such auditor shall hold office until the conclusion of the Annual General Meeting.

For subsequent appointment of auditors the government company shall write to the C & A.G. with a copy to the Central Government for the appointment of subsequent auditors at the Annual General Meeting.

The statutory auditors are appointed for a period of one year. The remuneration of the statutory auditors is fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Further the Comptroller and Auditor General of India shall have the power:

- (a) to direct the manner in which the company's accounts shall be audited by the auditor so appointed as mentioned above and to give such auditor, instructions in regard to any matter relating to the performance of his functions as such; and
- (b) to conduct supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purpose of such audit, to require information or additional information to be furnished to any person or persons so authorised, on such matters, by such person or persons, and in such form, as he may, by general or special order, direct.

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.

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 auditors' report.

The main duty in respect of audit of government companies is that the Secretary should hand over the audited accounts to the Government auditors for their report and comments. On receipt of comments from Government auditors, further reports should be prepared by the Secretary to be placed before the Board. If all the comments given by the Government auditors are satisfactorily replied to, a certificate to that effect will be obtained from the Accountant General of the respective state (in

the case of State Government Companies) and the Comptroller and Auditor General of India (in respect of Central Government Companies).

Provisions of Section 619 to apply to certain companies

Section 619B inserted by the Companies (Amendment) Act, 1974 w.e.f. 01-02-1975 extends the applicability of Section 619 to certain companies even though they are not strictly Government Companies as defined in Section 617 of the Act. According to Section 619B, the provisions of Section 619 shall apply to a company in which not less than fifty-one per cent of the paid-up share capital is held by one or more of the following or any combination thereof as if it were a Government company, namely:

- (a) the Central Government and one or more Government Companies;
- (b) any State Government or Governments and one or more Government Companies;
- (c) the Central Government, one or more State Governments, and one or more Government Companies;
- (d) the Central Government and one or more corporations owned or controlled by the Central Government;
- (e) the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
- (f) one or more corporations owned or controlled by the Central Government or the State Government;
- (g) more than one Government company.

It implies therefore that in the case of a company which falls in any of the aforesaid categories the same provisions relating to auditor would apply as they apply to Government Company.

35. RIGHT AND POWERS OF AUDITORS

The various rights and powers enjoyed by the auditors under the Companies Act, 1956 are as follows:

1. **Right to access to books, accounts and vouchers:** The auditor of a company shall have right of access, at all times, to the books, accounts and vouchers of the company, whether kept at the head office of the company or elsewhere [Section 227(1)].

The auditor shall also have access to books of account containing cost data which, under Section 209(1)(d), the Central Government requires from certain classes of companies to include in its accounts, in respect of utilisation of material, labour or other terms or costs.

The term vouchers includes, in addition to vouchers of sales, purchases, receipts and payments, all documents, correspondence, agreements, etc. which may in any way serve to vouch for the accuracy of the books and accounts.

The term 'books' includes the financial, statutory and statistical books.

They must have free access to the information which is necessary material for their report [*Newton v. Birmingham Small Arms Co. Ltd.*, (1906) 2 Ch 378]. The court will grant to an auditor an injunction for enforcing this right only when there has been a general meeting decision to appoint him or to continue his appointment [*Cuff v. London and County Land and Building Co. Ltd.*, (1912) 1 Ch 440 (CA)].

The right of access to books can be enforced by mandatory injunction but not where litigation is pending between the company and the auditor. Where the auditors were refused access to the books in a case of their alleged negligence, the court refused to make an order for access to be given but directed that the members of the company should meet for that purpose. [*Cuff v. London and County Land & Building Co. Ltd.*, (supra)].

2. **Right to obtain information and explanation:** The auditor shall be entitled to require from the officers of the company such information and explanation as he thinks necessary for the performance of his duties as auditor [Section 227(1)]. The Articles of a company cannot preclude the auditor team from availing himself of all information which is material to enable him to make his report and from fulfilling his statutory duties to the shareholders [*Newton v. Birmingham Small Arms Co.*, (1906) 2 Ch. 378]. In case the information is not supplied to the auditor, he can report the same to the members.
3. **Right to sign the audit report:** Only the person appointed as auditor of the company, or where a firm is so appointed, only a partner in the firm practising in India, may sign the auditor's report, or sign or authenticate any other document of the company required by the law to be signed or authenticated by the auditor (Section 229).
4. **Right to receive notice of and attend General Meeting:** The auditors have the right to attend any general meeting and to receive any notice and other communications relating thereto which members are entitled to receive and to be heard at any general meeting on any part of the business which concerns them as auditors [Section 231].
5. **Right to visit branch office and right of access to books:** Where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor—
 - (a) shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor; and
 - (b) shall have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.

In the case of a banking company having a branch office outside India, it shall be sufficient if the auditor is allowed access to such copies of, and extracts from, the books and accounts of the branch as has been transmitted to the principal office of the company in India. [Section 228(2)].

6. **Right to receive remuneration:** The auditor shall have the right to receive remuneration for auditing the accounts of the company [Section 224(8)].

The right of an auditor cannot be limited or abridged either by the Articles or by any resolution of the members [*Newton v. Birmingham Small Arms Co. Ltd.*, (supra)].

36. DUTIES OF AUDITORS

The scope and true purpose of an auditor and the duties of the auditor were discussed in a decision of the Madras High Court in *Registrar of Companies v. Arunajatai*, (1962), 32 Com Cases 1153 : (1963) 1 Comp LJ 323 (Mad), [See also *Institute of Chartered Accountants v. P.K. Mukherjee*, (1968) 38 Com Cases 628 : AIR 1968 SC 1104], where it was pointed out that where there was material before the auditor to arouse suspicion, he should have at least apprised of it in his report to the shareholders.

The duties of an auditor are many and varied. He must examine the original books of account, kept by the company to discover any inaccuracies or omissions therein, to examine the company's balance sheet and profit and loss account, and report on the original books of account and the annual accounts to the members.

Section 227(1A) requires an auditor to inquire:

- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members;
- (b) where the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;
- (c) where the company is not an investment or a banking company, whether so much of the assets of the company as consists of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (d) whether loans and advances made by the company have been shown as deposits;
- (e) whether personal expenses have been charged to revenue accounts;
- (f) whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash; and if no cash has actually been so received, whether the position as stated in the books is correct, regular and is not misleading.

Under Section 227(2), it is the duty of the auditor to make a report to the members of the company on the accounts examined by him, and on every balance sheet, every profit and loss account and on every other document declared by the Act to be part of or annexed to the balance sheet or profit and loss account and laid before the company in general meeting during his tenure of office. The report, besides other things necessary in any particular case, must expressly state:

- (1) Whether, in his opinion and to the best of his information and according to explanation given to him, the accounts give the information required by the Act and in the manner as required;
- (2) Whether the balance sheet gives a true and fair view of the company's affairs as at the end of the financial year and the profit and loss account gives a true and fair view of the profit or loss for the financial year;
- (3) Whether he has obtained all the information and explanations required by him for the purposes of his audit;
- (4) Whether, in his opinion, proper books of account as required by law have

been kept by the company, and proper returns for the purposes of his audit have been received from the branches not visited by him;

- (5) Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him as required by clause (c) of sub-section (3) of that section and how he has dealt with the same in preparing the auditor's report ;
- (6) Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.
- (7) Whether in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in Sub-section (3C) of Section 211;
- (8) In thick type or in italics the observation or comments of the auditors which have any adverse effect on the functioning of the company.
- (9) Whether any director is disqualified from having appointed as director under clause (g) of sub-section (1) of section 274.

Section 227(4) states that where any of the above matters is answered in the negative or with a qualification, the auditor's report must state the reason for the same.

Under Sub-section (4A) of Section 227 the Central Government is empowered to issue order requiring the auditor to include in his report a statement on such matters as may be specified. In exercise of this power the Central Government had issued an order called Companies (Auditor's Report) Order, 2003. It is the duty of the auditor to comply with this order when making his report to the shareholders. (See *Annexure I*)

Only the person appointed as auditor of the company or where a firm is so appointed, only a partner in the firm practising in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor (Section 229).

37. JUDICIAL PRONOUNCEMENTS ON THE DUTIES OF AUDITORS

The auditor owes a number of duties to the company and its shareholders. The foremost among them is to examine the books to ascertain that they are right. In the discharge of his duty, he must exercise a reasonable amount of care and skill. Therefore, an auditor will be liable to the company for any loss suffered due to breach of his duty of care and reasonable skill.

Auditors are, however, bound to see what exceptional duties are cast upon them by the statute. Ignorance of the special provisions, as in Section 227(1A) and the special order issued by the Central Government under Section 227(4A) imposing exceptional duties on the auditor would not afford any legal justification for not observing them.

The Courts have laid down the following rulings on auditor's duties:

- (a) The auditor must check the company's own cash account with its bank pass book and cheque counterfoils and with statement of its account obtained from its bank [*Fox and Son v. Morrish Grant & Co.* (1918) 35 T./L.R. 126]. He

is not entitled to assume that directors, officers or servants of the company who have kept its cash accounts have done so correctly, and so dispense with checking.

- (b) The auditor need not check that the company possesses the stock-in trade stated in its books of account or stock records, nor need to value its stock in trade, work-in-progress or finished products, [In *Re. Kingston Cotton Mills Co. Ltd.*, (No. 2) (1896) 2 Ch. 279]. He should obtain a certificate as to the amount and value of stock-in-trade from the officer or servant of the company charged with keeping it, and if this certificate agrees with the company's books and stock records, he need not investigate the matter further, unless the information in his possession should arouse his suspicion.

In practice, however, auditors check the valuation of stock-in-trade and work-in-progress more extensively than the law requires by ensuring that the company has an efficient system of recording purchases, sales and storage of stock and raw materials and for calculating the cost of each manufacturing process on its products, and also by making a few checks of items of stock-in-trade at random to make sure that they are correctly entered in the company's stock records.

- (c) If the company owns securities, the auditor should see that they are in proper custody. He should not be content with a certificate that the securities are in possession of a particular company, firm or person, unless the company, firm or person is trustworthy, and is respectable and is one that in the ordinary course of its business, keeps securities for its customers, i.e., it is a bank or a broker. [In *Re. City Equitable Fire Ins. Co.*, (1925) 1 Ch 407]. In this case the stock brokers of the company certified to the auditors that they were holding the company's securities, when in fact they did not do so and the company suffered loss. The auditors were held guilty of negligence. They should have set the matter right or reported to the shareholders.
- (d) An auditor, however, is not concerned with the policy of the company. In the words of Lord Justice Lindley in *Re London and General Bank* (No. 2) (1895) 2 Ch 673: "It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of the company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. He should bring these facts to the notice of the shareholders in his report. His business is to ascertain and state the true financial position of the company at the time of the audit ..."

In another passage in the same case *Lord Lindley, L.J.* observed : "An auditor, however, is not bound to do more than exercising reasonable care and skill in making inquiries and investigations. He is not an insurer: he does not guarantee that the books do correctly show the true position ... His obligation is not so onerous as this. Such I take to be duty of the auditors: he must be honest, i.e. he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true." (See also *Union Bank's case in Re. AIR 1925 All. 519*).

- (e) In the well known passages, in *Re Kingston Cotton Mills Co.*, (1896) 2 Ch 279. *Lopes L.J. said* : -An auditor is not bound to be detective or to approach his work with suspicion or with a foregone conclusion that here is something wrong. He is a watchdog, not a bloodhound; he is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and so rely upon their representations provided he takes reasonable care. Therefore *Donovan J. said in International Laboratories Ltd. v. Dewar*, (1933) I.D.L.R. 34, regarding the watchdog that ~~he~~ will not have performed the functions of his office if after one howl he retreats under the barn', or if he confines his protest to a fellow watchdog".

In a case before Bombay High Court, the court held that the auditor is required to employ reasonable skill and care, but he is not required to begin with suspicion and to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which excites suspicion or ought to excite suspicion in a professional man of reasonable competence. An auditor's duty is to see what the state of the company's affairs actually is, and whether it is reflected truly in the accounts of the company, upon which the balance sheet and the profit and loss accounts are based, but he is not required to perform the functions of a detective. What is reasonable care and skill must depend upon the circumstances of each case. Where there is nothing to excite suspicion and there is an atmosphere of complete confidence, based on the record of continued success in financial matters, less care and less severity of scrutiny may be considered reasonable. Whereas reasonable care and skill may be regarded as not exercised when, inspite of the presence of unusual features in the accounts or other *prima facie* reasons for believing that the affairs of the company may not be in order, the examination is perfunctory and not sufficiently detailed. [*Tri-Sure India v. A.F. Ferguson & Co.* (1987) 61 Comp. Cas. 548].

- (f) When the auditor forms an opinion he must exercise reasonable care and skill. If he performs the mental operations without exercising reasonable care and skill and then proceeds to give an unqualified statement, in other words, a clear certificate, he is in breach of his statutory duty. Once the auditor discovers alterations, mutilations in the invoices it is his duty to put an inquiry and he is not entitled to rest contented with the assurances of managing director of the company [*Thomas Gerard & Sons Ltd. In Re* (1967) 2 All E.R. 525].
- (g) *Lord Denning M.R. in Fomento (Sterling Areas) Ltd. v. Selsdon Fountain Pen Co.*, (1958) 1 All ER 11 (HL) observed : -An auditor is not to be confined to the mechanics of checking vouchers and making arthmetical computations. He is not to be written of as a professional add-upper' and substractor'. His vital task is to take care to see that errors are not made, be they errors of computations, or errors of omission or commission, or downright untruths. To perform this task properly he must come to it with an inquiring mind not suspicious of dishonesty. I agree, but suspecting that someone may have made mistake somewhere and that a check must be made to ensure that there has been none".
- (h) In *Deputy Secretary to Government of India v. S.N. Das Gupta*, A.I.R. 1955 Cal 414, Chakravati, C.J. said, "*vis-a-vis the shareholders* the auditor holds a position of trust and it is his bounden duty to honour that trust by being candid with the shareholders, and telling them frankly and fully everything with regard to the affairs of the company which has come to his knowledge and which is

material for the shareholders to know ... his duty is to make a full, careful and truthful report, in default of which he must be held to have failed in the discharge of his obligations.”

- (i) *It has been held in Council of Institute of Chartered Accountants of India v. V. Rajaram* (1960) 30 Comp. Cas 67, that a Chartered Accountant should himself verify the assets of the company of which he has been appointed auditor, and should not rely on the verification done by special examiners appointed by company itself according to the articles. If he fails to do so, he will be guilty of misconduct. Therefore, an auditor is personally liable for neglecting wilfully to perform his duties imposed by law.

Summary of Auditor's Duties

For the convenience of students, the various duties of an auditor are summarised below:

1. An auditor must make himself acquainted with his duties under the Act and articles, as well as the rules made under the Act.
2. He must act honestly and with reasonable skill, care and caution: and must not allow himself to be influenced by others in the discharge of his duties.
3. He must show the true financial position of the company as disclosed by the books. If proper books of account have not been kept, or they do not, in his opinion, show a true and fair view of the company's affairs he must state that fact in his report and even refuse to certify the accounts.
4. He must report all material facts and points to the shareholders.
5. He is not bound to give advice nor is he concerned with the policy or management of business. He must simply state the effect of what has been done, or not done, and the remedy for bad management will lie with the shareholders who can remove the directors or at least raise the matter at a meeting.
6. He is justified in trusting the servants of the company, provided he uses reasonable care.
7. If any suspicion occurs, he is bound to probe deep into it.
8. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs.
9. He is not under a duty to take stock, unless there are suspicious circumstances but he should make sure that the amount of stock stated to exist is a reasonable probable figure.
10. He must check the cash in hand and in the bank balance.
11. He must verify the existence of the company's securities and see that they are in safe custody. Thus, he should actually see the securities unless they have been deposited in the ordinary course of business e.g., with a bank.
12. Normally, an auditor owes no duty of care to a third party, except where he knows that the audited accounts are intended to be produced to that third party to induce him to invest in the company.
13. Where he has been asked to conduct a special audit, he must exercise the same amount of skill and care as a company auditor and make report to the Central Government.

14. His report must also contain the matters specified in the Companies (Auditor's Report) Order, 2003.

38. LIABILITIES OF AN AUDITOR

Apart from liability under the common law, the statutory liabilities of an auditor could be either Civil or Criminal.

Civil Liability

An auditor may be held liable to the company for negligence where loss is caused to the company due to the failure of the auditors to perform his duties with reasonable care and skill. He is also liable for (i) breach of trust regarding any money or property of the company or (ii) breach of duty.

Criminal Liability

An auditor is responsible for the destruction, mutilation, alteration, falsification or fraudulent concealment of any books, papers or documents belonging to the company with an intent to defraud or deceive; and also where he makes intentionally any false statement in any report or document prepared by him.

Criminal liability of an auditor may extend to imprisonment for a period of seven years and/or fine at the discretion of the court.

39. AUDIT OF BRANCH ACCOUNTS

Section 228 provides that if a company has branch offices, the accounts of every branch office must be audited by the company's auditor or the company may appoint another qualified auditor for the purpose. If any branch office of the company is outside India, the accounts shall be audited by a person qualified to audit accounts according to laws of that country or the company's auditor or a person qualified for appointment as auditor under the Companies Act, 1956. The appointment of a branch auditor must be made and his remuneration fixed, by the company in general meeting or by the Board of directors if so authorised by the general meeting. Where the accounts of a branch have been audited by a person other than the company's auditor, the company's auditor (a) shall be entitled to visit the branch if he considers it necessary for the performance of his duties as auditor and (b) shall have a right to access at all times to the books and accounts and vouchers of the company maintained at the branch office.

Provided that in the case of a banking company having a branch office outside India, it shall be sufficient if the auditor is allowed access to such copies of, and extracts from, the books and accounts of the branch as have been transmitted to the principal office of the company in India.

Where a company in general meeting decides to have the accounts of a branch office audited otherwise than by the company's auditor, the company in that meeting shall for the audit of those accounts appoint a person qualified for appointment as auditor of the company under Section 226, or where the branch office is situate in a country outside India, a person who is either qualified as aforesaid or an accountant duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country, or authorise the Board of directors to appoint such a person in consultation with the company's auditor.

The person appointed to audit the accounts of the branch office shall have the same powers and duties in respect of the branch audit as the company's auditor. He shall submit his report to the company's auditor.

Sub-section (4) of Section 228 empowers the Central Government to make rules providing for the exemption of any branch office from the aforesaid provisions to the extent specified in the rules.

In making such rules, the Central Government shall have regard to all or any of the following matters, namely:

- (a) the arrangement made by the company for the audit of accounts of the branch office by a person otherwise qualified for appointment as branch auditor even though such person may be officer or employee of the company;
- (b) the nature and quantum of activity carried on at the branch office during a period of three years immediately preceding the date on which the branch office is exempted from the provisions of this section;
- (c) the availability at a reasonable cost of a branch auditor for the audit of accounts of the branch office;
- (d) any other matter which, in the opinion of the Central Government justifies the grant of exemption to the branch office from the provisions of this section.

In pursuance of these powers, the Central Government has framed the Companies (Branch Audit Exemption) Rules, 1961.

Branch audit may be carried out at head office

Where the auditor of the company is also the auditor of a branch office, he may do the audit of the branch office at the registered or the head office itself, where all the documents necessary for his working should be provided to him or in the alternative he may do the job at the branch itself or he may visit the branch at his discretion. The Department has issued a clarification (*File No. 8/16/(1)/61-PR*), stating that there is no compulsion for the company's auditor to visit branches, but here again, it is a matter of discretion.

Branch audit report to be forwarded to statutory auditor

The branch/internal auditor shall forward his report on the accounts of the branch directly to the statutory auditor. If the statutory auditor requires any explanation/comments from the management in regard to the branch audit report, he would no doubt do so before making the observations in his audit report. There would, however, be no administrative objection to a copy of the branch audit report being sent to the Board of directors simultaneously with the direct transmission of the original branch audit report to the statutory auditor. [No. 10(1) CL. VI/61, dated 27th April, 1961].

Remuneration of branch auditor

The power to fix remuneration or to decide terms and conditions of appointment generally vests in the appointing authority. Sub-section (3)(d) of Section 228 makes a provision to this effect, namely that the branch auditor shall receive such remuneration and shall hold office subject to such terms and conditions as may be

fixed either by the company in general meeting or by the Board of directors, if so authorised by the company in general meeting.

40. SPECIAL AUDIT

Section 233A empowers the Central Government to appoint either any Chartered Accountant or the company's own auditor to conduct a special audit in certain circumstances. Accordingly Section 233A provides that where the Central Government is of the opinion—

- (a) that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or
- (b) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
- (c) that the financial position of any company is such so as to endanger its solvency;

The Central Government may at any time by order direct that a special audit of the company's accounts for such period as may be specified in the order, shall be conducted by a Chartered Accountant specially appointed by the Central Government for the purpose or it may be conducted by the company's own auditor. Such special auditor shall have the same powers and duties in relation to the special audit as an auditor of a company has under Section 227 and shall report to the Central Government. The report is to include all matters required to be included in auditors' report under Section 227 and if the Central Government so directs, also include a statement on any other matter referred to him by that Government. The Central Government on the receipt of the special report shall take such action on the report as it may consider necessary. But if the Government does not take any action on report within 4 months from the date of its receipt, it shall send to the company, a copy of the report with its comments for circulation among the members of the company. The expenses of the special audit, as determined by the Government, shall be paid by the company as an arrear of land revenue. The Central Government may also order any person to furnish any specified information to the special auditor. Failure to comply with such order will render the person punishable with fine up to ₹5000.

The Central Government on the receipt of the report of the special auditor shall take such action on the report as it may consider necessary. But if the Government does not take any action on the report within four months from the date of its receipt, it shall send to the company, a copy or relevant extract from the report with its comments thereon and require the company either to circulate that copy or those extracts to the members or to have such copy or extracts read before the company at its next general meeting [Section 233A(6)].

The expenses of and incidental to, any special audit under this section (including the remuneration of the special auditor) shall be determined by the Central Government (which determination shall be final) and paid by the company and in default of such payment shall be recoverable from the company as an arrear of land revenue [Section 233A(7)].

There is nothing in the section to indicate that the Central Government should, before appointing a special auditor, give the company or its management an opportunity of being heard.

In *D Hiralal Gulabchand (P) Ltd. Re C.P. Nos. 11 and 12/90/CLB*, a petition under Section 397/398 had been filed by the applicant before the High Court on grounds similar to those on which he wanted the appointment of a special auditor. The Company Law Board held that since the allegations made were sub judice before the High Court, having wider powers to set the controversy at rest, and since the company was a closely held one and no public interest was involved, this was not a fit case for an order under Section 233A.

41. COST AUDIT

Section 209(1)(d) provides that a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, should keep proper books of account showing such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account.

In pursuance of the provisions of Section 209(1)(d) of the Act, the Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs. These rules prescribe the manner in which the Cost Accounting Records should be maintained and also specify the particulars, which should be entered in the books of account.

When a company is required to include in its books of account the aforesaid particulars, Section 233B empowers the Central Government to direct, whenever it is necessary to do so, that an audit of cost accounts of the company should be conducted in such manner as may be specified in the order by a Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959. However, if in the opinion of the Central Government, sufficient number of qualified Cost Accountants are not available, that Government may by notification in the Official Gazette direct that for a specified period, a Chartered Accountant possessing the prescribed qualifications may be appointed to audit the cost accounts of the company.

The auditor under this section will be appointed by the Board of directors of the company in accordance with the provisions of Sub-section (1B) of Section 224 and with the previous approval for the Central Government, and not by the company in general meeting. Provided before the appointment of any auditor is made by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be so appointed to the effect that the appointment, if made, will be in accordance with the provisions of Sub-section (1B) of Section 224. An auditor of the company or a person disqualified from being appointed as an auditor of a company, cannot be appointed as cost auditor. Further if the cost auditor, after his appointment as such suffers from any of the disqualifications, he must cease to act as cost auditor. The disqualifications are the same as prescribed in Section 226(3) for a company auditor, already dealt with earlier in the study.

Since the cost auditor is required to comment on the scope of and performance of internal audit as per the provisions of Cost Audit (Report) Rules, 2011, it may not lead to proper and dispassionate discharge of the duties of the cost auditor if he was also the internal auditor of the company for the same period for which he is conducting the cost audit. Therefore, the cost auditor should not be also the internal

auditor of a company for the period for which he is conducting the cost audit. [DCA Circular No. 1/83 dated 20.1.1983].

An auditor can be proceeded under Section 543 as an officer only if he is formally appointed. Thus, he is not an "Officer" if he is only appointed *ad hoc* for a limited purpose, by the directors for a private audit, [R.V. Shacter, (1960) 2 Q.B. 252, C.A.]. He is, on the other hand a servant of the company or shareholders and must examine the affairs of the company on their behalf at the end of the year and report to them what he has found (*Deputy Secretary to Government of India v. S.N. Dass Gupta* A.I.R. 1956 Cal 414).

The cost audit conducted under Section 233B shall be in addition to an audit of the company conducted by auditor appointed under Section 224. The cost auditor shall have the same powers and duties as the company auditor, but he will make his report to the Central Government, forwarding a copy thereof to the company, within 180 days from the end of the company's financial year to which the cost audit report relates. The company, shall within 30 days from the date of receipt of a copy of the report, furnish the Central Government with full information and explanations on every reservation or qualification contained in such report. The Central Government may, after considering the report and information and explanations furnished by the company, take such action on the report as it may consider necessary. The Central Government may direct the company to circulate to its members the whole or a specified portion of the report with the notice of next annual general meeting. Failure to comply with the provisions of this section has been made punishable with fine upto ₹ 5,000 so far as the company is concerned, and every officer of the company who is in default shall be liable to be punished with imprisonment for a term which may extend 3 years, or with fine up to ₹ 50,000 or with both.

42. COST AUDIT REPORT

In exercise of the powers conferred by clause (b) of sub-section (1) of section 642 read with sub-section (4) of section 233B, and sub-section (1) of section 227 of the Companies Act, 1956 and in supersession of the Cost Audit Report Rules, 2001, except as respects things done or omitted to be done before such supersession, the Central Government introduced Companies (Cost Audit Report) Rules, 2011 vide notification No. G.S.R. 430(E) dated 03.06.2011.

The text of Companies (Cost Audit Report) Rules, 2011 are reproduced below:

Companies (Cost Audit Report) Rules, 2011

1. Short Title and Commencement-

(1) These rules may be called The Companies (Cost Audit Report) Rules, 2011.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions and Interpretations. –

In these rules, unless otherwise so provided,—

(a) "Act" means the Companies Act, 1956 (1 of 1956);

- (b) ~~Cost Auditor~~” means an auditor appointed to conduct an audit of cost records, under sub-section (2) of section 233B of the Act;
- (c) ~~Form-I~~” means the Form prescribed in these rules for filing cost audit report and other documents with the Central Government in the electronic mode;
- (d) ~~Form-II~~” means the Form of the cost auditor’s report and includes auditor’s observations and suggestions, and Annexure to the cost audit report;
- (e) ~~Form-III~~” means the Form of the performance appraisal report;
- (f) ~~Product~~” means any tangible or intangible good, material, substance, article, idea, know-how, method, information, object, service, etc. that is the result of human, mechanical, industrial, chemical, or natural act, process, procedure, function, operation, technique, or treatment and is intended for use, consumption, sale, transport, store, delivery or disposal.
- (g) ~~Product Group~~” in relation to tangible products means a group of homogenous and alike products, produced from same raw materials and by using similar or same production process, having similar physical or chemical characteristics and common unit of measurement, and having same or similar usage or application; and in relation to intangible products means a group of homogenous and alike products or services, produced by using similar or same process or inputs, having similar characteristics and common unit of measurement, and having same or similar usage or application;
- (h) ~~Report~~” means cost audit report duly audited and signed by the cost auditor in the prescribed form of cost audit report;
- (i) All other words and expressions used in these rules but not defined, and defined in the Act and rules made under clause (d) of sub-section (1) of section 209 and sub-section (4) of section 233B of the Act shall have the same meanings as assigned to them in the Act or rules, as the case may be.

3. Application – (1) These rules shall apply to every company in respect of which an audit of the cost records has been ordered by the Central Government under sub-section (1) of section 233B of the Act.

(2) Every company as specified in sub-rule (1) shall, within ninety days of the commencement of every financial year, file an application with the Central Government seeking prior approval for appointment of the cost auditor, through electronic mode, in the prescribed form, alongwith the prescribed fee as per the Companies (Fees on Applications) Rules, 1999, and requisite enclosures.

(3) Every cost auditor appointed under sub-rule (2) shall, within thirty days of receipt of letter of appointment, inform his appointment to the Central Government through electronic mode, in the prescribed form, alongwith the requisite enclosures.

(4) Notwithstanding anything contained in sub-rule (2) and (3) above, every company and every cost auditor shall follow the procedure prescribed vide Ministry of Corporate Affairs’ General Circular No. 15/2011 [File No. 52/5/CAB-2011] dated April 11, 2011.

4. Form of the Report - (1) Every cost auditor, who conducts an audit of the cost records of the company, shall submit the report along with auditor’s observations and

suggestions, and Annexure to the Central Government in the prescribed form and at the same time forward a copy of such report to the company.

(2) The cost audit report submitted on or after 1st day of April, 2012, irrespective of the financial year of the company to which it relates, shall be in the form prescribed under these rules.

(3) Every company as specified in sub-rule (1) of rule 3 shall, keep and maintain cost details, statements, schedules, etc. for each unit and each product or activity comprised in each product group, duly authenticated by atleast two Directors of the company and the cost auditor.

(4) The cost details, statements, schedules, etc. of every company, as specified in sub-rule (3), relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years shall be kept in good order:

(5) Every cost auditor, who submits a report under sub-rule (1), shall also furnish performance appraisal report, duly authenticated by the cost auditor, to the Board/Audit Committee of the company in the prescribed form.

(6) Every cost auditor, who submits a report under sub-rule (1), shall also give clarifications, if any, required by the Central Government on the cost audit report submitted by him, within thirty days of the receipt of the communication addressed to him calling for such clarifications.

5. Time limit for submission of Report – Every cost auditor shall forward his report referred to in sub-rule (1) of rule 4 to the Central Government and to the concerned company within one hundred and eighty days from the close of the company's financial year to which the report relates.

6. Cost Auditor to be furnished with the cost accounting records etc. – Without prejudice to the powers and duties the Cost Auditor shall have under sub-section (4) of section 233B of the Act, the company and every officer thereof, including the persons referred to in sub-section (6) of section 209 of the Act, shall make available to the cost auditor, such cost accounting records, cost statements, other books and documents, and Annexure to the Report, duly completed, as would be required for conducting the cost audit, and shall render necessary assistance to the cost auditor so as to enable him to complete the cost audit and submit his report within the time limit specified in rule 5.

7. Authentication of Annexure to the Cost Audit Report – The Annexure prescribed with the cost audit report shall be approved by the Board of Directors before submitting the same to the Central Government by the cost auditor. The Annexure, duly audited by the cost auditor, shall also be signed by the Company Secretary and at least one Director on behalf of the company. In the absence of Company Secretary in the company, the same shall be signed by at least two Directors.

8. Penalties – (1) If default is made by the cost auditor in complying with the provisions of rule 4 or rule 5, he/she shall be punishable with fine, which may extend to five thousand rupees.

(2) If a company contravenes any provisions of these rules, the company and

every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Act, shall be punishable as provided under sub-section (2) of section 642 read with sub-sections (5) and (7) of section 209 and sub-section (11) of section 233B of Companies Act, 1956 (1 of 1956).

9. **Savings** – The supersession of the Cost Audit Report Rules, 2001, shall not in any way affect—

- (a) any right, obligation or liabilities acquired, accrued or incurred thereunder;
- (b) any penalty, forfeiture or punishment incurred in respect of any contravention committed thereunder; and
- (c) any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, and; any such investigation, legal proceeding or remedy may be instituted, continued or enforced and any such penalty, forfeiture or punishment may be imposed as if those rules had not been superseded.

43. SOCIAL AUDIT

Section 227 (4A) empowers the Central Government to require, by order, that in the cases of such class or description of companies as may be specified in the order, the auditor's report will include a statement on such matters as may be specified therein. Before making such order, the Central Government may consult the Institute of Chartered Accountants of India in regard to the class or description of companies and other ancillary matters proposed to be specified therein. The Government has also the power to decide when such consultation is not necessary or expedient in any case.

The Government, in consultation with the Institute of Chartered Accountants of India issued a Notification on 12th June, 2003 called Companies (Auditor's Report), Order 2003" as empowered by Section 227(4A) of the Companies Act, whereby audit report shall have to contain additional information on the working of the company and the audit has been given the nomenclature -social audit".

In a socialistic society, where public participation in decision-making process is accepted, at least in theory, it is imperative that from a mere statutory financial audit' we must move towards performance audit' and efficiency audit'. Social audit is a combination of these two functions. It is not enough to reveal the assets and liabilities of a company as at a particular date. What is needed is how effectively were the assets utilised for optimum usage and benefit to the community. This audit is designated Social Audit and because it deals with the social benefit derived, like, current value accounting or is related to human assets accounting. What is implied is to give emphasis on the expenses side of the profit and loss account and the benefits acquired due to each expenditure and take credit in the Social Audit' and any failure to take corrective action by management ought to be taken to be debit side of he Social Audit. Because of the Social Audit, and management, worth the name, will ensure that debit or negative factors do not find place in the auditor's report as adverse publicity will be difficult to explain.

44. PROPER BOOKS OF ACCOUNTS

As we have seen a company is required by law, to maintain proper' books of

account with respect to its income and expenditure, sales and purchase of goods and assets and liabilities. A company engaged in producing, processing, manufacturing or mining activities is further required to maintain such particulars relating to utilisation of machine or labour and in respect of other items of costs as may be prescribed by the Central government [Section 209(1)]. The books of account to be maintained by a company should be proper as provided in Section 209(3) of the Act. It is provided that the maintenance of books would be deemed to be proper only if :

- (i) the books of account give a true and fair view of the state of affairs of company or the branch office, as the case may be;
- (ii) the books of account explain the transactions; and
- (iii) the books of account are kept on accrual basis and according to the double-entry system of accounting.

The shareholders, creditors and public financial institutions; who provide the funds and other authorities and persons, who have to deal with the company, are entitled to be provided with the true state of affairs of the company, so as to enable them to form a correct opinion about the true state of financial health of the company. If the books of account do not project the true state of affairs of the company, they are not deemed to be proper. The statutory auditor of the company is also required to state mandatorily in his report whether the company has maintained proper books of account or not. If he does not so state, he will be held liable for misfeasance along with the Directors and other officers of the company in default. Sub-section (2) of Section 541 of the Act provides, in the context of the winding up of the company, that it shall be deemed that proper books of account have not been kept in the case of any company if there have not been kept:

- (a) such books or accounts as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day in sufficient detail of all cash received and all cash paid; and
- (b) where the business of the company has involved dealings in goods, statements of the annual stock takings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

The expression proper is difficult to define precisely; its import will have to be gathered from the facts of each case. The term signifies that there should neither be suppression of any transaction nor inclusion of any fictitious transactions in the books of account.

45. TRUE AND FAIR VIEW

The auditor, in his report under Section 227(2) of the Companies Act, 1956, is required to state *inter alia*:

- (i) Whether, in his opinion, proper books of accounts as required by law, have been kept by the company;

- (ii) Whether in his opinion and to the best of his information, the accounts of the company give the information required by the Act in the manner so required;
- (iii) Whether the balance sheet gives a true and fair view of the company's affairs at the end of financial year; and
- (iv) Whether the profit and loss account gives a true and fair view of the profit and loss of the company for the financial year.

In the absence of any definition of the term true and fair view' in the Act, the meaning and scope has to be perceived and understood with reference to particular facts and circumstances of each case. Towards this end, the auditor is duty bound to ensure that:

- (i) proper books of accounts and other records are maintained;
- (ii) the balance sheet and profit and loss accounts are drawn up in a format and in accordance with the provisions of the Act and the Schedule VI thereto;
- (iii) the financial position and working results of the company are stated clearly. There should neither be an over statement nor an under statement in this regard;
- (iv) any material change in the method of accounting and the effect thereof on the financial position of the company is clearly indicated; and
- (v) there is a proper and full disclosure of the financial position of the company.

Section 211 of the Act also enjoins that every balance sheet of a company shall give true and fair view' of the state of affairs as at the end of the financial year and every profit and loss account should give true and fair view of the profits or losses of the company for the financial year. The Section, therefore, provides that the balance sheet of a company shall be in the form set out in Part I, Schedule VI or as near thereto as the circumstances admit or in such other form as the Central Government may approve either generally or in any particular case. The profit and loss account of the company should be drawn up as per the requirements of Part II of Schedule VI and must give the particulars prescribed therein as far as applicable.

Thus, the annual accounts of the company should not only be made out correctly in the prescribed format and in accordance with the requirements of the law but should also convey the fair view of the actual state of affairs and working results of the company. Consequently, every information which is considered relevant and necessary should be disclosed even if it is not specifically required by the law to be shown. Further, the information should be given unambiguously, in clear and precise terms and should be according to the commonly accepted accounting policies.

46. NOTES ON ACCOUNTS

One of the main objectives of the Annual Accounts of a company is to communicate effectively its strengths and weaknesses. The bare figures encompassing the amounts are not sufficient by themselves to depict and explain the true and fair view of the state of affairs of a company. It has, therefore, become necessary to explain and communicate some of the vital information through Notes on Accounts'. By and large the notes on accounts are explanatory. They elucidate the figures in the accounts and explain their significance. Sometimes, these notes

are clarificatory to meet the requirements of law. Whether a particular note is explanatory or clarificatory will depend on the facts in each case and the manner in which it is stated. Notes on accounts form an integral part of the accounts of a company and contain very interesting and vital information.

Contents of notes on accounts

The notes on accounts are intended to clarify and elucidate the financial position of a company as disclosed in its balance sheet and profit and loss account. Generally the notes on accounts dwell on the following matters:

1. Basis of accounting;
2. Significant accounting policies;
3. Material changes, if any, in the method of accounting;
4. The effect of material changes in the method of accounting on any item in the financial statement in physical terms to the extent ascertainable. Where such amount is not ascertainable, either wholly or in part, the fact should be stated;
5. Method of valuation of fixed assets;
6. Method of valuation of trade and other investments;
7. Method of providing depreciation;
8. Valuation of inventories;
9. Treatment of any income and expenditure on cash basis as against accrual basis;
10. Expenditure in foreign currency account;
11. Foreign exchange conversion;
12. Any disputed liabilities and claims against the company;
13. Any major litigation pending by or against the company;
14. Method of providing for retirement and terminal benefits;
15. Remuneration paid to managerial personnel and their calculation thereof.

The above list is only illustrative and not exhaustive. There could be many other items in the Books of Accounts which may be required to be explained, clarified or amplified so as to project a true and fair view of the state of affairs of the company.

47. GUIDELINES FOR FILING STATUTORY APPLICATIONS

Under Section 211

Applications seeking exemption under Section 211 of the Companies Act should be accompanied by:

- Specified Board resolution in support of the proposal indicating specific paras of Part II of Schedule VI and the financial year in respect of which exemption is sought.
- Form 23AAA is prescribed for this purpose.

The following information should invariably be furnished with the application in the fields forming part of the e-Form:

- The financial year for which exemption is sought.

- Precise reasons/justification for seeking exemption.
- If the company had been complying with the requirements in the past, reasons as to how the company has been complying in the past.
- It should be indicated as to whether the company is maintaining proper purchase/sales/stock registers so as to furnish true and fair view of its state of affairs in compliance of Section 209/211 read with Schedule VI to the Act.
- Details of total turnover and exports made by the company during the financial year in respect of which exemption is sought.

The companies may have to furnish any other additional information as may be asked for by the Department.

Under Section 212

Application seeking exemption under Section 212(8) need not be filed for each financial year as the Ministry of Corporate Affairs vide its General Circular No. 02/2011 dated 08.02.2011 has granted general exemption to companies under section 212(8) of the Companies Act, 1956 from attaching annual accounts of subsidiary companies for the financial year 2010-11 onwards subject to fulfillment of following conditions:-

- (i) The Board of Directors of the Company has by resolution given consent for not attaching the balance sheet of the subsidiary concerned;
- (ii) The company shall present in the annual report, the consolidated financial statements of holding company and all subsidiaries duly audited by its statutory auditors;
- (iii) The consolidated financial statement shall be prepared in strict compliance with applicable Accounting Standards and, where applicable, Listing Agreement as prescribed by the Security and Exchange Board of India;
- (iv) The company shall disclose in the consolidated balance sheet the following information in aggregate for each subsidiary including subsidiaries of subsidiaries:- (a) capital (b) reserves (c) total assets (d) total liabilities (e) details of investment (except in case of investment in the subsidiaries) (f) turnover (g) profit before taxation (h) provision for taxation (i) profit after taxation (j) proposed dividend;
- (v) The holding company shall undertake in its annual report that annual accounts of the subsidiary companies and the related detailed information shall be made available to shareholders of the holding and subsidiary companies seeking such information at any point of time. The annual accounts of the subsidiary companies shall also be kept for inspection by any shareholders in the head office of the holding company and of the subsidiary companies concerned and a note to the above effect will be included in the annual report of the holding company. The holding company shall furnish a hard copy of details of accounts of subsidiaries to any shareholder on demand;
- (vi) The holding as well as subsidiary companies in question shall regularly file such data to the various regulatory and Government authorities as may be required by them;

- (vii) The company shall give Indian rupee equivalent of the figures given in foreign currency appearing in the accounts of the subsidiary companies along with exchange rate as on closing day of the financial year;

ANNEXURE I

Vide Notification No. GSR 480(E) vide F. No. 2/28/2002-CL-V dated 12th June, 2003, the Central Government has, in exercise of the powers conferred by Section 227(4A) issued Companies (Auditor Report) Order, 2003 which is reproduced below:

COMPANIES (AUDITOR'S REPORT) ORDER, 2003

[Issued by the Ministry of Finance and Company Affairs (Department of Company Affairs) vide F. No. 2/28/2002-CL-V; Published in the Gazette of India Extraordinary Part-II, Section 3, Sub-section (i) dated 12-6-2003].

G.S.R. No. 480(E): In exercise of the powers conferred by Sub-section (4A) of Section 227 of the Companies Act, 1956 (1 of 1956), read with the Notification of the Government of India in the Department of Company Affairs, No GSR 443(E) dated the 18th October, 1972, as amended from time to time and in supersession of the Order No. GSR 909(E) dated the 7th September, 1988, published in the Gazette of India, Part II, Section 3, Sub-section (i) except as respects things done or omitted to be done before such supersession, and after consultation with the Institute of Chartered Accountants of India [constituted under the Chartered Accountants Act, 1949 (38 of 1949)], in regard to class of companies to which this order applies and other ancillary matters, the Central Government hereby makes the following Order, namely:-

1. Short title, application and commencement

- (1) This order may be called the Companies (Auditor's Report) Order, 2003.
- (2) It shall apply to every company including a foreign company as defined in Section 591 of the Act, except the following:
 - (i) a banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);
 - (ii) an insurance company as defined in clause 21 of Section 2 of the Act;
 - (iii) a company licensed to operate under Section 25 of the Act; and
 - (iv) a private limited company with a paid up capital and reserves not more than fifty lakh rupees and has not accepted any public deposit and does not have loan outstanding ten lakh rupees or more from any bank or financial institution and does not have a turnover exceeding five crore rupees.
- (3) It shall come into force on the 1st day of July, 2003.

2. Definitions

In this Order, unless the context otherwise requires:

- (a) "Act" means the Companies Act, 1956 (1 of 1956);

- (b) "Chit fund company", "aidhi company" or "mutual benefit company" means a company engaged in the business of managing, conducting or supervising as a foreman or agent of any transaction or arrangement by which it enters into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of instalments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to, members.

3. Auditor's report to contain matters specified in paragraphs 4 and 5

Every report made by the auditor under Section 227 of the Act, on the accounts of every company examined by him to which this Order applies for every financial year ending on any day on or after the commencement of this Order, shall contain the matters specified in paragraphs 4 and 5.

4. Matters to be included in the Auditor's Report

The Auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

- (i) (a) whether the company is maintaining proper records showing full particulars including quantitative details and situation of fixed assets;
- (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and, if so, whether the same have been properly dealt with in the books of account;
- (c) If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern;
- (ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;
- (b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
- (c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt in the books of account?
- (iii) (a) has the company either granted or taken any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under Section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and
- (b) whether the rate of interest and other terms and conditions of loans given or taken by the company, secured or unsecured, are *prima facie* prejudicial to the interest of the company; and
- (c) whether receipt of the principal amount and interest are also regular; and
- (d) if overdue amount is more than rupees one lakh, whether reasonable

steps have been taken by the company for recovery of the principal and interest; and

- (iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and service. Whether there is a continuing failure to correct major weaknesses in internal control system;
- (v) (a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and
 - (b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;
(This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year).
- (vi) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of Sections 58A, 58AA or any other relevant provisions of the Act and the rules framed thereunder, where applicable, have been complied with. If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal whether the same has been complied with or not?
- (vii) in the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business;
- (viii) where maintenance of cost records has been prescribed by the Central Government under Clause (d) of Sub-section (1) of Section 209 of the Act, whether such accounts and records have been made and maintained;
- (ix) (a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth-tax, Service tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor;
 - (b) in case dues of Income-tax/Sales tax/Wealth tax/Service tax/Custom duty/Excise duty/cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.
(A mere representation to the Department shall not constitute the dispute).

- (x) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;
- (xi) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;
- (xii) whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; if not, the deficiencies to be pointed out.
- (xiii) whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/mutual benefit fund/societies:
 - (a) whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;
 - (b) whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets;
 - (c) whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers;
 - (d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;
- (xiv) if the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under Section 49 of the Act;
- (xv) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;
- (xvi) whether term loans were applied for the purpose for which the loans were obtained;
- (xvii) whether the funds raised on short-term basis have been used for long term investment, if yes, the nature and amount is to be indicated;
- (xviii) whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company;
- (xix) whether security or charge has been created in respect of debentures issued?
- (xx) whether the management has disclosed on the end use of money raised by public issues and the same has been verified;

- (xxi) whether any fraud on or by the company has been noticed or reported during the year; if yes, the nature and the amount involved is to be indicated.

5. Reasons to be stated for unfavourable or qualified answers

Where, in the auditor's report, the answer to any of the questions referred to in paragraph 4 is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

ANNEXURE II

The text of Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011. are reproduced below:

Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011.

[Issued by the Ministry of Corporate Affairs vide F.No. 5/18/2005-CL-V; Published in the Gazette of India Extraordinary Part-II, Section 3, Sub-section (i) dated 05-10-2011].

G.S.R. (E) —In exercise of the powers conferred by sub-section (1) of section 642 read with section 610B of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules, namely :

(1) Short title and Commencement :- (1) These rules may be called the Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011.

(2) They shall come into force with effect from the 6th October, 2011.

(2) Definitions:

In these rules, unless the context otherwise require,

(a) “**Act**” means the Companies Act, 1956;

(b) “**Annexure**” means the Annexure enclosed to the rules;

(c) “**Extensible Business Reporting Language**” (**XBRL**), means a standardised language for communication in electronic form to express, report or file financial information by the companies under the Act;

(d) “**Document and forms**” means the documents and forms required to be filed with any authority as specified under the Act or rules or regulations made therein;

(e) “**Taxonomy**” means in extensible Business Reporting Language (XBRL) an electronic dictionary for reporting the business data as approved by the Central Government in respect of any documents or forms indicated in this rule.

(3) Filing of Balance Sheet and Profit and Loss Account with Registrar:

The following class of companies have to file their Balance Sheet, Profit and Loss Account and other documents as required under section 220 of the Companies

Act, 1956 with the Registrar using the Extensible Business Reporting Language (XBRL) taxonomy given in Annexure enclosed to the rules for the financial year ending on or after 31st March, 2011 with e-Form no. 23AC-XBRL and 23ACA-XBRL specified under the Companies (Central Government) General Rules and Forms, 1956, namely:

- (i) all Companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or
- (ii) all Companies having paid up capital of rupees five crore or above; or
- (iii) all companies having turnover of rupees hundred crore or above.

Provided that the companies in Banking, Insurance, Power Sectors and Non-Banking Financial companies are exempted for Extensible Business Reporting Language (XBRL) filing for the financial year 2010-11.

Annexure

Extensible Business Reporting Language (XBRL) Taxonomy for Balance Sheets and Profit and Loss Accounts as required under section 220 of the Companies Act, 1956 from the year 2010-11.

ANNEXURE III

SCHEDULE VI

(See section 211)

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY IN ADDITION TO THE NOTES INCORPORATED ABOVE THE HEADING OF BALANCE SHEET UNDER GENERAL INSTRUCTIONS

1. Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head/sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of the Schedule VI shall stand modified accordingly.
2. The disclosure requirements specified in Part I and Part II of this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 1956. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.
3. Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required (a) narrative descriptions or disaggregations of items recognized in those statements and (b) information about items that do not qualify for recognition in those statements.

Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation.

4. Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as below:

	<i>Turnover</i>	<i>Rounding off</i>
(i)	less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(ii)	one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

5. Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.
6. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

Notes: This part of Schedule sets out the minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss (hereinafter referred to as "Financial Statements" for the purpose of this Schedule) and Notes. Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards.

PART I – Form of BALANCE SHEET

Name of the Company.....

Balance Sheet as at

<i>Particulars</i>	<i>Note No.</i>	<i>(Rupees in.....)</i>	
		<i>Figures as at the end of current reporting period</i>	<i>Figures as at the end of the previous reporting period</i>
1	2	3	4

I. EQUITY AND LIABILITIES

- (1) **Shareholders' funds**
 (a) Share capital

- (b) Reserves and surplus
- (c) Money received against share warrants
- (2) **Share application money pending allotment**
- (3) **Non-current liabilities**
 - (a) Long-term borrowings
 - (b) Deferred tax liabilities (Net)
 - (c) Other Long term liabilities
 - (d) Long-term provisions
- (4) **Current liabilities**
 - (a) Short-term borrowings
 - (b) Trade payables
 - (c) Other current liabilities
 - (d) Short-term provisions

TOTAL**II. ASSETS**

- Non-current assets**
- (1)
 - (a) Fixed assets
 - (i) Tangible assets
 - (ii) Intangible assets
 - (iii) Capital work-in-progress
 - (iv) Intangible assets under development
 - (b) Non-current investments
 - (c) Deferred tax assets (net)
 - (d) Long-term loans and advances
 - (e) Other non-current assets
- (2) **Current assets**
 - (a) Current investments
 - (b) Inventories
 - (c) Trade receivables
 - (d) Cash and cash equivalents
 - (e) Short-term loans and advances
 - (f) Other current assets

TOTAL

See accompanying notes to the financial statements

Notes**GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET**

1. An asset shall be classified as current when it satisfies any of the following criteria:
 - (a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;

- (b) it is held primarily for the purpose of being traded;
- (c) it is expected to be realized within twelve months after the reporting date;
or
- (d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

2. An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.
3. A liability shall be classified as current when it satisfies any of the following criteria:
 - (a) it is expected to be settled in the company's normal operating cycle;
 - (b) it is held primarily for the purpose of being traded;
 - (c) it is due to be settled within twelve months after the reporting date; or
 - (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a trade receivable if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a trade payable if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6. A company shall disclose the following in the notes to accounts:
 - A. Share Capital
for each class of share capital (different classes of preference shares to be treated separately):
 - (a) the number and amount of shares authorized;
 - (b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
 - (c) par value per share;
 - (d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
 - (e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

- (f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
 - (g) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;
 - (h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
 - (i) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
 - Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
 - Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
 - Aggregate number and class of shares bought back.
 - (j) Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.
 - (k) Calls unpaid (showing aggregate value of calls unpaid by directors and officers)
 - (l) Forfeited shares (amount originally paid up)
- B. Reserves and Surplus
- (i) Reserves and Surplus shall be classified as:
 - (a) Capital Reserves ;
 - (b) Capital Redemption Reserve;
 - (c) Securities Premium Reserve;
 - (d) Debenture Redemption Reserve;
 - (e) Revaluation Reserve;
 - (f) Share Options Outstanding Account;
 - (g) Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof);
 - (h) Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)
 - (ii) A reserve specifically represented by earmarked investments shall be termed as a fund'.
 - (iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head Surplus'. Similarly, the balance of Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head Reserves and Surplus' even if the resulting figure is in the negative.

C. Long-Term Borrowings

(i) Long-term borrowings shall be classified as:

(a) Bonds/debentures.

(b) Term loans

— from banks.

— from other parties.

(c) Deferred payment liabilities.

(d) Deposits.

(e) Loans and advances from related parties.

(f) Long term maturities of finance lease obligations

(g) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due.

(v) Particulars of any redeemed bonds/ debentures which the company has power to reissue shall be disclosed.

(vi) Terms of repayment of term loans and other loans shall be stated.

(vii) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

D. Other Long Term Liabilities

Other Long term Liabilities shall be classified as:

(a) Trade payables

(b) Others

E. Long-term provisions

The amounts shall be classified as:

(a) Provision for employee benefits.

(b) Others (specify nature).

F. Short-term borrowings

(i) Short-term borrowings shall be classified as:

(a) Loans repayable on demand

— from banks.

— from other parties.

- (b) Loans and advances from related parties.
 - (c) Deposits.
 - (d) Other loans and advances (specify nature).
 - (ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
 - (iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
 - (iv) Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.
- G. Other current liabilities
- The amounts shall be classified as:
- (a) Current maturities of long-term debt;
 - (b) Current maturities of finance lease obligations;
 - (c) Interest accrued but not due on borrowings;
 - (d) Interest accrued and due on borrowings;
 - (e) Income received in advance;
 - (f) Unpaid dividends
 - (g) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorized capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under 'Other current liabilities'
 - (h) Unpaid matured deposits and interest accrued thereon
 - (i) Unpaid matured debentures and interest accrued thereon
 - (j) Other payables (specify nature);
- H. Short-term provisions
- The amounts shall be classified as:
- (a) Provision for employee benefits.
 - (b) Others (specify nature).

I. Tangible assets

- (i) Classification shall be given as:
 - (a) Land.
 - (b) Buildings.
 - (c) Plant and Equipment.
 - (d) Furniture and Fixtures.
 - (e) Vehicles.
 - (f) Office equipment.
 - (g) Others (specify nature).
- (ii) Assets under lease shall be separately specified under each class of asset.
- (iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.
- (iv) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

J. Intangible assets

- (i) Classification shall be given as:
 - (a) Goodwill.
 - (b) Brands /trademarks.
 - (c) Computer software.
 - (d) Mastheads and publishing titles.
 - (e) Mining rights.
 - (f) Copyrights, and patents and other intellectual property rights, services and operating rights.
 - (g) Recipes, formulae, models, designs and prototypes.
 - (h) Licenses and franchise.
 - (i) Others (specify nature).
- (ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses/reversals shall be disclosed separately.

- (iii) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

K. Non-current investments

- (i) Non-current investments shall be classified as trade investments and other investments and further classified as:
 - (a) Investment property;
 - (b) Investments in Equity Instruments;
 - (c) Investments in preference shares
 - (d) Investments in Government or trust securities;
 - (e) Investments in debentures or bonds;
 - (f) Investments in Mutual Funds;
 - (g) Investments in partnership firms
 - (h) Other non-current investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

- (ii) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.
- (iii) The following shall also be disclosed:
 - (a) Aggregate amount of quoted investments and market value thereof;
 - (b) Aggregate amount of unquoted investments;
 - (c) Aggregate provision for diminution in value of investments

L. Long-term loans and advances

- (i) Long-term loans and advances shall be classified as:
 - (a) Capital Advances;
 - (b) Security Deposits;
 - (c) Loans and advances to related parties (giving details thereof);
 - (d) Other loans and advances (specify nature).

- (ii) The above shall also be separately sub-classified as:
 - (a) Secured, considered good;
 - (b) Unsecured, considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- (iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

- (i) Long Term Trade Receivables (including trade receivables on deferred credit terms);
- (ii) Others (specify nature)
- (iii) Long term Trade Receivables, shall be sub-classified as:
 - (i) (a) Secured, considered good;
 - (b) Unsecured considered good;
 - (c) Doubtful
 - (ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
 - (iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

N. Current Investments

- (i) Current investments shall be classified as:
 - (a) Investments in Equity Instruments;
 - (b) Investment in Preference Shares
 - (c) Investments in government or trust securities;
 - (d) Investments in debentures or bonds;
 - (e) Investments in Mutual Funds;
 - (f) Investments in partnership firms
 - (g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled

special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

- (ii) The following shall also be disclosed:
 - (a) The basis of valuation of individual investments
 - (b) Aggregate amount of quoted investments and market value thereof;
 - (c) Aggregate amount of unquoted investments;
 - (d) Aggregate provision made for diminution in value of investments.

O. Inventories

- (i) Inventories shall be classified as:
 - (a) Raw materials;
 - (b) Work-in-progress;
 - (c) Finished goods;
 - (d) Stock-in-trade (in respect of goods acquired for trading);
 - (e) Stores and spares;
 - (f) Loose tools;
 - (g) Others (specify nature).
- (ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
- (iii) Mode of valuation shall be stated.

P. Trade Receivables

- (i) Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated.
- (ii) Trade receivables shall be sub-classified as:
 - (a) Secured, considered good;
 - (b) Unsecured considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- (iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q. Cash and cash equivalents

(i) Cash and cash equivalents shall be classified as:

- (a) Balances with banks;
- (b) Cheques, drafts on hand;
- (c) Cash on hand;
- (d) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

R. Short-term loans and advances

(i) Short-term loans and advances shall be classified as:

- (a) Loans and advances to related parties (giving details thereof);
- (b) Others (specify nature).

(ii) The above shall also be sub-classified as:

- (a) Secured, considered good;
- (b) Unsecured, considered good;
- (c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

S. Other current assets (specify nature).

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

T. Contingent liabilities and commitments (to the extent not provided for)

(i) Contingent liabilities shall be classified as:

- (a) Claims against the company not acknowledged as debt;
- (b) Guarantees;
- (c) Other money for which the company is contingently liable

(ii) Commitments shall be classified as:

- (a) Estimated amount of contracts remaining to be executed on capital account and not provided for;
- (b) Uncalled liability on shares and other investments partly paid
- (c) Other commitments (specify nature).

U. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.

V. Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilized amounts have been used or invested.

W. If, in the opinion of the Board, any of the assets other than fixed assets and non-current investments do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.

PART II – Form of Statement of Profit and Loss

Name of the Company.....

Profit and Loss Statement for the year ended

(Rupees in.....)

Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period
I. Revenue from operations		xxx	xxx
II. Other income		xxx	xxx
III. Total Revenue (I + II)		xxx	xxx
IV. Expenses:			
Cost of materials consumed		xxx	xxx
Purchases of Stock-in-Trade		xxx	xxx
Changes in inventories of finished goods work-in-progress and Stock-in-Trade		xxx	xxx
Employee benefits expenses			
Finance costs			
Depreciation and amortization expenses			
Other expenses			
Total expenses		xxx	xxx
V. Profit before exceptional and extraordinary items and tax (III-IV)		xxx	xxx

VI.	Exceptional items	xxx	xxx
VII.	Profit before extraordinary items and tax (V-VI)	xxx	xxx
VIII.	Extraordinary Items	xxx	xxx
IX.	Profit before tax (VII-VIII)	xxx	xxx
X.	Tax expense:		
	(1) Current tax	xxx	xxx
	(2) Deferred tax	xxx	xxx
XI.	Profit (Loss) for the period from continuing operations (VII-VIII)	xxx	xxx
XII.	Profit/(loss) from discontinuing operations	xxx	xxx
XIII.	Tax expense of discontinuing operations	xxx	xxx
XIV.	Profit/(loss) form Discontinuing operations (after tax)(XII – XIII)	xxx	xxx
XV.	Profit (Loss) for the period (XI+XIV)	xxx	xxx
XVI.	Earnings per equity share:		
	(1) Basic	xxx	xxx
	(2) Diluted	xxx	xxx

See accompanying notes to the financial statements

GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS

1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-section (2) of Section 210 of the Act, in like manner as they apply to a statement of profit and loss.
2. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from
 - (a) sale of products;
 - (b) sale of services;
 - (c) other operating revenues;
 - Less:
 - (d) Excise duty.
- (B) In respect of a finance company, revenue from operations shall include revenue from
 - (a) Interest; and
 - (b) Other financial services

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

3. Finance Costs

Finance costs shall be classified as:

- (a) Interest expense;
- (b) Other borrowing costs;
- (c) Applicable net gain/loss on foreign currency transactions and translation.

4. Other income

Other income shall be classified as:

- (a) Interest Income (in case of a company other than a finance company);
- (b) Dividend Income;
- (c) Net gain/loss on sale of investments
- (d) Other non-operating income (net of expenses directly attributable to such income).

5. Additional Information

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:-

- (i) (a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].
- (b) Depreciation and amortization expense;
- (c) Any item of income or expenditure which exceeds one per cent of the revenue from operations or Rs.1,00,000, whichever is higher;
- (d) Interest Income;
- (e) Interest Expense;
- (f) Dividend Income;
- (g) Net gain/loss on sale of investments;
- (h) Adjustments to the carrying amount of investments;
- (i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
- (j) Payments to the auditor as (a) auditor, (b) for taxation matters, (c) for company law matters, (d) for management services, (e) for other services, (f) for reimbursement of expenses;
- (k) Details of items of exceptional and extraordinary nature;
- (l) Prior period items;
- (ii) (a) In the case of manufacturing companies,-
 - (1) Raw materials under broad heads.

- (2) goods purchased under broad heads.
- (b) In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.
- (c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.
- (d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.
- (e) In the case of other companies, gross income derived under broad heads.
- (iii) In the case of all concerns having works in progress, works-in-progress under broad heads.
- (iv) (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance-sheet is made up.
- (b) The aggregate, if material, of any amounts withdrawn from such reserves.
- (v) (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.
- (b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.
- (vi) Expenditure incurred on each of the following items, separately for each item:-
 - (a) Consumption of stores and spare parts.
 - (b) Power and fuel.
 - (c) Rent.
 - (d) Repairs to buildings.
 - (e) Repairs to machinery.
 - (g) Insurance .
 - (h) Rates and taxes, excluding, taxes on income.
 - (i) Miscellaneous expenses,
- (vii) (a) Dividends from subsidiary companies.
- (b) Provisions for losses of subsidiary companies.
- (viii) The profit and loss account shall also contain by way of a note the following information, namely:-
 - (a) Value of imports calculated on C.I.F basis by the company

during the financial year in respect of –

- I. Raw materials;
 - II. Components and spare parts;
 - III. Capital goods;
- (b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
- (c) Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;
- (d) The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;
- (e) Earnings in foreign exchange classified under the following heads, namely:-
- I. Export of goods calculated on F.O.B. basis;
 - II. Royalty, know-how ,professional and consultation fees;
 - III. Interest and dividend;
 - IV. Other income, indicating the nature thereof

Note: Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements.”.

LESSON ROUND-UP

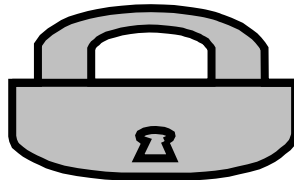


- Proper books of accounts shall be deemed to have been kept by a company if such books exhibit and explain the transactions and financial position of the business of the company, including books containing sufficiently detailed entries of daily cash receipts and payments.
- Every company is required to keep books of account at its registered office in respect of specified transactions. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide.
- The books of account should be kept on accrual basis and according to double entry system of accounting. Further, they must give a true and fair view of the affairs of the company or branch office and explain its transactions.

- As per the Act, books of account and other books and papers should be available for inspection by any director on working days during business hours.
- The Companies Act, 1956, specifically requires certain other books to be kept by a company for maintaining a record of its different activities in order to safeguard the interests of the shareholders and creditors. These books are known as Statutory Books.
- In addition to the books of account and statutory books, a company usually maintains a number of statistical books in order to keep complete records of numerous details connected with the business operations.
- The expression 'annual accounts' embraces both balance sheet and profit and loss account. In a wider sense, it also covers cash and fund flow statement, director's report etc.
- The term 'Balance Sheet' means a statement prepared from the books of a concern showing the debit and credit balances after the trading and profit and loss accounts have been prepared – a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date.
- Profit and loss account is a Statement by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation to its capital, and enables them to judge about the administration and management of the affairs of the company.
- The Act provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- The Act requires that at every annual general meeting of the company, the Board of directors must lay before the shareholders of the company a balance sheet and a profit and loss account for the period as specified therein; and in the case of non profit companies, an income and expenditure account.
- The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report. The Act gives other provisions also for authentication of annual accounts. The Act also requires the company to file such annual accounts with the Registrar of Companies.
- The Act provides that there shall be attached to every balance sheet laid before a company in general meeting (in practice, the annual general meeting) a report by its Board of directors, with respect to items as specified therein. The Board's Report shall also include a Directors' Responsibility Statement as required under the Act.
- Every company not required to employ a whole time secretary under the Companies Act and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in whole-time practice in such form and with such time, as to whether the company has complied with all the provisions of the Companies Act, 1956 and a copy of such certificate shall be attached with Board's report.
- The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. An audit of accounts is conducted with two-fold purpose: (i) detection and prevention of errors; (ii) detection and prevention of fraud.

- The Act provides that every company shall, at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next annual general meeting. The Act also provides for methods of appointment of auditors along with their qualifications and disqualifications.
- The Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India within the limits specified.
- The various rights and powers of auditors include right to access to books, accounts and vouchers, obtaining information, sign the audit report, receive notice of and attend the general meeting, visit branch offices and receive remuneration.
- The duties of an auditor are many and varied. He must examine the original books of account, kept by the company to discover any inaccuracies or omissions therein, to examine the company's balance sheet and profit and loss account, and report on the original books of account and the annual accounts to the members.
- Apart from liability under the common law, the statutory liabilities of an auditor could be either Civil or Criminal.
- The Act empowers the Central Government to appoint either any Chartered Accountant or the company's own auditor to conduct a special audit in certain circumstances.
- The Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs.
- The Act empowers the Central Government to direct, whenever it is necessary to do so, that an audit of cost accounts of the company should be conducted in such manner as may be specified. The Central Government has issued Companies (Cost Audit Report) Rules, 2011 containing *inter alia* provisions regarding the form of the Report, time limit of submission of the report, authentication of the annexure to the report, furnishing of records to the Cost auditor and penalties and action to be taken in case of contravention of the Rules.
- Social audit is a combination of performance audit and efficiency audit.
- By and large the notes on accounts are self-explanatory. The notes on accounts are intended to clarify and elucidate the financial position of a company as disclosed in its balance sheet and profit and loss account.

SELF-TEST QUESTIONS



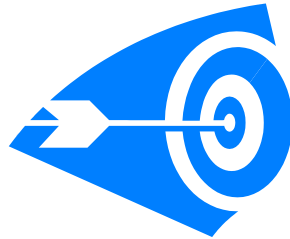
(These are meant for recapitulation only. Answers to these questions are not to be submitted for revaluation).

1. (a) What books of account are required to be kept by a company?
 (b) Who are the persons who can inspect books of account?
 (c) Can a director make inspection of the books of account?

2. Explain the law relating to the authentication, circulation, adoption and filing of the annual accounts.
 3. (a) How is the first auditor of a company appointed?
(b) What are the disqualifications of an auditor?
(c) Can an internal auditor act as a Statutory Auditor?
 4. What are the statutory rights and duties of an auditor?
 5. Write a short note on appointment of cost auditor.
 6. State the provisions of the Companies Act, 1956 in respect to the filling a casual vacancy.
 7. Auditor appointed at the Annual General Meeting of XYZ Ltd. resigned within 2 months of appointment. State the legal position.
 8. Write a note on Corporate Governance. Is it compulsory for all companies to adhere to the disclosures for corporate governance.
 9. What is Social Audit? State the matters to be included in the Report of the Auditors, in the light of CARO, 2003.
 10. Explain the provisions for the following as regards Clause 49:
 - (i) Audit committee.
 - (ii) Board of Directors and remuneration of Directors.
 - (iii) List of items to be placed before the Board of Directors.
 - (iv) Suggested list of items to be included in the Report on corporate governance.
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STUDY XXII
CORPORATE ACCOUNTABILITY - II
DIVISIBLE PROFITS AND DIVIDENDS

LEARNING OBJECTIVES



According to the generally accepted definition, “dividend” means the profit of a company which is not retained in the business and is distributed among the shareholders in proportion to the amount paid up on the shares held by them. Section 2(14A) defines ‘Dividend’ to include interim dividend. Both interim and final dividend when declared become debt. When the amount in the unpaid dividend account remains unclaimed and unpaid for a period of seven years, it shall be credited to Investor Education and Protection fund.

This study covers various aspects relating to dividend, topics covered are:

- Definition and meaning of dividend
- Restrictions on declaration of dividend and purpose behind it.
- Ascertainment of divisible profits and dividends
- Declaration of dividend
- To whom paid
- When payable
- Establishment of Investor Education and Protection Fund
- Dividend warrants
- Payment of interest out of capital
- Remittance of dividend or interest or sale proceeds to NRIs, foreigners and foreign companies.

1. DEFINITION AND MEANING OF DIVIDEND

Dividend is the return on the share capital subscribed for and paid to a company by its shareholders. The term dividend has been defined under Section 2(14A) of the Companies Act, 1956 (the Act) as “dividend includes any interim dividend.” The dictionary meaning of the term ‘dividend’ is sum payable as interest on loan or as profit of a company to the creditors of an insolvent’s estate or an individual’s share of it. In commercial term, however, dividend is the share of the company’s profit distributed among the members.

Difference between Dividend and Interest

While dividend is paid on preference and equity shares, interest is paid on debentures and long term and short term loans/borrowings including fixed deposits. Interest is a debt which like all debts is paid out of the company's assets generally. A dividend, however becomes a debt only after it has been declared by the company. Dividend cannot be paid out of the assets of the company, generally it can be declared only out of the profit available for the purpose. Interest is a charge on profits while dividend is an appropriation of profits. The power to pay dividend is inherent in a company and is not derived from the Companies Act, 1956 or the Memorandum or Articles of Association although the Act and the Articles generally regulate the manner in which dividends are to be declared.

Right to claim dividend will only arise after a dividend is declared by the company in general meeting and until and unless it is so declared, the shareholder has no claim against the company in respect of it. The observation of the Bombay High Court in *Bacha F Guzdar v. CIT* (1952) 22 Comp Cases 198 (Bom) was improved upon by the Supreme Court saying that the right to participation in the profits exists independent of any declaration by the company with only difference that the enjoyment of profits is postponed until dividends are declared [*Bacha F Guzdar (Mrs.) v. CIT* (1955) 25 Com. Cases 1 at p. 6]

Types of Dividend

Final Dividend

Final dividend is recommended by the Board of directors in its report to the shareholders, as per the requirements of Section 217 of the Companies Act, which is attached to the balance sheet for the relevant financial year. It is declared by the shareholders at the annual general meeting. Usually articles of association of companies provide that the shareholders cannot increase the rate or amount of dividend than the one recommended by the Board. The shareholders may, however, declare the payment of dividend on equity shares at a rate lower than the one recommended by the directors in their report.

It is the discretion of the Board of directors to recommend or not to recommend the declaration of final dividend, which has to be exercised in good faith in the interest of the company. The shareholders have no power to declare final dividend in the absence of a recommendation of the Board of directors in this regard.

Interim Dividend

Section 2(14A) defines 'Dividend' to include interim dividend. The Companies (Amendment) Act, 2000 has amended Section 205 to make provisions for interim dividend. The Board of directors may declare interim dividend. The interim dividend is paid between two annual general meetings of the company.

A company can normally estimate its profits for the current financial year on a fairly reasonable basis and in that event it can allocate to the reserves the prescribed percentage of profits on the basis of its estimated profits. As a measure of precaution, the company may allocate to the reserves a higher amount than the actual amount based on the prescribed percentage of its estimated profits.

Further, it should also provide for depreciation in full. It should transfer to the reserves an amount based on estimated profits after the end of the financial years and before the finalisation of the amounts for the financial year and thereafter decide to pay an interim dividend to its shareholders.

Prior to the coming into force of the Companies (Amendment) Act, 2000, the Act did not contain specific provisions for payment of interim dividend. However, if the articles of association of company authorised payment of interim dividend as per regulation 86 of the Table A of Schedule I, then the Board of directors of such company could declare an interim dividend where its profits warranted such payment. A mere resolution for declaration of an interim dividend did not create any liability and could be rescinded at any time before actual payment. This was so even if the cash to cover the proposed dividend had been placed into a separate account. The distinction between interim and final dividend was that, unlike interim dividend, a final dividend once declared by the company in general meeting was a debt and created an enforceable obligation. [*Punjab National Bank v. Union of India* (1986) 59 Comp Cases 35 (Del.)]

With the enactment of the Companies (Amendment) Act, 2000, this position has changed. Interim dividend stands on the same footing as that of the final dividend. Both interim and final dividend when declared become debt and are payable within 30 days of declaration.

Dividend on Preference Shares

A Preference share carries a preferential right as to dividend in accordance with the term of issue and the articles of association, subject to the availability of distributable profits. The preferential right to a dividend could either be a fixed amount or an amount calculated at a fixed rate. It may be cumulative or non-cumulative. Preference shares can carry dividend of a fixed amount, before any dividend is paid on the equity shares. If there are two or more classes of preference shares, the shareholders of the class which has priority are similarly entitled to their preferential dividend before any dividend is paid in respect of the other class. But these rights in respect of dividends are subject to three conditions. Firstly, preference shares are part of the company's share capital, consequently, preference dividends can be paid only if the company has earned sufficient profits. Secondly, a dividend becomes payable to the shareholders only when it is declared in the manner laid down in the Act and by the company's articles. Thirdly, there should have been a formal declaration. Preference shareholders are not entitled to treat the preference dividend as a debt and sue for its payment in the first instance. However, if the articles specify that the company's profit shall be applied, by way of payment of the preference dividend, the preference shareholder can sue for it even though it has not been declared [*Evling v. Israel & Oppenheimer Ltd.* (1918) 1 Ch. 101].

Dividend on Equity Shares

Dividend on equity shares are to be paid in accordance with the rights of the respective classes of shares. Equity shareholders are entitled to be paid dividend on their shares only after all dividends on preference shares have been paid to date. Although the equity shareholder stands second in preference to preference shareholders, he enjoys a privilege of a higher dividend as the preference dividend is fixed and cannot be increased, however, large the company's profits may be, unless

the preference shares carry the right to participate in surplus profits. Therefore, except in the above mentioned situation, the whole of the residual profits of the company after paying the preference dividend may be paid out as dividend to the equity shareholders either immediately or in later years.

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

Dividend can be paid out of the assets of the company.

- True
- False

Correct Answer: False

Dividend cannot be paid out of the assets of the company, and generally, can be declared only out of the profit available for the purpose.

2. RESTRICTIONS ON DECLARATION OF DIVIDEND AND PURPOSE BEHIND DECLARING DIVIDEND

The restriction that the company law puts on declaration of dividends by companies is that they must be paid only out of profits and after providing for depreciation. Of course, losses, if any of the previous years must be set off before declaring dividend.

However, in exceptional circumstances, the Central Government has the power to exempt a company or a class of companies from the provision of providing depreciation before declaration of dividend. The purpose of imposing this restriction is to ensure that the assets of companies are preserved for the benefit of their creditors and not to be distributed among members of the companies in the guise of dividends.

Sub-section (2B) has been inserted to Section 205 which provides that if a company fails to comply with the provisions of Section 80A i.e. redemption of irredeemable preference shares, it shall not declare any dividend on its equity shares so long as such failure continues.

3. ASCERTAINMENT OF DIVISIBLE PROFITS AND DIVIDENDS

‘Divisible profits’ means the profits which the law allows the company to distribute to the shareholders by way of dividend. According to Palmer’s Company Law, the terms ‘divisible profits’ and ‘profits in the legal sense’ are synonymous. The profits of a business mean the net proceeds of the concern after deducting the necessary outgoings without which those proceeds could not be earned. [*Bharat Insurance Co. Ltd. v. CIT* (1931) 1 Com. Cases 192, 196 (Lah)]. ‘Profits available for dividend’ has been held to mean the profits which the directors consider should be distributed after making provision for depreciation or past losses, for reserves or for other purposes.

A proposal for declaration of dividend involves various considerations like the annual working of the company, future prospects of the company’s business, building up of adequate reserves for future expansion etc. Simply because the company’s accounts disclose profits in any year, it does not follow that declaration of dividend is

a must. The concept of 'divisible profits' is undefined and is a highly relative term. The quantum of profit, the rate of dividend previously maintained, tax liabilities, employees' claim on bonus and similar other factors that are likely to claim a share in the profits have to be carefully scrutinised.

Here the question that arises is as to how profits are calculated for this purpose. Under Section 205(1) of the Act dividend can be paid by a company -

- (a) out of the profits of the company for that year after providing for depreciation under Section 205(2); and/or
- (b) out of the profits of the company for the previous financial year or years arrived at after providing for depreciation under Section 205(2) and remaining undistributed; or
- (c) out of moneys provided by the Central or State Government for the payment of dividend pursuant to a guarantee given by the Government.

Except the above, one cannot get any guidance from the Act as to how the profits are to be calculated for the purpose of payment of dividend. However, under Section 211(2) every profit and loss account of a company should give a true and fair view of the profit or loss of the company for the financial year and shall, subject, as aforesaid, comply with the requirements of Part II of Schedule VI, so far as they are applicable thereto. However, it is not compulsory to provide depreciation under Part II of Schedule VI. But, it has been mentioned in Section 205 that depreciation should be provided before dividend is declared out of profits. It should be noted that the Act provides for detailed guidelines for computation of profits for the purpose of managerial remuneration, payment of donations to charitable and other purposes not connected with the business of the company in Sections 349 and 350 of the Act.

Depreciation

Under Section 205(2) depreciation should be provided in any one of the following ways before arriving at the distributable profits, viz:

- (a) to the extent specified in Section 350; or
- (b) in respect of each item of depreciable asset, for such an amount as is arrived at by dividing ninety-five per cent of the original cost thereof to the company by the specified period in respect of such asset; or
- (c) on any other basis as approved by the Central Government which has the effect of writing off by way of depreciation ninety-five per cent of the original cost to the company of each such depreciable asset on the expiry of the specified period; or
- (d) in respect of any other depreciable asset where no rate of depreciation has been provided in this Act or any rules made thereunder, on such basis as is approved by the Central Government.

Section 350 of the Companies Act, 1956 [as amended vide Companies (Amendment) Act, 2000] provides that the amount of depreciation to be deducted is

the amount of depreciation on assets as shown by the books of the company at the end of the financial year at the rates specified in Schedule XIV. Schedule XIV prescribes the rates of depreciation of various assets both under Written-Down-Value Method and Straight Line Method for Single Shift, Double Shift and Triple Shift basis.

Under proviso to Section 350, where any asset is sold, discarded, demolished or destroyed for any reason before depreciation of such asset has been provided for in full, the excess, if any of the written down value of such asset over its sale proceeds or as the case may be, its scrap value, shall be written off in the financial year in which the asset is sold, discarded, demolished or destroyed.

Section 205(5) defines "specified period" in respect of any depreciable asset to mean the number of years at the end of which at least ninety-five per cent of the original cost of that asset to the company would have been provided for by way of depreciation if depreciation were to be calculated in accordance with the provisions of Section 350.

Provision of Depreciation

Schedule XIV which was inserted by the Companies (Amendment) Act, 1988 contains the rates of depreciation for various assets. Prior to the Companies (Amendment) Act, 1988, Companies while determining distributable profits for the purposes of declaring dividend had to provide for depreciation at the rates specified for various assets by the Income-tax Act, 1961.

Clause (c) of the proviso to the Sub-section (1) of Section 205 of the Act empowers the Central Government in public interest to allow any company to declare or pay dividend for any financial year out of profits for that year or any previous financial year(s) without providing for depreciation.

For obtaining approval of the Central Government, the Board of directors of a company proposing to pay dividend without providing for depreciation, should pass a resolution authorising the managing director or the company secretary to make an application to the Central Government.

As stated earlier, the Companies (Amendment) Act, 2000 has amended the provisions of Section 350 to the effect that the depreciation on assets as shown by the books of the company at the rate specified in Schedule XIV may be taken into account for payment of dividend.

Manner of providing depreciation

According to clause (k) of Sub-section (4) of Section 349, in computing net profit for the purpose of Section 349, depreciation to the extent specified in Section 350 shall be deducted.

Section 350 lays down that the amount of depreciation to be deducted in pursuance of clause (k) of Sub-section (4) of the Section 349 shall be the amount of depreciation on asset as shown by the books of the company at the end of the financial year expiring at the commencement of the Act or immediately thereafter and at the end of each subsequent financial year, at the rate specified in Schedule XIV.

Therefore, for the purposes of the Companies Act, depreciation has to be calculated in accordance with the rates specified in Schedule XIV. In this Schedule, assets have been classified into (I) Buildings; (II) Plant and Machinery; (III) Furniture and fittings; and (IV) Ships.

Under each class, several items of assets have been given and for each of them or group of them, depreciation rates have been prescribed under the written down value method (WDV) and the straight line method (SLM). A company is free to adopt either of the two methods of depreciation and use appropriate rates of depreciation. In the event of adoption of the straight line method of depreciation by a company the concept of specified period has no relevance.

So far as the class "plant and machinery" is concerned, two sets of depreciation rates, viz. General rate and special rate, have been prescribed, under each of the aforesaid methods, viz., WDV method and the SLM method. General rate is applicable in respect of items of plant and machinery and continuous process plants, which are operated 24 hours a day and are not covered by special rates. The items of plant and machinery, which are covered by special rates, have been put under four categories and for each of the said categories special rates of depreciation have been specified.

Choose the correct answer

Which of the following is prescribed by Schedule XIV for the rates of depreciation of various assets under the 'straight line method'?

- (a) Double shift basis
- (b) Triple shift basis
- (c) Single shift basis
- (d) All of the above

Correct answer: d

Schedule XIV prescribes the rates of depreciation of various assets both under the 'written down value method' and 'straight line method' for single shift, double shift and triple shift basis.

Loss of previous year(s) to be set off against profits of current year or previous years.

As per clause (b) of proviso to section 205(1) of the Companies Act, where a company has incurred any loss in any financial year or years falling after the commencement of the Companies (Amendment) Act, 1960, then the lower of the following two amounts, namely:

- (a) the amount of the loss, or
- (b) the amount of depreciation provided for that year or those years,

Should be set off against the profits of the year for which the dividend is proposed to be declared or against the profit of the company for any previous

financial year or years arrived at after providing for depreciation under Sub-section (2) or against both.

Transfer of Profits to Reserves

As we have discussed earlier, under Sub-section (2A) of Section 205 no dividend can be declared by a company for any financial year except on transfer to reserve of the company of such percentage of its profits for that year as has been prescribed (maximum being 10%). On exercise of their power under this sub-section the Central Government have issued the Companies (Transfer of Profits to Reserves) Rules, 1975 prescribing the percentages of profits to be transferred to reserves before declaring dividend. Under rule 2 of the rules, the following percentages of profit will have to be transferred before a dividend is declared:

<i>Rate of dividend</i>	<i>Amount to be transferred to Reserves</i>
(a) If the proposed dividend exceeds 10% but does not exceed 12.5% of the paid-up capital	Not less than 2.5% of the current profits.
(b) If the proposed dividend exceeds 12.5% but does not exceed 15% of the paid-up capital	Not less than 5% of the current profits
(c) If the proposed dividend exceeds 15% but does not exceed 20% of the paid-up capital	Not less than 7.5% of the current profits.
(d) If the proposed dividend exceeds 20% of the paid-up capital	Not less than 10% of the current profits.

However, if a company wishes to transfer more than 10% of profits to reserves in a year, it can do so after complying with the provisions of Rule 3 of Companies (Transfer of Profits to Reserves) Rules, 1975.

The conditions as per Rule 3 are:

1. Where a dividend is declared—
 - (a) it should not be less than the average of the rates at which dividends were declared by the company for the last three years immediately preceding the financial year; or
 - (b) where Bonus shares have either been issued in the financial year in which dividend is declared or in the three years immediately preceding the financial year, it should not be less than the average amount (quantum) of dividend declared for the last three years immediately preceding the financial year.

The conditions are not applicable where the net profits after the tax are lower by 20% or more than the average net profits after tax of the two financial years immediately preceding the financial year.

2. Where no dividend is declared, the amount proposed to be transferred to the

reserves from the current profits shall be lower than the average amount of the dividends to the shareholders declared in the three years immediately preceding the financial year.

A newly incorporated company is prohibited from transferring more than ten per cent of its profits to its reserves. [Circular No. 20/76 (5/10/76-CL-XIV and 1/1/76-CL.VI) 26.07.1976].

The Department of Company Affairs (Now Ministry of Corporate Affairs) has given certain clarifications in regard to the aforementioned rules which are reproduced in Annexure I.

As an incentive to increase the investment in the desired area higher rates of depreciation has to be provided under Section 205 of the Act than warranted on the basis of the effective working life of the assets resulting in diminution of profits both for distribution of dividend and for managerial remuneration. In order to remove hardship on this count the Ministry of Corporate Affairs (MCA) approves of proposals for provisions of depreciation at lower rates on such assets in order to enable companies to pay dividend to shareholders. An application will have to be made to MCA for obtaining the approval showing the profits earned before provision of depreciation and after provision of depreciation on the normal rates arrived at and the quantum of dividend proposed together with a certificate from the suppliers of machinery or approved valuers about the normal working life of asset.

Dividend in Case of Absence or Inadequacy of Profits

In case of absence or inadequacy of profits, dividend can be declared under Section 205A(3) of the Act out of the accumulated profits earned by the company in the previous years and transferred by it to reserves. Such declaration should be in accordance with the rules prescribed in this regard by the Government. If such a declaration does not conform to the rules, the declaration of dividend will require the previous approval of the Central Government. In exercise of its powers under this sub-section, the Central Government has framed rules known as Companies (Declaration of Dividend Out of Reserves) Rules, 1975.

Under these rules dividend can be declared from amounts drawn from reserves (i.e. free reserves only and not from any specific reserves) in case of absence or or inadequacy of profits in any year subject to the following conditions:

- (a) the rate of dividend declared shall not exceed the average of the rates of dividend declared by it during the immediately preceding last five years or 10% of the paid-up capital, whichever is less;
- (b) the total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one-tenth of the sum of its paid-up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared; and
- (c) the balance of reserves after such drawal shall not fall below 15% of the paid-up share capital

It should be noted that this rule will not apply to declaration of dividend out of the

profits/surplus carried forward to the Balance Sheet by a company. It will apply only to declaration of dividend out of the profits of the previous years transferred to the reserves.

4. DECLARATION OF DIVIDEND

A dividend when declared becomes a debt and a shareholder is entitled to sue for recovery of the same after expiry of the period of 30 days prescribed under Section 207, in *Re Severn and Wye & Severn Bridge Rly. Co.* (1896) 1, Ch 559. A dividend when proposed does not become a debt but only becomes debt when declared (*Kastur Chand Jain v. Gift Tax Officer* AIR 1961 Cal. 649).

The Act does not specifically provide who shall declare final dividend. But under Section 173(1), the declaration of a dividend has been shown as ordinary business at an annual general meeting of a company. Similarly there is a reference to dividend in Section 217 whereunder directors are required to mention in their report to the shareholders the amount, if any, which they recommend by way of dividend. Therefore, it could be assumed that the intention of the legislature is to empower the annual general meeting to declare final dividend. In *Raghunandan Neotia v. Swadeshi Cloth Dealers Ltd.* (1964) 34 Comp. Cas. 570 (Cal.) the Calcutta High Court held that the cumulative effect of all the provisions of the Act is that the declaration of dividends should be made at the annual general meetings. In *Kantilal v. CIT*, (1956) 26 Comp. Cas. 357 (Bom.), the Bombay High Court has held that it is well established and the law is quite clear that a dividend can only be declared by the shareholders of the company. Articles of companies usually contain provisions with regard to declaration of dividends. These will be on the pattern of Regulations 85-94 of Table 'A' of Schedule I to the Act. It would be seen that under Regulation 85 the power to declare a dividend vests with the general meeting, but it has no power to declare a dividend exceeding the amount recommended by the Board.

But if a dividend is so declared at the general meeting, the company cannot declare a further dividend for the same year (Circular No. 2 issued by the Department of Company Affairs dated 25.10.75) There can be no declaration of dividend for past years in respect of which the amounts have already been closed at previously held annual general meeting. [*Raghunandan Neotia v. Swadeshi Cloth Dealers Ltd. (Supra)*]. Under Section 205(1A) of the Act, the Board of directors is authorised to declare interim dividend. Hence, if articles does not provide otherwise, Board may declare interim dividend.

Revocation of Declared Dividend

As already stated earlier, a dividend including interim dividend once declared becomes a debt and cannot be revoked, except with the consent of the shareholders.

If a dividend is declared and paid to shareholders, the character of the payment cannot be altered by a subsequent resolution.

But where a dividend has been illegally declared, the directors will be justified in revoking the declared dividend. If an illegally declared dividend is paid then the directors shall be responsible, liable and accountable to the company personally.

Payment of Dividend in Cash or in Kind

According to Section 205(3), dividend can be paid only in cash, not in kind. The

articles may provide that any meeting of the company declaring a dividend may resolve that the dividend be paid wholly or partly by distribution or issue of paid-up shares. In the absence of such express authority dividends may not be paid otherwise than in cash. In one case, where the dividend was paid by allotting shares, it was held that the market value of the shares on the date of the declaration of dividend was to be taken into consideration for computing the income of shareholders for the purposes of tax.

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

Dividend can be paid in cash as well as in kind.

- True
- False

Correct Answer: False

According to Section 205(3), dividend can be paid only in cash, not in kind.

Liability of Directors, Shareholders and Auditors for Improper Dividend

The directors are personally liable to account for improper payment of dividend to the extent to which it has caused loss to the company. If for instance they have paid dividend out of capital they have to compensate the company for the loss. On the other hand, if a member received dividend knowing that it is paid out of capital he is liable to make good the loss to the company and the directors can recover the amount so paid. At the instance of any individual shareholder, the directors can be restrained from going ahead with the payment of an improper and illegal dividend [*Hoole v. Great Western Rly Co.* (1867) 3 Ch. App. 262].

An auditor who is party to the payment of dividend which is improper is liable to be proceeded against and the amount which is improperly paid may be recovered from him.

Shareholders Right to Dividend

Once a dividend is declared a shareholder has the right to claim dividend against the company. (*Bacha F. Guzadar (Mrs.) v. CIT* (1955) 25 Com. Cases 1: AIR 1955 SC 74). A shareholder cannot compel the company by any process of law to declare a dividend. The usual practice is for the Board to recommend and the annual general meeting to declare the dividend. The annual general meeting will have the power, subject to the provisions of the Act to determine the amount of dividend to be distributed.

5. WHO IS ELIGIBLE TO RECEIVE DIVIDEND

Under Section 206 of the Act a dividend in respect of a share has to be paid to the registered shareholder of the share or to his order or to his bankers. For this purpose, usually companies close the register of members under Section 154 of the Act or fix a record date, of which 7 days notice should be given by publication of advertisement in two newspapers—one in English and the other in the language of the region in which the registered office of the company is situated. The purpose of such notice is to give an opportunity to those who hold blank transfer deeds to lodge them with the company duly completed. Dividend is paid to those whose names appear on the record date or

the last day of the closure of register of members, as the case may be. The dividend is payable to the shareholder whose name appears in the register of members on the appropriate date even though prior to that date he has sold the shares and the transfer deed in respect thereof has not been lodged with the company [*Chunilal Khushaldas Patel v. H K Adhyaru* (1956) 26 Comp. Cas 168 (S.C)].

Recently, it was held in the case of *Commissioner of Income-Tax v. Aatur Holdings P. Ltd.* [(2008) 146 Comp Cas 152 (Bom)], that merely because a person may have purchased or been in receipt of shares, in the absence of the shares being registered in his name in the books of account of the company, such a person is not entitled to receive the dividend. The dividend has to be paid by the company in the name of the registered shareholders and it is the registered shareholders alone who claim dividend under section 27 of the Securities Contracts (Regulation) Act, 1956.

Section 206A was inserted by the Companies (Amendment) Act, 1988 w.e.f. 15.6.1988 providing for right to dividend, rights shares and bonus shares to be held in abeyance pending registration of transfer of shares. It provides that in case instrument of transfer of shares is pending registration with the company, the dividends in relation to such shares should be transferred to the special bank account opened by the company under Section 205A unless the company is authorised by the registered shareholders in writing to pay such dividend to the transferee specified in the instrument of transfer. In *S V Nagarajan v. Lakshmi Vilas Bank Ltd. and another* (1997) 26 CLA 308 (CLB) it was held that when a company returns a transfer deed on the ground of non-tally of the transferor's signature on the deed with the one in its own records, before the date of issue/allotment of bonus/rights shares, there will be no application for registration pending with it on that date and it cannot be faulted for its failure to comply with Section 206A of the Act.

6. WHEN DIVIDEND IS PAYABLE

Under Section 207 of the Companies Act, 1956, dividend has to be distributed within 30 days of the declaration. Posting of dividend warrants within 30 days will be deemed to be payment irrespective of the fact whether the warrant has been encashed or not under regulation 91 of Table A of Schedule I to the Act. In the case of joint holders the warrant has to be sent to the registered address of the first named joint holder or to such person and to such address as the joint holders may in writing direct.

However, as per proviso to the Section 207 in the following circumstances dividend need not be paid within 30 days viz.:

- (i) Where dividend could not be paid by reason of the operation of any law e.g. in the case of non-residents, dividend need not be paid within 30 days if permission for remittance where required has not been received therefor from the Reserve Bank of India within 30 days;
- (ii) Where a shareholder has given directions to the company regarding the payment of dividend and these directions cannot be complied with;
- (iii) Where there is a dispute regarding the right to receive dividend;
- (iv) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (v) Where, for any other reason, the failure to pay the dividend or to post the warrant was not due to any default on the part of the company.

N.Kumar v. M.O.Roy, Assistant Director, S.F.I.O [(2007) 80 SCL 55 (MAD)], a company, for the financial year 1995-96, declared the dividend on 19-9-1996 and failed to distribute same within the prescribed period. A complaint has been filed against the company and its directors on 23-8-2006 for the contravention of provisions under Section 207 of the Companies Act, 1956. A director contended that he had resigned before the declaration of dividend so he could not be held liable for the contravention of Section 207. The court held that the director was not a whole-time director to be aware about the entire affairs of the company. The director could not be held vicariously liable for the contravention under Section 207 and therefore the proceedings were liable to be quashed as against the director.

Any failure to comply with the requirements of Section 207 renders every director of the company, who is knowingly a party to the default, liable for punishment with simple imprisonment for a term which may extend to three years and he shall also be liable to a fine of one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of 18% p.a. during the period for which default continues.

As per Section 55A, non-payment of dividend shall, in case of listed public companies and in case of those public companies which intend to get their securities listed on any recognised Stock Exchange in India be administered by the SEBI.

The obligation to post the dividend warrant and the failure to satisfy that obligation would occur at the place where the obligation has to be performed and that place would be the registered office of the company and not the address at which the warrant has to be posted. Hence, jurisdiction to punish an offence under Section 207 is of the Court at the place where the registered office of the company is situated. [*Hanuman Prasad Gupta v. Hiralal* (1970) 40 Comp. Cas 1058 (S.C)]

Under Section 205A, if a dividend declared by a company has not been paid or claimed within 30 days of the declaration, the same shall within 7 days thereafter i.e. (7 days after the expiry of 30 days from the date of declaration, have to be transferred to a special account to be opened by the company in that behalf in any scheduled bank to be called "Unpaid Dividend Account of.....Company Limited/Company (Private) Limited". Subsequently dividend claims will be met from this account. According to Section 205A(5), if any amount remains unpaid or unclaimed for a period of seven years from the date of such transfer, the amount so remaining unpaid/unclaimed together with any interest credited thereto should be transferred to the 'Investor Education and Protection Fund'.

The company had deposited the unpaid dividend into the special dividend account. Unless the petitioners had got knowledge about non-encashment, the question of transferring the said amount to an unpaid dividend account would not arise, because that amount was already in that account. [*Krebs Biochemicals Ltd. v. ROC* (2002) CLC 1564 (AP)].

The foregoing provisions shall equally apply to payment of interim dividend.

Under Section 205(3) dividend has to be paid in cash. Dividend can be distributed in cash or by issue of a cheque or warrant.

In *Krebs Biochemicals Ltd. & Ors. v. ROC* [(2003) 57 CLA 75 (AP)], the company transferred dividend to a special dividend account and also Post dividend

warrants to the shareholders within the stipulated 42 days (now 30 days) from the date of the declaration of dividend. The Registrar of companies carried out an inspection of the company on 29.09.1997 and concluded that the company had failed to transfer the unpaid dividend to the special account within the time stipulated under Section 205A(1) of the Act. The ROC initiated prosecution proceedings against the company and its directors and filed a complaint on 15.4.1998. The company and its directors challenged the prosecution before the High Court contending that it had deposited the entire dividend amount in a separate dividend account and dispatched the dividend warrants within stipulated time and that the complaint of ROC was barred by limitation also (which is 6 months as per Section 468(2) of Cr.P.C.).

Allowing the appeal of the company, the Court stated that once the limitation period begins, it cannot be stopped. The averments made in the complaint do not constitute an offence under Section 205A (8) of the Act and is barred by limitation.

Choose the correct answer

Within how many days from the date of declaration, the dividend has to be distributed?

- (a) 10 days
- (b) 20 days
- (c) 30 days
- (d) 60 days

Correct Answer: (c) 30 days

7. ESTABLISHMENT OF INVESTOR EDUCATION AND PROTECTION FUND

The provisions of Section 205C inserted with effect from 31.10.1998 are as follows:

The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter referred to as the "Fund") [Sub-section (1)].

As per sub-section (2), there shall be credited to the Fund the following amounts, namely:

- (a) amounts in the unpaid dividend accounts of companies;
- (b) the application moneys received by companies for allotment of any securities and due for refund;
- (c) matured deposits with companies;
- (d) matured debentures with companies;
- (e) the interest accrued on the account referred to in clauses (a) to (d);
- (f) grants and donations given to the Fund by the Central Government, State Government, companies or any other institutions for the purposes of the Fund; and
- (g) the interest or other income received out of the investments made from the Fund.

However, no such amounts as mentioned in (a) to (d) above shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

The explanation to Sub-section (2) of Section 205C clarifies that no claims shall lie against the Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of any such claims.

The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed [Sub-section (3)].

The Central Government shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Central Government may appoint, to administer the Fund, and maintain separate account and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor-General of India [Sub-section (4)].

It shall be competent for the authority or committee appointed under Sub-section (4) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established [Sub-section (5)].

8. DIVIDEND WARRANTS

Clause (b) of Section 205(5) specifically provides that any dividend payable in cash may be paid by cheque or warrant and it shall be deemed to have been paid when the cheque or warrant therefor is posted to the registered address or to such other address as provided by the shareholder entitled to the payment of dividend. So far as the company is concerned, the person entered in the Register of members is the holder of shares though he may be merely a benamidar having no beneficial interest in the shares for another person (a beneficiary).

“Dividend warrant” is an order by the company to its banker to pay the amount specified therein to the shareholder whose name is written therein. The shareholder may, at his discretion thereafter draw the amount of the warrant from his account with the bank and with whom he deposits the warrant for collection.

A company cannot take any notice of any private arrangement between the vendor and purchaser of shares. If a dividend warrant issued to but not received by a shareholder, is encashed by an unauthorised person directly or indirectly, the company will have to bear the loss, because in such cases the dividend cannot be said to have been paid to the registered holder within the meaning of Section 206. For this reason, a warning note is printed on the reverse of the dividend warrant to save the company from the liability due to dividend warrant falling in hands of fraudulent persons.

However, companies have also been authorised to make the payment of dividend through ECS facility.

Distribution of dividend through ECS

1. DCC/FITTC/Cir-3/2001 dated 15.10.2001 issued by the SEBI, Depositories and Custodian Cell

It has been brought to our notice that some of the companies are not utilising the facility of Electronic Clearing Services (ECS) for distributing dividends, other cash benefits, etc., to the investors. It is advised that all the companies should mandatorily use ECS facility wherever available. In the absence of availability of ECS facility, the companies may use warrants for distributing the dividends.

2. DCC/FITTC/Cir-4/2001 dated 13.11.2001 issued by SEBI, Depositories and Custodian Cell

Please refer to our Circular No. DCC/FITTC/CIR-3/2001, dt. 15.10.2001.

It is further advised that at present only some of the companies print the bank account details of the investors on the warrants (payment instrument), for distribution of dividends, other cash benefits, etc. There are some companies, which are not printing the bank account details on the payment instruments. SEBI has also received complaints about fraudulent encashment of the dividend and other cash benefit instruments. To avoid such situations the companies are advised to mandatorily print the bank accounts details furnished by the depositories, on the payment instruments.

***Dividend Mandate**

The shareholders may desire that their dividends be credited directly to their bank account. The request will be made in a form duly filled and sent to the company. This is known as 'Dividend Mandate'. This authorises the company to pay dividends directly to bank account of the shareholder. This form is also used for purposes like payment of interest on debentures and other securities.

Use of information technology in cash transaction of listed companies for payment of dividends

The shareholders have complained in the past about loss of dividend warrants sent by post due to pilferage in transit or undue delay in receipt of dividend warrants through post.

Under Section 205(5)(b) of the Companies Act, 1956 a company may remit dividend in cash or by cheque or by warrant. It is however well-known that the amount of dividend can also be transmitted electronically to the shareholders after obtaining their consent in this regard and asking them to nominate the specific bank account number to which the dividend due to them should be remitted.

The Central Vigilance Commissioner has issued an order dated 27.11.1998 directing that the Banks may switch over to remittance of dividends by computerised means as it will help to improve the vigilance administration. The Central Vigilance Commissioner has also requested the Department of Company Affairs (now Ministry of Corporate Affairs) that in the interest of greater transparency listed companies in India may be directed that they should go in for computerised cash transaction so far as payment of dividend, interest, refund etc. are concerned.

Consequently, the Ministry of Corporate Affairs, has now advised listed companies to encourage their shareholders to send their authorisation to remit dividend to their designated bank account by means of electronic transfer as this will result in avoiding delay in remittance of dividends etc.

Can Dividends be Paid out of Capital

Dividend cannot be paid out of capital, even if the articles of association

* The TDS may be printed on the reverse side of the Counterfoil (of the Dividend Warrant) duly signed by persons responsible for deduction of tax. General Circular No. 10/2003 dated 13.02.2003.

authorise such payment. As per Section 205, dividend may be paid out of the following three sources only:

- out of current profits;
- out of profits for any previous financial year or years; and
- out of moneys provided by the Central or State Government for the payment of dividend.

Directors who knowingly paid dividends out of capital shall be held personally liable to make good the amount to the company. When a misrepresentation was made to the shareholders by the directors that the dividends were being paid out of profits while they were actually paid out of capital, the shareholders would not be accountable and the directors alone would be accountable to the company [*Oxford Benefit Building & Investment Society, In re* (1886) 35 Ch. D 502]. But if the members knowingly received dividend which was paid out of capital, the directors would have a right of indemnity against such members. The shareholders cannot keep the dividend with them and have to return the amount received to the company (*Towers v. African Tug Co.* (1904) 1 Ch. 558 (CA)—*Moxham v. Grant* (1900) 1 QB 88 (CA)). In another case, due to an unintentional mistake on the part of the directors, dividend was paid out of capital, on realising/mistake the directors recovered such dividend. No action can be taken against such directors.

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

Dividend can be paid out of capital only when the Articles of Association authorise such payment.

- True
- False

Correct Answer: False

Dividend cannot be paid out of capital even if the Articles of Association authorise such payment.

9. PAYMENT OF INTEREST OUT OF CAPITAL

The normal rule of law is that dividend can be paid only out of profits and must not be paid out of capital. An exemption to the rule is contained in Section 208 which, in effect, provides that where shares are issued to raise money to defray the cost of works or building or of plant or project which cannot be made profitable for a long period, the company may pay interest on the amount of the capital paid-up in respect of such shares and may charge the same to capital as part of the cost of works, buildings or project or plant provided the following conditions are satisfied:

- (a) **Authority and Sanction of the Central Government**—The payment should be authorised by the articles. In the alternative, a special resolution is passed and prior sanction of the Central Government is obtained. Prior sanction of the Central Government is necessary even when the articles authorise such payment. Before sanctioning any such payment, the Central Government is empowered to appoint a person to inquire into and report to the Central

Government on the circumstances of the case. It may even require the company to give security for payment of the costs of the inquiry.

- (b) **Time Period**—The payment of interest shall be made only for such period as may be determined by the Central Government and that period shall in no case extend beyond the close of the half-year next after the half-year during which the work or building has been actually completed or the plant provided.
- (c) **Rate of Interest**—The rate of interest shall, in no case, exceed four per cent per annum or such other rate as the Central Government may notify in the Official Gazette.
- (d) **Charge to Capital**—The payment of interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

Payment of Dividend out of Capital Profits

The term 'capital profits' may be defined to mean those profits which arise otherwise than in the normal course of the business and earned out of capital transactions. The usual sources of capital profits are:

- (1) Profits on sale of fixed assets.
- (2) Profits on revaluation of fixed assets.
- (3) Premium on issue of shares/debentures/bonds/redemption of debentures.
- (4) Profits on reissue of forfeited shares.
- (5) Capital redemption reserve account.
- (6) Profit prior to incorporation i.e. profits which accrues to a company till the date of incorporation.

The Companies Act does not mention specifically whether capital profits i.e. profits which arise where a company sells part of its fixed assets at a price higher than the original cost of such asset, can be distributed as dividend.

However, in the two important cases of *Lubbock v. British Bank of South America* (1892) 2 Ch. 198 and *Foster v. The New Trinidad Lake Asphalt Co. Ltd.* (1901) 1 Ch.208 the courts have held that capital profits cannot be considered as available for distribution as dividend unless:

- (a) the articles of association authorise such a distribution; and
- (b) the surplus is realised and remains after a valuation of the whole of the assets and liabilities.

10. REMITTANCE OF DIVIDEND OR INTEREST OR SALE PROCEEDS TO NRIs, FOREIGNERS AND FOREIGN COMPANIES

In terms of Foreign Exchange Management (Current Account Transaction) Rules, 2000 read with AD (MA Series) Circular No.11, dated 16.5.2000, an authorised dealer is empowered to remit payment of dividend by Indian companies to non-resident shareholders. For the purpose, the authorised dealers are empowered

to devise their own documentation complying with Section 10(5) of Foreign Exchange Management Act, 1999.

Rate of Dividend on Preference Shares

Schedule 1 to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 prescribe the rate of dividend on preference shares or convertible preference shares issued under these regulations. Accordingly, the rate of dividend shall not exceed 300 basis points over the Prime Lending Rate of State Bank of India prevailing as on the date of the Board Meeting of the company in which the issue of such share is recommended.

Students may note that the Institute has published Secretarial Standard on Dividend (SS-3) and a Guidance Note on Dividend.

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

If a dividend is declared and paid to shareholders, the character of the payment cannot be altered by a subsequent resolution.

- True
- False

Correct Answer: True

ANNEXURE I

CLARIFICATIONS OF THE DEPARTMENT

Queries arising from the Companies (Transfer of Profits to Reserves) Rules, 1975 and the Companies (Declaration of Dividend Out of Reserves) Rules, 1975 answered.

The Department has received a number of queries in respect of the abovementioned rules. The points raised have been duly considered and the Department's views thereon indicated below:

Query 1: Whether arrears of depreciation mentioned in Sub-section (1) of Section 205 should also be provided before arriving at the profits for the purpose of transfer of specified percentage thereof to reserve in terms of Rule 2 of the Transfer of Profits to Reserves Rules?

Answer: Yes, arrears of depreciation mentioned in Sub-section (1) should also be provided.

Query 2: Whether the term 'current profits' used in rule 2 refers to profits after tax or before tax?

Answer: It refers to profit after tax.

Query 3: Whether the profits transferred to development rebate reserve should

be excluded in working out current profits for ascertaining the amount to be transferred to reserves under the rules?

Answer: The current profits mean profits after statutory transfer to the development rebate reserve.

Query 4: Whether reference to dividend made in the rules is to both equity and preference dividend or to equity dividend alone?

Answer: The reference is to equity dividend and also to that portion of dividend relating to participating preference shares over and above the fixed rate of preference dividend.

Query 5: Whether transfer to development rebate reserve, capital reserve or special reserve will meet the requirement of transfer to reserves under the rules?

Answer: The reply is in the negative.

Query 6: Where the proposed dividend is less than 10 per cent, is it necessary to transfer any amount to reserves under the rules?

Answer: No amount is required to be transferred to reserve in such cases.

Query 7: Whether a company can transfer to reserves a higher percentage of its dividend than that applicable to the proposed dividend slab such transfer being of less than 10 percent of its current profits.

Answer: The reply is in the affirmative.

Query 8: Whether for the purposes of Rule 3(i) it is necessary to declare a dividend?

Answer: Yes, it is necessary to declare dividend.

Query 9: Whether these Rules make the provisions of Section 5A of the Companies (Temporary Restrictions of Dividend) Act, 1974 mandatory in certain cases?

Answer: Since there is no inconsistency with the provisions of the Companies (Temporary Restrictions on Dividend) Act, the provisions of these Rules will have to be complied with.

Query 10: Whether after transfer of 10 percent of the current profits to reserve, the remaining undistributed profits could be carried forward in the profit and loss account?

Answer: The Rules do not prohibit a company from carrying forward any balance of current profit and loss account without transferring them to reserves.

Query 11: Whether for working out the average rate of dividends for the purpose of rule 2(1), no dividend years should be excluded?

Answer: The reply is in the negative.

Circular No. 8/76/(1/1/76-CL-V). Dated 18.5.1976, read with 12/76 (1/176-CL-V), dated 10.06.1976.

Enquiries have made in regard to the clarification of the term 'reserves' mentioned in the Transfer of Profits to Reserves Rules framed in pursuance of Section 205(2A). The matter has been examined and the Department is of the view that the term 'reserves' referred to in the said rules means only 'free reserves'.

Circular No. 21/76(8/30(205A)/75-CL-V), dated 19.07.1976.

Query: Rule 2 prescribes that amounts should be transferred to reserves depending on the amount of dividends to be declared. The amount to be transferred is expressed as a percentage of current profits. Neither the Act nor the rules define 'current profits'. Having regard to the word 'current' used, it would appear that past losses are not to be deducted as required for the computation of net profits under Section 349. Further, there is a controversy whether the profit should be the amount before tax or the amount after tax. Having regard to the words 'profit after tax' used in rule 3 in contradiction to the words 'current profits' used in rule 2 and the ordinary meaning of the words 'current profits', it would appear that the profits after tax have to be considered as current profits. It is not clear whether items like development rebate reserve written back or adjustments relating to previous years can be taken into account arriving at current profits.

Answer: Sub-section (2A) of Section 205 provides for the declaration or payment by a company of a dividend only after providing for depreciation and after the transfer to the reserves of a percentage of its profits. The profits available for distribution as dividends can only be the profits after tax and not before tax. The expression 'current profits' used in rules 2 and 3 of the Transfer of Profits to Reserve Rules accordingly refers to profits after tax. Further items like 'development rebate reserve' written back, or adjustments relating to previous years will also have to be taken into account before arriving at the 'current profits' for the purpose of the said Rules.

Letter No. 6/13/75-CL-XIV, dated 7.2.1976.

ANNEXURE II

Depreciation for the purpose of declaration of Dividend under Section 205 in case of companies referred to in Section 616 (C) of the Companies Act, 1956 (the Act) .

1. It has been noticed that despite having clear provision in section 616 (C) of the Companies Act, 1956, the companies engaged in the generation or supply of electricity are approaching Ministry of Corporate Affairs for fixing rate of depreciation in individual cases. The Ministry has, considered the whole matter and it is hereby clarified that Section 616 (C) the Companies Act, 1956 provides that the same shall apply to companies engaged in the generation or supply of electricity, except in so far as the said provision is inconsistent with the provisions of the Indian Electricity Act, 1910 or the Electricity Supply Act, 1948 as repealed by enactment of the Electricity Act, 2003.

2. Govt. of India, Ministry of Power vide resolution dated 6th January 2006 has notified Tariff Policy in terms of section 3 of the Electricity Act, 2003. The said Tariff Policy inter-alia provides that rates of depreciation as notified by Central Electricity Regulatory Commission (CERC) would be applicable for the purpose of tariffs as well

as accounting. CERC, while notifying regulation vide notification dated 19.01.2009, in exercise of power conferred under section 178 of the Electricity Act, 2003, has also notified the rates of depreciation as well methodology for computing such depreciation and Depreciation is to be provided up to 90% of the cost of asset.

3. Since the rates of depreciation and methodology notified under Electricity Act, 2003 are inconsistent with the rates given in Schedule XIV of the Act and the former being special Act, the former shall prevail over rates notified under Schedule XIV of the Companies Act by virtue of section 616(c) of the Companies Act. Accordingly, it is clarified that companies referred to in Section 616(c) of the Companies Act can distribute dividend out of profit arrived at after providing for depreciation following the rates as well as methodology notified by CERC and the same shall be sufficient compliance of section 205 of the Companies Act, 1956.

General Circular No. 31/2011 (No: 51/23/2011-CL-III) dated 31.05. 2011

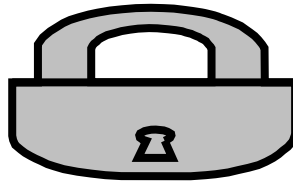
LESSON ROUND-UP



- Under Section 2(14A) of the Companies Act, 1956, 'dividend' includes any interim dividend.
- Dividend is the share of the company's profit distributed among the members.
- Final dividend is recommended by the Board of Directors in its report to the shareholders.
- The interim dividend is paid between two annual general meetings of the company.
- Both interim and final dividend when declared become debt and are payable within 30 days of declaration.
- A preference share carries a preferential right as to dividend in accordance with term of issue subject to availability of distributable profits.
- Dividend must be paid only out of profits and after providing for depreciation as provided under section 205 of Companies Act, 1956.
- Central Government is empowered to allow any company to declare or pay dividend for any financial year out of profits for that year without providing for depreciation.
- Relevant sections for calculating depreciation are Sections 205, 349, 350, Schedule XIV of the Companies Act. Companies (Transfer of profits to Reserves) Rules, 1975 are also applicable. Further in case of Absence or inadequacy of profits, declaration of dividend should be in accordance with the rules known as Companies (Declaration of Dividend out of Reserves) Rules, 1975.
- Under Section 173(1), declaration of dividend is an ordinary business at an annual general meeting.

- Dividend can be paid only in cash.
- A dividend in respect of a share has to be paid to the registered shareholder of the share or to his order or to his banker.
- Any failure to comply with the requirements of distribution of dividend renders every director liable. In case of listed companies, non payment of dividend shall be administered by SEBI also.
- Unclaimed and unpaid dividend amounts which were unclaimed and unpaid for a period of seven years from the date of becoming due shall be transferred to Investor Education and Protection Fund. No claim shall lie against the fund or the Company in respect of such amounts.
- There is an exemption to the general rule that dividend can be paid only out of profits and must not be paid out of capital. Under section 208, with the previous approval of the Central Government, interest may be paid out of capital.
- Institute of Company Secretaries of India has published Secretarial Standards on Dividend i.e., SS-3 and a Guidance Note on Dividend.

SELF TEST QUESTIONS



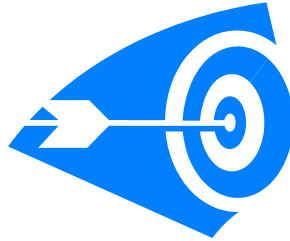
(These are meant for recapitulation only. Answer to these are not to be submitted for evaluation)

1. An equity dividend of 12% was declared at the annual general meeting of Z Ltd. The directors convened an extra-ordinary general meeting of the company to consider and approve a further 3% equity dividend for the same year, on the plea that the earlier profit were not correctly computed. Some of the shareholders of the company raised objection to this additional dividend. Examine the legality of the directors' proposal.
 2. Define Interim Dividend. Distinguish between 'Interim Dividend' and 'Final Dividend'.
 3. (a) Explain the law relating to declaration and payment of final dividend.
(b) State the legal provisions relating to disposal of unpaid and unclaimed dividend.
 4. "Interim dividend once declared becomes debt." Comment on this statement.
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STUDY XXIII

SOLE SELLING AND SOLE BUYING AGENTS

LEARNING OBJECTIVES



This lesson explains the meaning and appointment and re-appointment of sole-selling agents. It also gives powers to the Central Government to investigate in the terms of appointment of sole-selling agents and prohibit the appointment in certain cases. The lesson also enumerates the duties of a company secretary in this respect.

At the end of the lesson, you should be able to understand:

- Meaning of sole-selling agents.
- Appointment of sole-selling agents.
- Powers of the Central Government to investigate in the terms of appointment.
- Company's duty in the investigation and penalties.
- Powers of the Central Government to prohibit the appointment of sole-selling agents in certain cases.
- Re-appointment of sole-selling agents.
- Duties of a Company Secretary in connection with appointment of sole selling agents.
- Remuneration of sole-selling agents.
- Sole buying or purchasing agents.
- No compensation to sole-selling agents for loss of office.
- The Companies (Appointment of Sole Agents) Rules, 1975.

1. SOLE SELLING AGENTS — MEANING

The expression "Sole Selling Agent" has not been defined in the Companies Act, 1956. However, Section 294AA of the Act makes a mention of "individual, firm or body corporate" as a sole selling agent. Therefore, we may define a sole selling agent of a company as an individual, firm, or body corporate, who or which has been appointed by an agreement with the company as an agent with exclusive rights to sell the specified products of the company in a specified area.

The relationship of sole selling agent and the appointing company is that of a principal and an agent and is governed by the provisions contained in Chapter X of the Indian Contract Act, 1872. Section 182 of the Contract Act lays down that an "agent" is a person employed to do any act for another, or to represent another in

dealings with third persons. The relationship is to be determined not by name but by the conduct of the parties and the purpose of their dealings. The appointing company is called the "principal".

Therefore, when a company gives a person exclusive right to sell its specified goods in a specified area, he is called a "sole selling agent".

While determining whether an individual, a firm or a company is a sole selling agent or not, regard shall be had to the actual relationship existing between the parties. Though in the agreement, the expression "principal to principal basis" may be used yet its terms may lead to the conclusion that the sole selling agent has been appointed.

In *Shaligram Jhajharia v. National Company Ltd.*, (1965) 35 Comp. Cas. 706 (Cal), a company appointed a "corporation as its exclusive distributors in U.S.A., its possessions, Canada and Mexico for sale of jute backing cloth.....", the Calcutta High Court had held the corporation to be a sole selling agent. The relationship is to be determined not by name but by conduct of the parties and the purport of their dealings.

It was held in *W.T. Lamb & Sons v. Goring Brick Co.*, 1932 1 KB 710 and *Hope Prudhomme & Co v. Hamel & Horley*, A.I.R. 1925 P.C. 161 that a "sole selling agent" has to be distinguished from "a buyer with the sole right to sell the goods of a particular manufacturer".

Sole Selling Agents are not employees of company [*J.Sarabhai and Co. v. New Swadeshi Mills of Ahmedabad*, (1967) 37 Comp. Cas. 753 (Guj)].

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

The sole selling agents are the employees of the company.

- True
- False

Correct Answer: False

2. APPOINTMENT OF SOLE SELLING AGENTS

Section 294 of the Companies Act regulates the appointment of sole selling agents. It provides:

No company shall appoint a sole selling agent for any area for a term exceeding five years at a time. Provided that nothing in the foregoing shall be deemed to prohibit the re-appointment or the extension of the term of office, of any sole selling agent by further periods not exceeding five years on each occasion.

Sub-section (2) of the section, lays down that the Board of directors of a company shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. Sub-section (2A) clarifies that if the company in general meeting as aforesaid

disapproves the appointment, it shall cease to be valid with effect from the date of that general meeting.

In *Arantee Manufacturing Corporation v. Bright Bolts Pvt. Ltd.* (1967) 37 Comp. Cas. 758, the Bombay High Court had held that the provisions of Section 294(2) are mandatory and not directory and added that section 294(2) contains a condition precedent to that of its very act of making the appointment of a sole selling agent by the Board of directors. Therefore, if any appointment is made by the Board without such a condition, namely, that the appointment shall cease to be valid if it is not approved by the company in the next general meeting of the company as is mentioned in sub-section (2) of section 294 the same would be contrary to the provision and would be void *ab initio*.

In *Shaligram Jhajharia v. National Company Ltd.* (*ibid*), the Calcutta High Court had held that the agreement or the contract of appointment of sole selling agent in that case was void *ab initio* in as much as it did not contain the requisite condition mentioned in section 294(2). Therefore, there was nothing which could be approved of or ratified by the general body of shareholders.

The Department of Company Affairs, now Ministry of Corporate Affairs after examining the implications of the decision in Arantee's case had clarified that the sole selling agency agreement which does not incorporate the condition prescribed in section 294(2) will be void *ab initio* and will continue to remain so even if it is approved by the company in the first general meeting held after the date on which the appointment is made, as an agreement which is invalid from the start cannot be treated as valid if the general meeting approves it — [Circular No. 12(11)-CL VI/68/dated 06.11.1968].

If the appointment of a sole selling agent was not placed at all at the first general meeting held after the appointment, or if the appointment for some reason was not considered though placed at the first general meeting, and was thus not approved at such meeting, the appointment would be invalid from its very inception. In any case, it would become invalid after the first general meeting if the appointment was not approved at the meeting and an appointment which became invalid could not be resuscitated or revived and could not be ratified by approval at subsequent meeting. [*Shaligram Jhajharia v. National Company Ltd.* (*ibid*)].

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

A company cannot appoint a sole selling agent for any area for a term exceeding five years at a time.

- True
- False

Correct Answer: True

3. POWERS OF THE CENTRAL GOVERNMENT TO INVESTIGATE TERMS OF APPOINTMENT

Section 294(5) contains the relevant provisions. The sub-section reads:

"(a) Where a company has a sole selling agent (by whatever name called) for

an area and it appears to the Central Government that there is good reason so to do, the Central Government may require the company to furnish to it such information regarding the terms and conditions of the appointment of the sole selling agent as it considers necessary for the purpose of determining whether or not such terms and conditions are prejudicial to the interests of the company;

- (b) if the company refuses or neglects to furnish any such information, the Central Government may appoint a suitable person to investigate and report on the terms and conditions of appointment of the sole selling agent;
- (c) if after perusal of the information furnished by the company or, as the case may be, the report submitted by the person appointed under clause (b), the Central Government is of the opinion that the terms and conditions of appointment of the sole selling agent are prejudicial to the interests of the company, the Central Government may, by order, make such variations in those terms and conditions as would, in its opinion, make them no longer prejudicial to the interests of the company;
- (d) as from such date as may be specified by the Central Government in the order aforesaid, the appointment of the sole selling agent shall be regulated by the terms and conditions as varied by the Central Government.

In *Nanavati & Co. (P) Ltd. v. R.C. Dutt & Others* (1975) 45 Comp. Cas. 91, the Bombay High Court had held that the power exercisable by the Company Law Board under sub-section (5)(c) of Section 294 is neither violative of Article 14 of the Constitution nor opposed to natural justice. The Court had further held that any proceedings initiated under Sub-section (5) of Section 294 should be guided by the principles of natural justice. When the Central Government makes an order varying the terms of a sole selling agency agreement, it should give an opportunity to the sole agent or agents affected, to be heard before making any order prejudicial to him or them, even though the order may be only an administrative order.

Section 294(5)(c) empowers the Central Government to vary terms of sole selling agency, but it does not empower Central Government to change character of agency so as to make it an ordinary agent; character of selling agency has to be retained but with such terms and conditions as are no longer prejudicial to the interests of company.

With regard to the investigation of the terms and conditions of appointments by a company which has more selling agents than one in any area or areas and in accordance with the provisions of sub-section (6) of section 294 of the Act, if it appears to the Central Government that there are good reasons so to do, the Central Government may require the company to furnish to it such information regarding the terms and conditions of appointment of all the selling agents as it considers necessary for the purpose of determining whether any of those selling agents should be declared to be the sole selling agent for such area or any of such areas.

According to sub-section (6)(b) of section 294, if the company refuses or neglects to furnish any such information, the Central Government may appoint a suitable person to investigate and report on terms and conditions of appointment of all the selling agents.

Sub-section 6(c) of Section 294 confers further powers on the Central Government. It lays down: "if after perusal of the information furnished by the company or, the report submitted by the person appointed under clause (b), as the case may be the Central Government is of the opinion that having regard to the terms and conditions of appointment of any of the selling agents and to any other relevant factors, that selling agent is for all intents and purposes, the sole selling agents for such area, although there may be one or more other selling agents of the company operating in that area, the Central Government may by order declare that selling agent to be the sole selling agent of the company for that area with effect from such date as may be specified in the order and may make suitable variations in such of the terms and conditions of appointment of that selling agent as are, in the opinion of the Central Government, prejudicial to the interests of the company." As from the date specified in clause (c) appointment of the sole selling agent declared to be the sole selling agent, shall be regulated by the terms and conditions as varied by the Central Government [Section 294(6)(d)].

Company's Duty in Investigation

Sub-section (7) of section 294 lays down that : "It shall be the duty of the company—

- (a) to produce to the person appointed under clause (b) of sub-section (5) or clause (b) of sub-section (6), all books and papers of, or relating to, the company which are in its custody or power; and
- (b) otherwise to give to that person all assistance in connection with the investigation which the company is reasonably able to give.

Penalty for not complying Section 294(7)

Sub-section (8) of section 294 contains penalty provision in the event of the company refusing or neglecting to comply with the provisions of sub-section (7). It lays down:

"(8) If a company refuses or neglects —

- (a) to furnish the information required by the Central Government under clause (a) of sub-section (5) or clause (a) of sub-section (6), or
- (b) to produce to the person appointed under clause (b) of sub-section (5) or clause (b) of sub-section (6) any books and papers which are in its custody or power or otherwise to give to that person any assistance which it is reasonably able to give,

the company and every officer of the company who is in default shall be punishable with fine which may extend to fifty thousand rupees and with a further fine of not less than five hundred rupees for every day after the first during which such refusal or neglect continues".

4. POWER OF THE CENTRAL GOVERNMENT TO PROHIBIT THE APPOINTMENT OF SOLE SELLING AGENT IN CERTAIN CASES (SECTION 294AA)

Section 294AA of the Companies Act, 1956 imposes restrictions on the appointment of sole selling agents and vests in the Central Government power to prohibit the appointment of sole selling agents in certain cases.

Sub-section (1) of the Section lays down:

"(1) Where the Central Government is of opinion that the demand for goods of any category, to be specified by that Government, is substantially in excess of the production or supply of such goods and that the services of sole selling agents will not be necessary to create a market for such goods, the Central Government may, by notification in the Official Gazette, declare that sole selling agents shall not be appointed by a company for the sale of such goods for such period as may be specified in the declaration."

Ministry of Corporate Affairs vide its notification No. G.S.R. 601(E) dated 16.07.2010 provides that in exercise of the powers conferred by sub-section (1) of Section 294AA of the Companies Act, 1956 (1 of 1956), the Central Government, being of the opinion that the demand for the category of goods specified in the Table below is substantially in excess of the production or supply of such goods and that the services of the sole selling agents will not be necessary to create a market for such goods, hereby declares that sole selling agents shall not be appointed by any company for the sale of such goods in India for a period of three years from the date of publication of this notification in the Official Gazette.

TABLE

Every category of "Bulk drugs", "drugs" and "formulations" as defined in the Drugs (Prices Control) Order, 1995, not being, –

- (i) any bona fide preparation included in the Ayurvedic (including Siddha) or Unani (Tibb) systems of medicine; or
- (ii) any preparation included in the Homeopathic system of medicine.

The Central Government has been given power to approve or to refuse to approve the appointment of a sole selling agent, who has a substantial interest in the company. Sub-section (2) of section 294AA lays down: "No company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as sole-selling agent of that company unless such appointment has been previously approved by the Central Government".

The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that in case the provisions of Section 294AA (2) are not attracted to the appointment of sole selling agents at the time of entering into the agreement with them, it will not be obligatory on the companies to comply with the said provisions for the continuance of the said appointment for the remaining duration of their current tenure but not during any extension thereof, even if the provisions of sub-section (2) of section 294AA become applicable after the appointment due to the sole selling agent's acquiring substantial interest as defined in the Explanation under the Section (vide Circular No. 1/78 dated 7.3.1978).

The provisions of Sub-section (3) of Section 294AA of the Act are more stringent. They are: "No company having a paid-up share capital of rupees fifty lakhs or more shall appoint a sole selling agent except with the consent of the company accorded by a special resolution and the approval of the Central Government."

However, it has been clarified by the Department of Company Affairs, now Ministry of Corporate Affairs, that where the provisions of section 294AA(3) were not attracted to the appointment of sole selling agent at the time of entering into an agreement with the sole selling agent, it will not be obligatory on the companies to comply with the said provisions for the continuance of the appointment already made for the remaining duration of the current tenure even if section 294AA(3) becomes applicable after the appointment due to increase in capital. (Vide Circular No. 11/17 dated 21.11.1977).

The term "**substantial interest**" has been defined in Explanation (b) to sub-section (8) of section 294AA as:

- (i) in relation to an individual, means the beneficial interest held by such individual or any of his relatives, whether singly or taken together, in the shares of the company, the aggregate amount paid-up on which exceeds five lakhs of rupees or five per cent of the paid-up share capital of the company, whichever is the lesser;
- (ii) in relation to a firm, means a beneficial interest held by one or more partners of the firm or any relative of such partners, whether singly or taken together, in the shares of the company, the aggregate amount paid-up on which exceeds five lakhs of rupees or five per cent of the paid-up share capital of the company, whichever is the lesser;
- (iii) in relation to a body corporate, means the beneficial interest held by such body corporate or one or more of its directors or any relative of such director, whether singly or taken together, in the shares of the company, the aggregate amount paid-up on which exceeds five lakhs of rupees or five per cent of the paid-up share capital of the company, whichever is the lesser.'

The object of this provision is to safeguard against the siphoning of the company's funds by way of commission charged by the sole selling agents having substantial interest in the company to the detriment of other shareholders.

In order to keep check on the undesirable activities of the managing/whole-time directors to appoint such organisations as selling agents in which they are interested either directly and/or through their family members, the Central Government takes into consideration the following guidelines:

- (a) Where the involvement of the proposed sole selling agent either directly or through his family members, in the selling agency is quite substantial, the appointment is not approved.
- (b) Where, however, the interest of the proposed sole selling agent and/or his family members in the selling agency is nominal, then the appointment is approved but with certain conditions to safeguard the interest of the company.
- (c) Where it is not expressly stated, the Central Government directs the concerned company to incorporate a clause, on the following lines, in the agreement with the Managing Directors: "The Managing Director shall not, so long as he functions as such, become interested or otherwise concerned directly or through his wife and/or minor children in any selling agency of the company in future without the prior approval of the Central Government.
- (d) Where it is found that the appointment of the sole selling agency/company as also the person proposed as managing/whole-time director is essential for

the efficient conduct of the business of the company, the Central Government while fixing his managerial remuneration, takes into account the monetary benefits which the appointee concerned, directly or indirectly will be getting from the selling agency company. (Company Law Board's Annual Report 1968-69, Para 95).

The Central Government has notified the Companies (Appointment of Sole Agents) Rules, 1975 containing rules and forms of application for approval by the Central Government to the appointment of the sole selling agents by companies. It may be mentioned here that some of these provisions are equally applicable to the appointment of sole purchasing or buying agents appointed by companies.

Sub-section (7) of Section 294AA clarifies that if a company in general meeting disapproves the appointment referred to in Sub-section (3), the appointment if already made by the Board of directors, shall cease to have effect from the date of the general meeting even though the Central Government may have accorded its approval.

The provisions of the Act with regard to appointment of sole selling agents may be tabulated as under:

<i>Paid-up capital structure of the company appointing sole selling agents</i>	<i>Statutory requirements for the appointment of sole selling agents</i>
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1	2
Where the company's paid up share capital is less than rupees fifty lakhs.	Ordinary resolution – Section 294(2)
Where the company's paid-up share capital is rupees fifty lakhs or more.	Special resolution and approval of the Central Government – Section 294AA(3)
Where the company's paid-up share capital is less than rupees fifty lakhs but the proposed sole selling agent has substantial interest in the company.	Previous approval of the Central Government and consent of the company in general meeting by ordinary resolution – Section 294AA(2) read with 294(2)
Where the company's paid-up share capital is rupees fifty lakhs or more and the proposed sole selling agent has substantial interest in the company.	Previous approval of the Central Government and consent of the company in general meeting by special resolution – Section 294AA(2) and (3).

Choose the correct answer

Where the company's paid-up share capital is rupees fifty lakhs or more and the proposed sole selling agent has substantial interest in the company, which of the following formalities are required to be complied with:

- (a) Previous approval of the Central Government.
- (b) Consent of the company in General Meeting by special resolution.
- (c) Previous approval of the Central Government and consent of the company in general meeting by special resolution.
- (d) None of the above.

Correct Answer: c

5. RE-APPOINTMENT OF SOLE SELLING AGENTS

The term 'appointment' in relation to sole selling agent and sole buying or purchasing agent includes re-appointment. [Explanation (a) to section 294AA]. Therefore, initially the appointment can be made for a period of five years only, but the term may be extended from time to time for five years on each occasion [Section 294(1) and the proviso].

6. DUTIES OF A COMPANY SECRETARY IN CONNECTION WITH APPOINTMENT OF SOLE SELLING AGENTS

It is the duty of the Company Secretary —

- (a) to ensure that appointment of sole selling agent is not prohibited by the Central Government under section 294AA;
- (b) to examine carefully, the terms and conditions of appointment of the proposed sole selling agent keeping in view, inter alia, the provisions of the Indian Contract Act, 1872 and also the M.R.T.P. Act, 1969;
- (c) to ensure that the sole selling agency agreement is properly drafted and in a precise language free of words and expression which may be opened to varying interpretations;
- (d) to place the proposal for the appointment before the Board of directors of the company in all its details and with full disclosures, particularly the interest of any of the directors of the company;
- (e) to ensure that the Board resolution approving the appointment contains authorisation for execution of the agreement for and on behalf of the company, for affixation of the common seal of the company in the presence of the authorised directors and persons in accordance with the provisions of the articles of association of the company. The resolution must also contain authority in favour of the company secretary to file a certified true copy with the Registrar of Companies;
- (f) to have the appointment approved by the shareholders by ordinary or special resolution, as the case may be, at the general meeting held after the appointment, for which the company secretary must have issued notice under the authority of the Board of directors of the company and also appended thereto the prescribed Explanatory Statement as laid down in Section 173(2) of the Companies Act;
- (g) to make application to the Central Government for approval of the appointment of the sole selling agent, in the prescribed e-Form I as per Rule 2 of the Companies (Appointment of Sole Agents) Rules, 1975, either before appointment or subsequent to the appointment, as the case may be.

7. CONDITION TO FORM PART OF AGREEMENT

The agreement to be entered into by and between the company and the sole selling agent (appointed by the Board of directors) must contain the conditions as prescribed in section 294(2) of the Companies Act, "that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made."

8. REMUNERATION OF SOLE SELLING AGENTS

The Companies Act, 1956 does not specify or limit the remuneration payable to the sole selling agents. However, the remuneration should not be excessive and should be commensurate with the nature of services being rendered. The quantum of remuneration is subject to the approval by the company in general meeting by a special resolution and also by the Central Government in the case of those companies whose paid-up share capital is rupees fifty lakhs or more.

9. SOLE BUYING OR PURCHASING AGENTS

Sub-section (8) of Section 294AA of the Companies Act provides that the provisions of the section except those of sub-section (1), shall apply so far as may be to the appointment by company of a sole agent for buying or purchasing of goods on behalf of the company. It means that a company shall not appoint any individuals, firm or body corporate having substantial interest in the company as its sole buying or purchasing agent unless such an appointment has been previously approved by the Central Government.

A company having a paid-up share capital of rupees fifty lakhs or more shall not appoint a sole buying or purchasing agent except with the consent of the company accorded by a special resolution and the approval of the Central Government.

If the company in general meeting disapproves the appointment of the sole buying or purchasing agent, such appointment shall cease to have effect from the date of the general meeting.

A company seeking approval for appointment of sole buying or purchasing agent shall furnish to the Central Government such particulars as may be prescribed.

Section 294AA (4) of the Act provides that the provisions of Sub-sections (5), (6) and (7) of section 294 of the Act shall so far as may be, apply to the sole purchasing or buying agents of a company.

The appointing company has to make an application to the Central Government for its approval to the appointment, in Form II under Rule 2 of the Companies (Appointment of Sole Agents) Rules, 1975.

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

The appointment of a sole selling agent shall be cease to be valid if it is not approved by the company in the first General Meeting held after the date on which the appointment is made.

- True
- False

Correct Answer: True

10. NO COMPENSATION TO SOLE SELLING AGENT FOR LOSS OF OFFICE

According to Section 294A, no company shall pay or be liable to pay any

compensation to its sole selling agent for the loss of his office in the following cases:

- (a) where the appointment of the sole selling agent ceases to be valid by virtue of sub-section (2A) of section 294;
- (b) Where the sole selling agent resigns his office in view of the reconstruction of the company or its amalgamation with any other body corporate or bodies corporate and is appointed as the sole selling agent of the reconstructed company or of the body corporate resulting from the amalgamation;
- (c) where the sole-selling agent resigns his office, otherwise than on the reconstruction of the company or its amalgamation as aforesaid;
- (d) where the sole selling agent has been guilty of fraud or breach of trust in relation to, or of gross negligence in, the conduct of his duty as the sole selling agent;
- (e) where the sole selling agent has instigated or has taken part directly or indirectly in bringing about the termination of the sole selling agency.

In other cases compensation for loss of office may be paid.

With regard to the amount of compensation payable to a sole selling agent in the event of loss of his office, Sub-section (2) of Section 294A lays down:

"The compensation which may be paid by a company to its sole selling agent for loss of office shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term, or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which his office ceased or was terminated, or where he held his office for a lesser period than three years, during such period."

11. MEANING OF RELATIVE

Section 6 of the Companies Act, 1956, states that a person shall be deemed to be a relative of another, if, and only if;

- (a) they are members of Hindu Undivided Family; or
- (b) they are husband and wife; or
- (c) the one is related to the other in the manner indicated in Schedule IA to the Act.

Schedule IA to the Companies Act, 1956 gives the following list of relatives:

1. Father
2. Mother (including step-mother)
3. Son (including step-son)
4. Son's wife
5. Daughter (including step-daughter)
6. Father's father
7. Father's mother

8. Mother's mother
9. Mother's father
10. Son's son
11. Son's son's wife
12. Son's daughter
13. Son's daughter's husband
14. Daughter's husband
15. Daughter's son
16. Daughter's son's wife
17. Daughter's daughter
18. Daughter's daughter's husband
19. Brother (including step-brother)
20. Brother's wife
21. Sister (including step-sister)
22. Sister's husband.

12. THE COMPANIES (APPOINTMENT OF SOLE AGENTS) RULES, 1975

In exercise of the powers conferred by Section 294AA read with Clause (a) of sub-section (1) of section 642 of the Companies Act, 1956, the Central Government, vide Notification G.S.R. No. 137(E) dated 1.3.1975, made the Companies (Appointment of Sole Agents) Rules, 1975. The Rules came into force with effect from March 1, 1975.

Rule 2 of the said Rules provides that every company seeking approval of the Central Government for the appointment of sole selling agents or sole agents for the buying or purchasing of goods on behalf of the company under section 294AA of the Companies Act, 1956, shall apply in Form I or Form II, respectively, and furnish the particulars specified therein.

Rule 2A of these rules provides that the Forms prescribed in these rules may be filed through electronic media or through any other computer readable media as referred under Section 610A of the Companies Act, 1956 (1 of 1956);

Rule 2B provides that the electronic form shall be authenticated by the authorised signatories using digital signatures, as defined under the Information Technology Act, 2000 (21 of 2000);

Rule 2C provides that the Forms prescribed in these rules, when filed in physical form, may be authenticated by authorized signatory by affixing his signature manually.

Rule 3 of the said Rules lays down that every application made by a company under these Rules shall be accompanied by the following:

1. Application fee as per details given below:

(GSR 501, dated 6.7.1999 refers)

Companies with authorized capital	Amount of fee
(a) Less than ₹ 25 lacs	₹ 500/-
(b) ₹ 25 lacs or more but less than ₹ 5 crores	₹ 1000/-
(c) ₹ 5 crores or above	₹ 2000/-

Application fee shall be paid by Demand Draft drawn in favour of Pay and Accounts Officer, Ministry of Corporate Affairs, New Delhi.

Rule 3 provides for the payment options. Accordingly, where application is filed through electronic media or through any other computer readable media, the user may choose any one of the following payment options namely (i) Credit Card; or (ii) Internet Banking; or (iii) Remittance at the Bank Counter; or (iv) any other mode as approved by Central Government. The requisite fee as specified in the Companies (Fees on Applications) Rules, 1968, shall be payable through any of the accredited branches of following Banks—

- (a) Punjab National Bank
- (b) State Bank of India
- (c) Indian Bank
- (d) ICICI Bank
- (e) HDFC Bank.

The Rules also contain Form I and Form II relating to application for Central Government's approval for appointment of agents.

Attachments with Form I

1. Certificate from the auditor of the sole selling agent certifying the figure of expenditure
2. Copy of proposed agreement
3. Details of the interest of the sole selling agent in the shares of the company
4. Copy of the particulars of directorship in the company held or controlled by the sole selling agent
5. Particulars of inter-se relationship to other sole selling agent in other areas for same products of the company
6. Break-up of sales in respect of each of the last three years (In respect of the product in which the sole selling agent under consideration has been appointed and for the territory for which he has been so appointed)
7. Foreign shareholding in the principal company and the sole selling agent and the profits remitted to the foreign countries on these shareholdings during the last three years
8. In case the sole selling agent is a partnership firm, details of working partners, details of capital invested in the partnership firm during the last three years and details of the profits earned by the partners during the last three years
9. Optional attachment(s) – if any

Attachments with Form II

1. Copy of certificate from the auditor of the sole buying agent certifying the figure of expenditure.
2. Copy of proposed agreement.
3. Details of the interest of the sole buying agent in the shares of the company.
4. Copy of the particulars of directorship in the company held or controlled by the sole buying agent.
5. Details of persons and their relationship to the directors of the buying agency.
6. Optional attachment(s) – if any.

13. GUIDELINES FOR FILING STATUTORY APPLICATIONS UNDER SECTION 294AA OF THE COMPANIES ACT 1956

An application submitted under Section 294AA of the Companies Act, 1956 should be in accordance with the Companies (Appointment of Sole Agents) Rules, 1975 and be accompanied by the following:

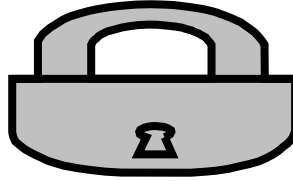
- A copy each of certified copies of Board of Directors resolution/and Special Resolution by members approving the proposal to appoint Sole Selling Agent and the terms and conditions of appointment.
- A copy of previous approval obtained from the Central Government in respect of appointment of the Sole Selling Agents for earlier period, if any.
- A certified copy of the Marketing/Sole Selling Agency Agreement proposed to be entered into with the Sole Selling Agents.
- Percentage of shares held by the applicant company, its directors and their relatives in the Sole Selling Agent/profit sharing ratio, if the proposed Sole Selling Agent is a partnership firm.
- Percentage of shares held by the Sole Selling Agents, its directors and their relatives in the applicant company/their profit-sharing ratio.
- Justification for variation, if any, of rate(s) of commission for earlier appointment and those proposed (in case of reappointment(s)).

LESSON ROUND-UP



- Sole selling agent of a company means an individual, firm, or body corporate, who or which has been appointed by an agreement with the company as an agent with exclusive rights to sell the specified products of the company in a specified area.

- The relationship of sole selling agent and the appointing company is that of a principal and an agent and is governed by the provisions of the Indian Contract Act, 1872.
- No company shall appoint a sole selling agent for a term exceeding the prescribed period. Provided that nothing in the forgoing shall be deemed to prohibit the re-appointment or the extension of the term of office, of any sole selling agent by further periods as prescribed.
- The Act empowers the Central Government to vary terms of sole selling agency but not the character of the agency. If it appears to the Central Government that there are good reasons so to do, the Central Government may require the company to furnish to it such information regarding the terms and conditions of appointment of all the selling agents as it consider necessary for the purpose of determining whether any of those selling agents should be declared to be the sole selling agent for such area or any of such areas.
- The company's duties have also been identified in the investigation process. Penalty in the event of the company refusing or neglecting to comply with the specified provisions has been imposed under the Act.
- The Companies Act imposes restrictions on the appointment of sole selling agents and vests in the Central Government power to prohibit the appointment of sole selling agents in certain cases.
- The provisions of the Companies Act with regard to appointment of sole selling agents are summarized in the following sentences:
 - (i) If a company's paid up share capital is less than rupees fifty lakhs, an ordinary resolution has to be passed for the appointment of sole selling agent.
 - (ii) If the company's paid-up share capital is rupees fifty lakhs or more, Special resolution and approval of the Central Government is required to be passed for the appointment of sole selling agent.
 - (iii) Where the company's paid-up share capital is less than rupees fifty lakhs but the proposed sole selling agent has substantial interest in the company, previous approval of the Central Government and consent of the company in general meeting by ordinary resolution is required for the appointment of sole selling agent.
 - (iv) Where the company's paid-up share capital is rupees fifty lakhs or more and the proposed sole selling agent has substantial interest in the company, previous approval of the Central Government and consent of the company in general meeting by special resolution is required for the appointment of sole selling agent.
- The term 'appointment' in relation to sole selling agent and sole buying or purchasing agents includes re-appointment.
- The company secretary has also been given certain duties in this respect under the Act.
- The remuneration of the sole-selling agents should not be excessive and should be commensurate with the nature of services being rendered.
- A company shall not appoint any individual, firm or body corporate having substantial interest in the company as its sole buying or purchasing agent unless such an appointment has been previously approved by the Central Government.
- No company shall pay or be liable to pay any compensation to its sole selling agent for the loss of his office in the cases enumerated under the Act.
- In respect of appointment of sole-selling agents, the Central Government has made the Companies (Appointment of Sole Agents) Rules, 1975.

SELF-TEST QUESTIONS

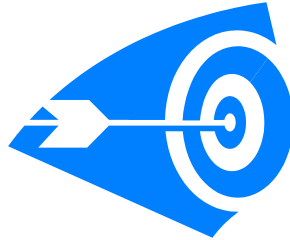
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. XYZ Ltd., has several factories producing a number of consumable goods. The company desires to appoint a sole selling agent for two of its major products for the whole of India. The company's present paid-up capital is ₹ 10 crores. Prepare a note for the Board detailing legal requirements and restrictions, if any, on such appointments.
 2. Explain and illustrate the meaning of 'relative' under the Companies Act, 1956.
 3. Analyse in detail the provisions relating to appointment of sole selling agents.
 4. Explain how the provisions of the Companies Act, 1956 regarding appointment of 'sole selling agents' protect the interests of the shareholders of the company and consumers.
 5. Explain the provisions relating to the re-appointment of Sole-Selling Agent.
 6. Is there any law relating to the remuneration of Sole Selling Agent?
 7. What is the scope of power of the Central Government in relation to the appointment of Sole Selling Agent?
 8. Prepare a note detailing various restrictions on the appointment of sole selling agents for consideration of your sales director, who is planning to appoint sole selling agent.
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STUDY XXIV

BOARD'S REPORT AND DISCLOSURES

LEARNING OBJECTIVES



It is mandatory for the Board of Directors of every company to present annual accounts to the shareholders along with its report, known as the “Board’s Report”. The Board’s Report enables shareholders, lenders, bankers, government and the public to make an appraisal of the company’s performance. It also reflects the level of corporate governance in the company. After going through this chapter, you will be able to learn the following:

- Introduction
- Disclosures under Companies Act
- Disclosures under Listing Agreement
- Disclosures pursuant to directions of RBI
- Approval, Signing and Dating of the Board’s Report
- Filing of the Board’s Report
- Right of Members to copies of Balance Sheet, Board’s Report, etc.
- Liability for mis-statement
- Chairman’s Speech
- Compliance Certificate
- Need for Compliance Certificate
- Scope of Compliance Certificate
- Penalty for Non-compliance, for false Compliance Certificate
- Certification without Qualification
- Professional Responsibility.

1. INTRODUCTION

The Board of Directors of a company must strive to maximize wealth while adhering to good corporate governance principles and practices. The efficacy of the Board of Directors is not determined simply by gauging whether it fulfils its legal requirements but, more importantly, by its philosophy and the manner in which it translates the understanding of its responsibilities for the benefit of the stakeholders of the company.

The Board’s Report, is a comprehensive document circumscribing both financial

and non-financial information, serving to inform the stakeholders about the performance and prospects of the company, relevant changes in management, capital structure, major policies, recommendations as to the distribution of profits, future programmes of expansion, modernization and diversification, capitalization of reserves, further issue of capital, etc.

The matters to be included in the Board's Report have been specified in Section 217 of the Companies Act, 1956. Apart from this, Sections 212, 219, 220, 222, 292A and 383A of the Companies Act, 1956 also contain provisions in relation to the Board's Report. The Board's Report of companies whose shares are listed on a stock exchange must include additional information as specified in the Listing Agreement. Further, the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992 and the regulations, rules, directions, guidelines, circulars, etc. issued thereunder, necessitate certain additional disclosures to be made in the Board's Report.

DISCLOSURES UNDER COMPANIES ACT

Disclosures under Section 217(1)

Section 217(1) provides that there shall be attached to every balance sheet laid before a company in general meeting (in practice, the annual general meeting) a report by its Board of Directors, with respect to:

- (a) the state of the company's affairs;
- (b) the amount, if any, which it proposes to carry to any reserves in such balance sheet;
- (c) the amount, if any, which it recommends should be paid by way of dividend;
- (d) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the balance sheet relates and the date of the report.
- (e) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.

For proper appreciation of State of Affairs of the Company, information like financial results, further issue of capital or debentures; change in accounting year; production and sales targets and achievement thereof; marketing policies; manpower training and executive development programmes may be disclosed.

The Board's Report should disclose the amount which has been transferred to reserves in the balance sheet, for instance, general reserve, debenture redemption reserve, capital redemption reserve, etc. if no amount is proposed to be transferred to reserves, a statement to that effect should be incorporated in the Board's Report.

Regarding recommendation of dividend in the Board's Report, it should not be recommended subject to any condition such as approval of financial institutions or banks or foreign collaborators or compliance with any contractual obligations.

Further, if any interim dividend has been paid during the year, details of the

amount per share and percentage of such interim dividend should also be disclosed in the Board's Report.

Regarding events occurring after the balance sheet date and before AGM, which affects materially the solvency of the undertaking of the company or is otherwise of great importance to the shareholders cannot be taken into account in drawing up the balance sheet and the profit and loss account, Professional bodies have recommended that such an event should be brought to the notice of the shareholders either in the directors' report or in the chairman's statement. Although the expression "material changes and commitments if any, affecting the financial position of the company..." occurring in the new clause (d) of Sub-section (1) of Section 217 seems to be clear enough to itself, it may be stated, purely by way of illustration, that the expression would include event such as the following, namely, the disposal of a substantial part of the undertaking, the profit or loss whether of a capital or revenue nature, changes in the capital structure, alteration in the wage structure arising out of trade union negotiations, purchases, construction, sale or any catastrophe befalling the fixed assets, incurring or any reduction of long term indebtedness, awards in litigation entering to a cancellation of contracts and refund of taxes or completion of assessments. [Department of Company Affairs (now MCA) Vide Letter No. 8/16(1)61-PR dated 9.5.1961].

The Board's Report should include a statement as per the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988 with respect to the matters of conservation of energy; technology absorption and foreign exchange earnings and outgo.

Under the above mentioned rules, Board Report should include details of consumption of electricity, coal and furnace oil and others, either from internal generation or otherwise under the prescribed Form 'A'. Apart from this reasons for variation in the consumption of power and fuel from standards of previous year and separate details for different products/items produced by the company and covered under these rules are also to be mentioned. These rules are applicable to twenty-one industries listed in schedule attached to the rules.

Although clause (e) of Sub-section (1) of Section 217 does not make any specific mention of research and development efforts made by the company, though details of these are to be disclosed under Form 'B' of the Rules. It lays down particulars to be disclosed in respect of technology absorption. This Form is divided into two parts - one relating to Research and Development and other relating to technology absorption, adaptation and innovation. Technology absorption, innovation, adaptation and Research and Development are interrelated items. It is significant to note that disclosure in respect of imported technology during the last five years reckoned from the beginning of the financial year should be included.

Section 217(1) (e) uses the expression 'foreign exchange earnings and outgo'; particulars of disclosure relating to this are covered in these rules. It includes activities relating to exports; initiatives taken to increase exports; development of new export markets for products and services; and export plans and total foreign exchange used and earned.

It is pertinent to note that as regards foreign exchange earnings and outgo, details are required to be furnished as per the requirements of Part II of Schedule VI.

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

The Board's report is a comprehensive document circumscribing both financial and non-financial information about the performance and prospects of the company for the benefit of the stakeholders.

- True
- False

Correct answer: True

Multiple choice question

What are the contents of the Board's report with regard to disclosures as per the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988?

- (a) Matters relating to energy conservation
- (b) Matters relating to water consumption
- (c) Matters relating to technology absorption
- (d) Matters relating to foreign exchange earnings and outgo

Correct answer: a, c and d

The Board's report should include a statement as per the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988, with respect to the matters of conservation of energy, technology absorption and foreign exchange earnings and outgo.

Disclosures under Section 217(2)

The Board's report shall, so far as is material for the appreciation of the state of the company's affairs by its members and will not in the Board's opinion be harmful to the business of the company or of any of its subsidiaries, deal with any changes which have occurred during the financial year:

- (a) in the nature of company's business;
- (b) in the company's subsidiaries or in the nature of the business carried on by them; and
- (c) generally in the classes of business in which the company has an interest.

Accounts of Holding and Subsidiary Companies

The Balance sheet of a holding company, which is placed before the shareholders for adoption in an annual general meeting under Section 210, should have attached to it the following documents relating to each of its subsidiaries (Section 212):

- (a) a copy of the balance sheet of the subsidiary;
- (b) a copy of its directors' report';
- (c) a copy of its profit and loss account;
- (d) a copy of its auditors report';
- (e) a statement containing the following particulars:
 - (1) The extent of holding company's interest in the subsidiary at the end of the last financial year.

- (2) The net aggregate amount of profits or losses in the subsidiary so far as it concerns the members of the holding company and is not dealt with in the holding company' accounts;
- (3) The net aggregate amount of profits or losses in the subsidiary so far as those profits are dealt with or provision is made for those losses, in the holding company's accounts
- (4) Any change in the holding company's interest in the subsidiary between the end of the financial year of the subsidiary and financial year of the holding company;
- (5) Details of any material change occurring between the end of the financial year of the subsidiary and the financial year of the holding company in respect of:
 - (i) the subsidiary's fixed assets;
 - (ii) its investments;
 - (iii) the moneys lent by it; and
 - (iv) the moneys borrowed by it for any purpose other than that of meeting current liabilities.

Where the Board of directors of the holding company is unable to obtain the necessary information for the purpose aforesaid, then a report to that effect should be attached to the balance sheet of the holding company. [Section 212(6)]

The Central Government may, on the application or with the consent of the Board of directors of the company, waive the compliance of these requirements either wholly or to such an extent, as may be directed, in relation to any subsidiary [Section 212(8)]. The profit and loss account, the report of the Board of directors and the report of the auditors in respect of the subsidiary company are to be made out in the same manner as required under the Act for the holding company.

Where any person responsible for securing compliance with the provisions of Section 212, fails to take all reasonable steps to comply with the provisions of this section, he shall, in respect of each offence be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ten thousand rupees or with both.

Provided that in any proceedings against a person in respect of an offence under this section it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that the provisions of this section were complied with and was in a position to discharge that duty. It is also provided that no person shall be sentenced to imprisonment for such offence unless it was committed wilfully [Section 212(9)].

The financial year of the subsidiary company may end on the same day or not as that of the holding company, but should not be earlier than six months from the day on which the holding company's financial year ends. [Section 212 (2)(c)]. Where the subsidiary has a shorter year, then the documents referred to above should be for two or more financial years, the total duration of which is not less than the duration of the financial year of the holding company. Section [212 (2)(d)]: A holding company may by resolution, authorise its representatives to inspect the books of its subsidiaries.

With a view to securing uniformity where it appears to the Central Government desirable for a holding company or a holding company's subsidiary, to extend its financial year and for that purpose to postpone the submission of the relevant accounts, to a general meeting, the Central Government may, under Section 213 on the application of or with the consent of the directors of the company whose financial year is to be extended, direct that in the case of that company, the submission of accounts to a general meeting, the holding of an annual general meeting or the making of an annual return shall not be required to be submitted, held or made, earlier than the dates specified in the direction.

Under Section 212(1)(e) of the Companies Act, a statement of the holding company's interest in the subsidiary as specified in Section 212 (3) shall be attached to the balance sheet of a holding company having a subsidiary at the end of the financial year as at which the holding company's balance sheet is made out. No standard form in respect of the statement referred to above has, however, been given in the Act. The statement referred to in the above section is to be signed by two persons by whom the balance sheet of the holding company is required to be signed. This statement is not required to be certified by the Auditors.

Besides the compliance of the provisions of Section 212 of the Companies Act, 1956, the companies shall also comply with the requirements of Accounting Standard 21 issued by the Institute of Chartered Accountants of India.

Power of the Central Government under section 212(8) of the Companies Act, 1956

As per section 212 (8) of the Companies Act, 1956, the Central Government may, on the application or with the consent of the Board of directors of the company, direct that in relation to any subsidiary, the provisions of this section shall not apply, or shall apply only to such extent as may be specified in the direction. Therefore, an application can be made by the holding company to the Central Government for a direction that the provisions of section 212 shall not apply, or shall apply only to such extent as may be specified in the direction. An application under sub-section (8) has to be made electronically in the prescribed e-form 23AAB.

Ministry of Corporate Affairs (MCA) vide its Circular No. 2 /2011 dated 8th February, 2011 has given direction under Section 212(8) of the Companies Act, 1956.

Reason for giving such direction

A large number of companies approach the Ministry for exemption under Section 212(8) of the Companies Act, 1956. The Ministry examined the matter in the context of the globalizing Indian economy, the increased number of subsidiaries, and the introduction of accounting standards on consolidated financial statements and decided that a general exemption be granted subject to fulfillment of certain conditions.

Direction under Section 212(8) of the Companies Act, 1956

The Central Government vide its Circular No. 2 /2011 dated 8th February, 2011 directs that the provisions of Section 212 shall not apply in relation to subsidiaries of

those companies which fulfill the following conditions:

- (i) The Board of Directors of the Company has by resolution given consent for not attaching the balance sheet of the subsidiary concerned;
- (ii) The company shall present in the annual report, the consolidated financial statements of holding company and all subsidiaries duly audited by its statutory auditors;
- (iii) The consolidated financial statement shall be prepared in strict compliance with applicable Accounting Standards and, where applicable, Listing Agreement as prescribed by the Security and Exchange Board of India;
- (iv) The company shall disclose in the consolidated balance sheet the following information in aggregate for each subsidiary including subsidiaries of subsidiaries:—(a) capital (b) reserves (c) total assets (d) total liabilities (e) details of investment (except in case of investment in the subsidiaries) (f) turnover (g) profit before taxation (h) provision for taxation (i) profit after taxation (j) proposed dividend;
- (v) The holding company shall undertake in its annual report that annual accounts of the subsidiary companies and the related detailed information shall be made available to shareholders of the holding and subsidiary companies seeking such information at any point of time. The annual accounts of the subsidiary companies shall also be kept for inspection by any shareholders in the head office of the holding company and of the subsidiary companies concerned and a note to the above effect will be included in the annual report of the holding company. The holding company shall furnish a hard copy of details of accounts of subsidiaries to any shareholder on demand;
- (vi) The holding as well as subsidiary companies in question shall regularly file such data to the various regulatory and Government authorities as may be required by them;
- (vii) The company shall give Indian rupee equivalent of the figures given in foreign currency appearing in the accounts of the subsidiary companies along with exchange rate as on closing day of the financial year.

The aforesaid circular is effective in respect of balance sheet and profit and loss account prepared regarding financial year ending on or after 31st March, 2011.

Particulars in respect of certain employees [Section 217(2A)]

Board's report shall also include a statement showing the name of every employee of the company who — (i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than such sum as may be prescribed (Presently, ₹ 60,00,000 per year w.e.f. 31.3.2011; or (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than such sum per month as may be prescribed (Presently, ₹ 5,00,000 per month, Notification no. G.S.R. 289 (E) dated 31.3.2011); or (iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and

dependent children, not less than two per cent of the equity shares of the company. "Remuneration" has the meaning assigned to it in the Explanation to Section 198.

The aforesaid shall also indicate — (i) whether any such employee is a relative of any director or manager of the company and if so, the name of such director or manager, and (ii) such other particulars as may be prescribed.

The particulars in respect of employees, to be included in Board's Report have been prescribed by the Companies (Particulars of Employees) Rules, 1975. They are as follows:

- (a) Designation of the employee;
- (b) Remuneration received, including allowance and perquisites, i.e., all expenses incurred by the company in providing any benefit or amenity to the employee, and not 'net take home pay'. In other words, total amount spent by the company on the employee is to be disclosed.
- (c) Nature of employment, whether contractual or otherwise;
- (d) Other terms and conditions;
- (e) Name of duties of the employee;
- (f) Qualifications and experience of the employee;
- (g) Date of commencement of employment;
- (h) Age of the employee;
- (i) Last employment held by such employee before joining the company. 'Last employment' means the post last held in any other company or in any organisation, etc. The particulars of the last employment including the designation of post and the period during which it was held may also be indicated.
- (j) The percentage of equity shares held by the employee in the company within the meaning of Sub-clause (iii) of Clause (a) of Sub-section (2A) of Section 217 of the Act.

Choose the correct answer

Which of the following are some of the particulars that need to be disclosed in respect of employees as prescribed by the Companies (Particulars of Employees) Rules, 1975?

- (a) Nature of employment
- (b) Name of duties of the employee
- (c) Qualification and experience of the employee
- (d) All the above points

Correct answer: d

Directors' Responsibility Statement [Section 217(2AA)]

The Board's report shall include a Directors' Responsibility Statement as required under Section 217(2AA) indicating therein—

- (i) that in the preparation of the annual accounts, the applicable accounting

standards had been followed along with proper explanation relating to material departures;

- (ii) that the directors had selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;
- (iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (iv) that the directors had prepared the annual accounts on a going concern basis.

Director's Responsibility Statement is aimed at highlighting the accountability of the directors with a view to ensuring good corporate governance. It will make the directors accountable to safeguard the assets of the company and to take positive steps in this regard.

Corporate Governance Voluntary Guidelines, 2009 state that Directors' Responsibility Statement should also include a statement that proper systems are in place to ensure compliance of all laws applicable to the company. It should follow the "comply or explain" principle. Apart from this, SS-10 i.e. Secretarial Standard on Board's Report states that board's report should include a statement by the board that the company has devised proper systems to ensure compliance of all laws applicable to the company.

Note: Any information required by the Act to be stated in the accounts which may as well be included in a statement annexed thereto, may be given in Board's report instead of being given in the accounts. In such a case, the report must be annexed to the accounts and the auditors must report on the information given in the report in addition to the report on the accounts (Proviso to Section 222).

Comment on Auditor's Report [Section 217(3)]

The Board is also bound to give fullest information and explanation as regards any reservation, qualification or adverse remarks contained in the auditors' report; in an addendum to the report. This obviously means that where the auditors of the company have made a separate or qualified report the Board should meet again and add an addendum to its report, containing explanation on the matters raised by the auditors in their report. Reference to notes made in the accounts by the auditors in their report is treated as a qualified report by the auditors to which the Board must reply.

Other Disclosures

- The Board's report shall also specify the reasons for the failure, if any, to complete the buy-back within the time specified in Sub-section (4) of Section 77A. [Sub-section (2B) of Section 217].
- Where a company fails to make preferential allotment within 12 months from the date of passing of Special Resolution by the shareholders, a disclosure should be made in the Board's Report along with the reasons for such failure.

- Section 292A(1) stipulates that every public company having a paid up capital of not less than ₹ five Crore should constitute an Audit Committee. In terms of Sub-section (4) of Section 292A, the annual report of the company should disclose the composition of the Audit Committee. Unless it is reported elsewhere, this information should be furnished in the Board's Report.

Further, Sub-section (9) of Section 292A provides that if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons through the Board's Report to the shareholders.

- It is desirable that where the redemption of debentures or preference shares was due during the year but has not taken place, the Board's Report should explain the reasons therefore.
- The Board's Report should specify the resolutions which were passed by the shareholders in the previous meeting(s) but which have not been acted upon and the reasons therefore.
- Any appointment, reappointment or change in the office of a director (including whole-time director, additional director, alternate director or a director filling a casual vacancy) whether by virtue of rotation, resignation, death or otherwise should be indicated in the Board's Report.
- As a good corporate practice, the Board's Report should disclose if any director has incurred any disqualification on account of non-compliance with any of the provisions of the Act. Acts of omission/commission by the company itself, as a result of which the directors may be liable for disqualification, should be disclosed.
- The Board should, as a good corporate practice, inform the shareholders about the amounts, if any, which have been transferred during the year to the Investor Education and Protection Fund established under Section 205C and the Rules framed thereunder.

Compliance Certificate

According to the proviso to Sub-section (1) of Section 383A, every company not required to employ a whole-time secretary and having a paid-up capital of ₹ 10,00,000 or more must attach to the Board's Report a Compliance Certificate from a Secretary in whole-time practice as to whether the provisions of the Act have been complied with or not.

The Board should give full information and explanation in its Report on every reservation, qualification or adverse remark contained in the Compliance Certificate.

3. DISCLOSURES PURSUANT TO THE LISTING AGREEMENT OF STOCK EXCHANGES

Management discussion and analysis report (MDAR) (Clause 49 of the Listing Agreement)

The MDAR should either form a part of the Board's Report or be given as an addition thereto in the annual report to the shareholders. The MDAR should include a

discussion on the industry structure and development; opportunities and threats; segment-wise or product-wise performance; outlook; risks and areas of concern; internal control systems and their adequacy; discussion on financial performance with respect to operational performance; material developments in human resources/ industrial relations front, including number of people employed.

MDAR should be considered and approved by the Board in a meeting of the Board and not through resolution passed by circulation.

Report on Corporate Governance

Corporate governance aims to improve the company's image, efficiency, effectiveness and social responsibility. It encompasses in itself a range of corporate controls and accountability mechanisms designed to meet the aims of corporate stockholders. It deals with issues regarding transparency accounting integrity, composition of the board of directors, the role of non-executive directors and their accountability to shareholders, etc.

A compliance report on corporate governance should be included as a separate section in the annual report confirming compliance/non-compliance of the requirements of Clause 49 of the listing agreement with reasons for non-compliance. The extent to which the non-mandatory requirements have been adopted should be specifically highlighted.

The reference of inclusion of report on corporate governance in the annual report should be made in the Board's Report and, as a good corporate practice, information relating to any non-compliance of the requirements of Clause 49 of the listing agreement should be incorporated in the Board's Report.

Disclosures as required by other clauses of Listing Agreement

The following disclosures are also to be made by the Board in its report:

- (i) in case the shares are delisted, the fact of delisting, together with reasons therefore;
- (ii) in case the securities are suspended from trading, the reasons therefore;
- (iii) the name and address of each stock exchange at which the company's securities are listed and also confirmation that annual listing fee has been paid to each such exchange.

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

The Management Discussion and Analysis Report (MDAR) should either form a part of the Board's report or be given as an addition thereto in the annual report to the shareholders.

- **True**
- **False**

Correct answer: True

4. DISCLOSURES PURSUANT TO EMPLOYEE STOCK OPTION AND EMPLOYEES STOCK PURCHASE SCHEMES

SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 provide that the Board shall disclose, either in the Board's Report or in an annexure to the Board's Report, various details with regard to ESOS.

5. DISCLOSURES PURSUANT TO DIRECTIONS OF RBI

Apart from the foregoing provisions of 217 of the Companies Act, 1956, Reserve Bank of India has on 31.1.1998 issued certain directions to be complied with by all non-banking companies receiving deposits, with regard to their report to be attached to every balance sheet to be placed before the shareholders at every annual general meeting. The Board's report of such a company shall include the following particulars or information, namely—

- (i) the total number of accounts of public deposit of the company which have not been claimed by the depositors or not paid by the company after the date on which the deposits became due for repayment.
- (ii) the total amounts due under such accounts remaining unclaimed or unpaid beyond the dates referred to in clause (i) aforesaid.

The above mentioned RBI directions further lay down that the said particulars shall be furnished with reference to the position as on the last day of the financial year to which the report relates, and if the amounts remaining unclaimed or undisbursed, as referred in sub-clause (ii) above of the preceding clause, exceed in the aggregate the sum of Rupees five lakhs, there shall also be included in the report a statement on the steps taken or proposed to be taken by the Board of directors for the payment of the amounts due to the depositors and remaining unclaimed or undisbursed.

6. APPROVAL OF THE BOARD'S REPORT

The Board's Report should be considered, approved and signed at a meeting of the Board, convened in accordance with the provisions of the Act and not by means of a resolution passed by circulation.

As specimen of the Board resolution for approval of the Board's Report is as follows:

“RESOLVED that, pursuant to Section 217 and subject to the Auditor's Report under Section 227(2) of the Companies Act, 1956, being without any reservation or disqualification or adverse remark, the draft of the Board's Report for the year ended....., 2007, as laid on the table, be and is hereby approved and that the said Report be signed by the Chairman on behalf of the Board and that the Secretary of the company be directed to issue the same to the members of the company together with the printed copies of the audited accounts, and the Auditor's Report.”

A specimen of the Board's resolution for approval of the Board's Report containing response to Auditors' comments and qualifications is as follows:

“RESOLVED that, pursuant to Section 217 of the Companies Act, 1956 the draft of the Board's Report for the year ended, 2007 as circulated earlier and as

modified by incorporating the information and explanation given by the Board on every reservation, qualification or adverse remark contained in the Auditor's Report under Section 217, and as laid on the table, be and is hereby approved and that the Board's Report be signed by the Chairman on behalf of the Board and that the Secretary of the company be directed to issue the same to the members of the company together with the printed copies of the audited accounts, and the Auditors' Report."

7. SIGNING AND DATING OF THE BOARD'S REPORT

Section 217(4) provides that the Board's Report and any addendum thereto should be signed by the Chairman of the Board if he is authorized in that behalf by the Board and, where he is not so authorized, by not less than two directors of the company, one of whom shall be a managing director, where there is one.

The Board's Report may bear the same dates as that of the auditor's report but it could be dated later than the date of auditors' report if, in the case of any reservation, qualification or adverse remark contained in the auditors' report, the Board has responded with its comments and given full information and explanations in its report.

Default by a director, or by any other person who has been charged by the Board with the duty of seeing that the provisions of this section are complied with and fails to take all reasonable steps to comply with the provisions of the section or if a chairman signs the Board's report without being authorised so to do will render himself liable for each offence to be punishable with imprisonment upto 6 months or with fine upto ₹20,000 or with both. The punishment of imprisonment can be ordered only if the offence was committed wilfully.

In *T.P.G Nambiar v. ROC* (1998) 92 Comp. Cas. 564 (Kar), it was held that just because statement under Section 217 furnished to Registrar of Companies was not properly numbered or it was in a blue sheet etc., that by itself could not be an offence to proceed against directors.

Besides, in any proceedings against a person in respect of an offence under Sub-section (1) of Section 217, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that the provisions of that sub-section were complied with and that person was in a position to discharge that duty.

8. FILING OF THE BOARD'S REPORT

Section 220 provides that after the balance sheet and the profit and loss account have been laid before the company at an annual general meeting, a copy of the balance sheet and the profit and loss account along with all documents required to be annexed or attached thereto should be filed with the Registrar of Companies within 30 days, along with the prescribed fees. The Board's Report has to be attached to the balance sheet.

The Ministry of Corporate Affairs (MCA) vide its General Circular No. 37/2011 dated 07.06.2011 has mandated the following class of companies to file balance sheet and Profit and Loss Account along with Director's and Auditor's Report in XBRL form only from the year 2010-11:

- All listed companies and their Indian subsidiaries,

- All companies with paid capital of Rs. 5 Crore and above
- All companies with turnover of Rs.100 Crore or above.

However banking Companies, insurance companies, power companies and Non Banking Financial Companies (NBFCs) are exempted, till further orders.

Non-banking financial company accepting/holding public deposits should deliver to RBI an audited balance sheet as on the last day of each financial year and an audited profit and loss account in respect of that year as adopted by the company in general meeting together with a copy of the report of the Board laid before the company in such meeting in terms of Section 217(1), within 15 days of such meeting as also a copy of the report and the notes on accounts furnished by its auditor. [Direction 8(1) of the Non-Banking Financial Companies Acceptance of Deposits (Reserve Bank) Directions, 1998].

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

If the Auditor's Report contains any adverse remarks as regards any reservation, the Board is not bound to give any explanation or clarification regarding the matter.

- **True**
- **False**

Correct answer: False

The board is bound to give full information and explanation as regards any reservation, qualification or adverse remarks contained in the auditors' report.

9. RIGHT OF MEMBERS TO COPIES OF BALANCE SHEET, BOARD'S REPORT, ETC.

Section 219(1) provides that a copy of the balance sheet and profit and loss account, Board's Report and auditor's report should be sent to every member atleast 21 days before the date of the annual general meeting. Proviso (b)(iv) to Section 219(1), which contains an exception to this rule, states that listed companies may send a statement containing the salient features of the above documents in Form 23AB (i.e. abridged balance sheet and abridged profit and loss account) instead of sending the full balance sheet, profit and loss account, etc., if copies of the full balance sheet, profit and loss account, etc., are made available for inspection at the company's registered office during working hours for a period of 21 days before the date of the annual general meeting. Further, as per Section 219(1)(c), the copies may be sent less than 21 days before the date of the meeting, where it is so agreed by all members entitled to vote at the meeting. Compliance Certificate issued by a secretary in whole time practice should also be sent along with the other documents referred to in Section 219(1) of the Act.

In terms of Clause 32 of the listing agreement, a copy of the Board's Report alongwith a copy of the complete and full Balance Sheet and Profit and Loss Account should be sent by the company to each shareholder and upon application to any member of the Exchange. The company may supply a single copy of complete and full Balance Sheet, Profit and Loss Account and Board's Report to shareholders residing in one household (i.e. having same address in the books of the company/registrar/share transfer agents). However on receipt of request, such documents should be supplied to any shareholder in such household.

10. LIABILITY FOR MIS-STATEMENT

The Board shall be collectively responsible for any statement in its Report which is false in any material particular, knowing it to be false or for any omission of a material fact, knowing it to be material. In terms of Section 628 of the Act, any person (including a director) making or omitting any such statement shall be punishable with imprisonment for a term which may extend to two years and with fine.

“On the principle laid down in *Hedley Byrne & Co. Ltd. v. Heller and Partners Ltd.* (1963) 2 All ER 575 (HL): (1964) 1 Comp LJ 14 (HL) a director may incur liability to individual shareholders who act in reliance upon a negligent misstatement made, e.g, in the directors’ report since the relationship between a director and the members will normally be such as to impose a duty to take care in making such statements. Whether a similar liability may be incurred to non members is a question of fact in each case, depending upon the circumstances in which the statement is made.”

11. CHAIRMAN’S SPEECH

The Companies Act, 1956 does not have any statutory provision regarding circulation, publication or otherwise of Chairman’s Speech. However, it is customary in big companies for the chairman to make a speech highlighting the various aspects of company’s operations during the year and indicating the prospects of the company for the future. Basically, the chairman’s speech is to give details or highlight aspects which are not covered in the director’s report as the latter document includes only statutory information.

The chairman’s speech is delivered by him at the annual general meeting before the meeting takes up the consideration of the statutory items starting from reading of the notice, auditors’ report and the discussion on the accounts of the company. Copies of the speech are sometimes distributed to the members attending the annual general meeting.

It is also customary to publish the chairman’s speech or an abridged version thereof in leading newspapers for the interest of the general public and prospective investors. A note is also added that the speech published does not purport to be the proceeding of the meeting as a pre-cautionary measure since Section 197 of the Act prohibits the publication at the company’s cost any report of the proceedings of a meeting unless it covers all the matters given in Section 193.

The Department of Company Affairs – now MCA, has, however, advised vide circular No. 3/91 dated 15.2.1991 that from the point of view of economy in expenditure as also saving newsprint which is imported out of scarce foreign exchange resources, publication of chairman’s speech in newspapers/magazines be avoided.

Like the directors’ report, the chairman’s speech is drafted by the secretary in coordination with the heads of other operating functions before it is finalised by the chairman. Since there is no statutory provision relating to chairman’s speech there is no hard and fast rule as to what it should contain and thus the length, style and nature of the speech varies from chairman to chairman and company to company.

The chairman’s speech for a particular company may differ from year to year depending on the circumstances, but the matters which are generally included in the speech are:

- (a) review of the company’s working;

- (b) progress during the year;
- (c) difficulties and constraints faced by the company during the year;
- (d) measures initiated to overcome such difficulties; and
- (e) immediate and future prospects of the company.

Where the chairman delivers his speech before commencing the statutory items of business at the annual general meeting the minutes of the meeting must include a reference to this and could be worded either that after the chairman's speech, he requested the secretary to read the auditor's report or include a brief summary of the speech in the minutes of the meeting.

12. COMPLIANCE CERTIFICATE UNDER SECTION 383A

The Companies (Amendment) Act, 2000 has inserted a new proviso in sub-section (1) of Section 383A of the Companies Act, 1956. As per this proviso every company not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all provisions of the Act and a copy of such certificate shall be attached with Board's report referred to in Section 217. Accordingly, every company not required to employ a whole-time secretary and having a paid-up share capital of rupees ten lakhs or more but less than rupees five crores is required to file with the Registrar of Companies a Compliance Certificate from a Secretary in Whole-time Practice and also attach a copy of that certificate with Board's report. The Department of Company Affairs (now MCA) has vide its General circular No. 35/2003 (No.17/47/2002-CL V) dated 11th December, 2003 clarified that company which is not required to employ a whole-time secretary but has nevertheless employed a whole-time company secretary, such a company is not required to obtain compliance certificate from a practising company secretary. In other words, no company employing a full time Company Secretary is required to also obtain a compliance certificate from a Company Secretary in practice (PCS).

Guidelines for issuing compliance certificate and signing Annual Returns issued by ICSI in 2007 prescribe that a member of the Institute in practice who is entitled –

- (i) to issue compliance certificate pursuant to the proviso to Sub-section (1) of Section 383A of the Companies Act, 1956 (1 of 1956); and/or
- (ii) to sign an Annual Return pursuant to the proviso to Sub-section (1) of Section 161 of the Companies Act, 1956 (1 of 1956), shall be deemed to be guilty of professional misconduct if he-
 - issues compliance certificates; and/or
 - signs Annual Return

for more than eighty companies in aggregate, in a calendar year.

Provided, however, that in the case of a firm of Company Secretaries, the ceiling of eighty companies aforesaid would apply to each partner therein.

13. NEED FOR COMPLIANCE CERTIFICATE

The successive Annual Reports on the Working and Administration of the Companies Act, 1956 reveal that a large number of documents are returned for rectification of defects and also remain pending for being taken on record. While this state of affairs has perhaps resulted from the constraints under which the offices of the ROCs operate, it cannot be denied that in case of documents returned for rectification, a large number of errors or omissions arise on account of mis-interpretation or ignorance of the provisions of law.

Further, the Department of Company Affairs (now MCA) institutes every year a large number of prosecutions against the companies and their officers in default for contravention of various provisions of the Companies Act. Most of the companies against which prosecutions are instituted are private limited companies or small public limited companies which do not have the benefit of expert professional services of qualified Company Secretaries.

Thus, it is well established fact that smaller companies fall prey to violations of the provisions of the Companies Act in the absence of professional support as compared to companies which have employed a qualified Company Secretary.

Compliance Certificate is, therefore, salutary as it creates an awareness among companies to comply with provisions of the Companies Act and also provides a mechanism for self regulation by companies.

Compliance Certificate will not only act as an effective mechanism to ensure that the legal and procedural requirements under Companies Act are duly complied with but also instill professional discipline in the working of the company besides building up the necessary confidence in the state of affairs of the company. It will relieve the company and its directors including the nominee directors from the consequences of unintended non-compliance of the provisions of the Companies Act. It will further curb the tendency on the part of the smaller companies to cut short the procedural requirements which primarily occur due to ignorance or lack of professional support. It will act as a pre-emptive check to monitor compliance with the requirements of the Companies Act and the Rules made thereunder.

The Company Secretaries, while undertaking the work of issuing Compliance Certificate will act as a friend and guide to the management of companies.

For the purpose of this proviso the relevant date for determining the paid-up share capital shall be date on which the Board's report is signed. Further Sub-rule (2) of Rule 3 provides that the Compliance Certificate shall relate to the period pertaining to the financial year of the company. So, every company to which the section is applicable is required to attain a Compliance Certificate from a secretary in whole-time practice for the financial year in which the Board's report is signed.

Under e-filing system of MCA, companies are required to file Compliance Certificate online with the Registrar of Companies within 30 days from the date on which its Annual General Meeting is held, along with e-form 66. Provided that where the annual general meeting of such company for any year has not been held there shall be filed with Registrar such certificate within thirty days from the latest day on or before which that meeting should have been held in accordance with the provisions of

the Act. In case, AGM is held and adjourned the Compliance Certificate should be filed with ROC within 30 days from the date on which such adjourned meeting is held provided such statutory meeting was held within statutory limit.

It may be noted that for e-filing purpose, Compliance Certificate is required to be converted in pdf file and then the said pdf file is to be attached to e-form 66.

The Compliance Certificate must be laid by the Company at its Annual General Meeting (Sub-rule (4) of Rule 3). As a good secretarial practice, the certificate should be read at the meeting and also made available to the members for inspection. It is also necessary for the company to attach a copy of the Compliance Certificate with the Board's report while forwarding the same to members and others under Section 219 of the Act.

14. SCOPE OF COMPLIANCE CERTIFICATE

The scope of Compliance Certificate would comprise of certification of the compliance of various requirements under the Companies Act and the Rules thereunder. The PCS should certify compliance only in respect of matters specified in the Form prescribed under the Rules and where any matter is not applicable, he should specify accordingly.

At the time of issue of the first Compliance Certificate, PCS should verify the registers and records maintained by the company from the first day of the financial year except where there are reasons for PCS to verify the records for the earlier years. Such occasions may arise in respect of maintenance of registers, retirement of directors by rotation, issue of share certificate when the allotments were made in the earlier years, payment of managerial remuneration, etc.

15. PENALTY FOR NON-COMPLIANCE OF SECTION 383A

Where a company fails to comply with the requirement of filing the Compliance Certificate with the ROC or attaching the copy of such certificate with Board's Report, in terms of Sub-section (1A) of Section 383A the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 500 for every day during which the default continues.

However, in any proceedings against a person in respect of an offence under this sub-section, it shall be a defence to prove that all reasonable efforts to comply with the provisions were taken.

16. MODE AND PERIOD OF APPOINTMENT OF PRACTISING COMPANY SECRETARY (PCS)

As the Compliance Certificate is required to be addressed to the members of the company, it would be in the fitness of things that the appointing authority is the members to whom this certificate is addressed. It is advisable that the PCS is appointed by the members in the annual general meeting of the company. Such appointment shall be from the conclusion of that annual general meeting until the conclusion of the next annual general meeting. It is also recommended that the first appointment of the PCS may be made by the Board of directors to hold office until the conclusion of the annual general meeting held after such appointment.

The Board may fill any casual vacancy in the office of PCS to hold office until the conclusion of the next annual general meeting. However, if such a vacancy is caused by the resignation of PCS, it is advisable that the vacancy is filled up by the company in general meeting.

17. CERTIFICATION WITH QUALIFICATION

As specified in the Form, the qualification, reservation or adverse remarks, if any, may be stated by the PCS at the relevant places. It is recommended that the qualifications, reservations or adverse remarks of PCS, if any, should be stated in thick type or in italics in the Compliance Certificate.

If the scope of work required to be performed, is restricted on account of limitations imposed by the client or on account of circumstantial limitations (like certain books or papers being in custody of another person or Government Authority) the certificate may be qualified as such.

PCS shall have due regard to the circulars and/or clarifications issued by the Department of Company Affairs from time to time. It is recommended that a specific reference of such circulars at the relevant places in the certificate may be made, wherever necessary.

18. PENALTY FOR FALSE COMPLIANCE CERTIFICATE

Section 628 deals with penalty for false statements. According to this section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a 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, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

In view of this, a PCS will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate.

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

Every company not required to employ a whole-time secretary under Section 383A(1) of the Act and having a paid-up share capital of ₹10 lakhs or more shall obtain a certificate from a secretary in whole-time practice.

- True
- False

Correct answer: True

19. PROFESSIONAL RESPONSIBILITY

While the newly inserted provision has opened up the much awaited significant area of practice for company secretaries, it equally casts onerous responsibility on them and poses a greater challenge whereby they have to justify fully the faith and confidence reposed by the Government and trade and industry and measure up to their expectations. Company Secretaries must take adequate care while issuing

Compliance Certificate. It is based on this certificate that confidence of the company, Government and trade and industry will build-up *vis-à-vis* our profession. Any failure or lapse on the part of PCS in issuing a Compliance Certificate may not only attract penalty for false statement under Section 628 and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his negligence in issuing the Compliance Certificate. Therefore, it becomes imperative for the PCS that he exercises great care and caution while issuing the Compliance Certificate and also adheres to the highest standards of professional ethics and excellence in providing his services.

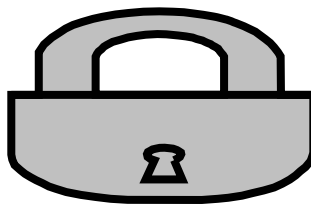
LESSON ROUND-UP



- Attaching Board's report to every balance sheet is mandatory. Apart from giving a complete review of performance of company for the year under report, it highlights various disclosures having impact on business. It also highlights the future strategy of the company.
- The matters to be included in Board's Report should be under the provisions of Companies Act, Listing Agreements, SEBI Guidelines and RBI directions.
- Under Companies Act the matters to be included should be with respect to state of company's affairs, the amount which it proposes to carry to any reserves, recommendation of amount of dividend, material changes, conservation of energy, technology absorption, foreign exchange earning and outgo, particulars in respect of certain employees, director's responsibility statement, Audit Committee, Account of holding and subsidiary company.
- As per listing agreement, management discussion and analysis report, Report on Corporate Governance, fact of delisting, suspension of securities are the matters to be included in the Board's Report.
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 provides for certain disclosures.
- As per RBI's directions, certain disclosures are required to be made by non-banking companies receiving deposits.
- Board's report should be signed by the Chairman of the Board, if so authorized and if not so authorized then by not less than two directors of the company, one of whom shall be managing director, where there is one.
- The Board shall be collectively responsible for any statement in its Report which is false in any material particular or for any omission of a material fact.
- In accordance with the proviso to Sub-section (1) of Section 383A of the Companies Act, 1956, a company is required to file with Registrar a Compliance Certificate in e-form 66 within 30 days from the date on which AGM is held.

- Compliance Certificate would comprise of Certification of the Compliance of various requirements under the Companies Act and the Rules thereunder.
- If a practicing company secretary gives a false statement relating to materially relevant fact or omit a material fact in the compliance certificate etc. penal provisions of section 628 of the Companies Act, 1956 will be attracted. He shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.
- Institute has published Guidance Note on Board's Report.

SELF-TEST QUESTIONS

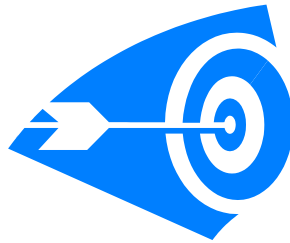


(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. Board's Report is a comprehensive document circumscribing both financial and non-financial information. Explain how?
 2. State the disclosures in Board's Report under listing agreement.
 3. State the provisions for signing and dating of Board's Report.
 4. What is the need and scope of Compliance Certificate.
-

STUDY XXV
REGISTERS AND RETURNS

LEARNING OBJECTIVES



Under the Companies Act, 1956, a company is required to maintain certain registers and records. There are some other registers and records, the maintenance of which is not statutorily required but is essential for the smooth, efficient and systematic functioning of a company. This chapter covers the maintenance, authentication, preservation and inspection of statutory book/registers prescribed under various provisions of the Company Law, non-statutory books, various forms/returns required to be filed to Registrar of Companies, provisions relating to Annual Return under the following topics:

- Statutory Books/register
- Secretarial Standard on Registers and Records. (SS-4)
- Electronic forms
- Statutory books elaborated (covering Annual Return)
- Procedure for keeping registers and returns at a place other than the registered office
- Non-statutory Registers
- Filing of various forms/Returns with Registrar of Companies
- Preparation and filing of returns with the Registrar of Companies
- Guidelines for preparing/filing forms, documents, returns etc.
- Condonation of Delay
- Penalty for filing false documents/statements with the Registrar.

Note: The e-forms are being constantly revised to be compatible with the technical requirements. The updated forms are available at the website of MCA (www.mca.gov.in)

1. STATUTORY BOOKS/REGISTERS

The Companies Act, 1956 lays down that every company incorporated under this Act must maintain and keep at its registered office certain books, registers and copies of certain returns, documents etc. and to give certain notices, file certain returns, forms, reports, documents etc. with the Registrar of Companies within certain specified time limits and with the prescribed filing fees. These books are known as Statutory Books. Some of the statutory registers are required to be kept open by the

company for inspection by directors, members, creditors of the company and by other persons. The company is also required to allow extracts to be taken from certain documents, registers, returns etc. and furnish copies of certain documents on demand by a member or by any other person on payment of specified fees.

Every company incorporated under the Act is required to keep at its registered office, *inter alia*, the following statutory books and registers –

1. Register of investments in securities not held in company's name. [Section 49(7)]
2. Register of deposits. [Section 58A and the Companies (Acceptance of Deposits) Rules, 1975 and the RBI Non Banking Financial Companies Directions]
3. Register of securities bought back. (Section 77A)
4. Register of charges. (Section 143)
5. Register and index of members. [Sections 150, 151 and the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001]
6. Register and index of debenture holders. (Section 152)
7. Register and index of beneficial owners. (Section 152A)
8. Foreign register of members and debenture holders and their duplicates. [Section 157(1) and 158(4)]
9. Annual Return (Section 163)
10. Books containing minutes of general meeting and of Board and of committees of Directors. [Section 193(1)]
11. Register of Postal Ballot [Section 192A and the Companies (Passing of the resolutions by postal ballot) Rules, 2001]
12. Books of accounts. [Section 209(1)(a) to (c)]
13. Cost account records for Companies engaged in industries so specified by Central Government [Section 209(1)(d)]
14. Register of contracts with companies/firms in which directors are interested. [Section 301(5)]
15. Register of Directors/Managing Directors/Managers/Whole-time Directors/Secretary. (Section 303)
16. Register of directors' shareholdings. (Section 307)
17. Register of loans or investments made, guarantees given and security provided to other body corporate. (Section 372A)
18. Register of Renewed and Duplicate Share Certificates. [Rule 7 of the Companies (Issue of Share Certificate) Rules, 1960]
19. Register of records and documents destroyed [Section 163 and the Companies (Preservation and Disposal of Records) Rules, 1966]
20. Register of sweat equity shares [Section 79A and the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003]
21. Dividend Register

2. SECRETARIAL STANDARDS

The Institute has issued Secretarial Standard (SS-4) on register and records. It seeks to prescribe a set of principles in relation to various registers and records including the maintenance and inspection thereof. Adherence by the Company to the Secretarial Standard is recommendatory.

3. STATUTORY BOOKS ELABORATED

(1) Register of Investments Not Held in Company's Name

Section 49 of the Act provides that the investments of a company must be held in its own name, except as allowed by Sub-sections (2), (3), (4) and (5) of the Section or any other law in force. It is stated that, if any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall forthwith enter in a register maintained by it for the purpose:

- (a) the nature, value and such other particulars as may be necessary to fully identify the shares or securities in question; and
- (b) the bank or person in whose name or custody the shares or securities are held.

The register should be maintained at the registered office of the company. This register has to be kept open for the inspection of any member or debenture holder of the company during the business hours of the company, without paying any charge, during business hours, subject to such reasonable restrictions as the company may, by its articles or in general meeting, impose, so that not less than two hours in each day are allowed for inspection. Only one person at a time should be allowed to inspect the register.

If default is made in the maintenance of the register, the company and every officer of the company who is in default, shall be punishable with fine which may extend to fifty thousand rupees. If inspection required (as mentioned above) is refused, the Company Law Board* may, by order, direct an immediate inspection of the register.

Entries in the register should be authenticated by the Secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

(2) Register of Deposits

As per Rule 7 of the Companies (Acceptance of Deposits) Rules, 1975, every company other than a banking company accepting deposits has to keep at its

* It shall be substituted by Central Government after the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely:

- (a) name and address of the depositor and details of nominee, if any;
- (b) date and amount of each deposit;
- (c) duration of deposit and the date on which each deposit is repayable;
- (d) rate of interest;
- (e) date/dates on which payment of interest on the deposits is to be made;
- (f) any other particulars relating to deposit.

The register should be maintained deposit receipt number-wise.

The register of deposits is required to be preserved in good order for a period of not less than eight calendar years from the financial year in which the latest entry is made in the register.

If default is made, the company and every officer of the company in default shall be punishable with fine up to ₹ 500/- each and further fine of ₹ 50/- per day if default continues.

Register of deposits can be taken to be a part of books of accounts within the meaning of Section 209. Hence, where the work regarding fixed deposits is entrusted to a Registrar by a company, it is advisable for the Board to approve of keeping the said Register with the Registrar and file a copy of the said resolution with the ROC.

As per Rule 4(16) of the Non Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, every non-banking financial company shall keep one or more registers in respect of all deposits in which the particulars of each depositor shall be entered separately. The register shall be kept at each branch office in respect of the deposits accounts opened by that branch of the company and a consolidated register for all the branches taken together at the registered office of the company. The Register shall be preserved in a good order for a period of not less than eight calendar years following the financial year in which the latest entry is made. However, if the company keeps the books of accounts referred to in Sub-section (1) of Section 209 of the Companies Act, 1956 at any place other than its registered office in accordance with the proviso to that sub-section, it shall be deemed to be sufficient compliance with the clause if the register aforesaid is kept at such other place, subject to the condition that the company delivers to the Reserve Bank of India a copy of the notice filed with the Registrar of Companies under the proviso to that sub-section within seven day of such filing.

The register is not open for inspection. Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

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

The register of deposits is required to be preserved in good order for a period of not less than eight calendar years from the financial year in which the latest entry is made in the register.

- **True**
- **False**

Correct Answer: True

(3) Register of Securities Bought Back

Under Section 77A(9) every company is required to keep at its registered office a Register of securities bought-back and enter therein the following particulars, namely:

- (i) the consideration paid for securities bought back;
- (ii) the date of cancellation of securities;
- (iii) the date of extinguishing and physically destroying of securities and such other particulars as prescribed in Form No. 4B of the Companies (Central Government's) General Rules and Forms, 1956 and Annexure B to the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

Entries in the register should be made in chronological order.

If company fails to maintain this register then the company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both.

The register is not open for inspection.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved for a minimum period of 8 years from the date of completion of buy-back and should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

(4) Register of Charges

Under Section 143 (1), every company is required to keep at its registered office a Register of charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or any property of the company. The Register should contain the following:

- a short description of the property charged;
- the amount of the charge;

- except in the case of bearer securities, the names of the persons entitled to the charge; and
- particulars of any modification of a charge and every satisfaction of a charge.

Entries in the register should be made in chronological order of creation of the charge and modification thereof.

If any officer of the company knowingly omits or willfully authorises or permits the omission of any entry required to be made as per sub-section (1), he is punishable with fine which may extend to five thousand rupees.

Under Section 144, the Register of charges and instruments creating charge shall be open for inspection by any member or creditor without fee and of any other person on payment of fee of such sum as may be prescribed, during business hours for not less than two hours each day. The Central Government has vide notification dated 13.7.88 w.e.f. 15.7.88, prescribed a fee of ₹ 10 for inspection of this register by persons other than members and creditors. However, company is not required to supply copies of these. If default is made, the company and every officer in default is punishable with fine upto rupees five hundred each and further fine of rupees two hundred for each day during which the refusal continues.

In the wake of MCA-21 project, the physical data of the companies in Registrar of Companies is being digitized. The documents, in so far as these are available in digitised form, shall be available for public inspection through electronic means using the internet.

The Company Law Board may also by order compel an immediate inspection of the said copies or register.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

Instrument creating a charge should be preserved for a period of 8 years from the date of satisfaction of charge and should be kept in custody of the secretary of the company or any other person authorized by the Board for the purpose.

The register should be preserved permanently in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

(5) (a) Register of Members

Every company is required to maintain a register of members, which should indicate the following particulars:

- Name, address and the occupation of the member;
- Date on which he was entered as a member;
- Date on which he ceased to be a member;
- The details of the shares standing in his name, such as, the number of the certificate, distinctive number of the shares, etc.

In addition to the aforesaid particulars the register of members should also be

in conformity with the format as prescribed under Rule 7 of the Companies (Issue of Share Certificates) Rules, 1960. The Appendix to the rules provide the format of register of members. In the case of Joint shareholders, the particulars of each joint holder should be recorded in the register.

Separate register should be maintained for each class of equity and preference shares.

Apart from the aforesaid information, this format provides for giving information about cash payable on shares, cash paid on shares and full particulars of transfer of shares.

Particulars of every share certificate issued in accordance with rule-4, sub-rule (1), shall be entered in the Register of Members maintained in the form set out in the appendix annexed to the abovesaid rules of persons to whom it has been issued, indicating the date of issue. Further, all entries in this register are required to be authenticated by the secretary or any other person so authorized by the Board of directors [Rule 7 of the Companies (Issue of Share Certificates) Rules, 1960].

Under Section 163 of the Companies Act, 1956, register of members should be kept at the registered office of the company and except when it is closed under the provisions of the Act, shall be open during business hours (subject to such reasonable restrictions as the company may impose, so that not less than two hours in each day are allowed for inspection) to inspection of any member or debenture holder without fee, and of any other person, on payment of such sum as may be prescribed for each inspection. The Central Government has vide notification dated 13.7.88 w.e.f. 15.7.88 prescribed a sum of ₹ 10 for inspection hereunder. Further, the member or debenture holder or other person may make extracts from the register, index, etc. without fee or require a copy of any such register, index or copy or any part thereof on payment of such sum as may be prescribed for every 100 words or part thereof required to be copied. Vide Government's notification dated 13.7.88 w.e.f. 15.7.88 the sum prescribed for requiring a copy of the register as above is, rupee one for every 100 words or part thereof.

A member can obtain on requisition, copies of register of members only on prescribed payment and a mere request to chairman by letter is insufficient. [*Maknam Investments Ltd. In re* [1996] 87 Comp. Cas 689 (Cal.)].

The company is required to send the copy within ten days of receiving the requisition together with the charges therefor. The penalty for not allowing inspection of register or not supplying a copy would involve fine which may extend to five hundred rupees for every day during which the default continues. The register of members can be kept at a place other than the registered office of the company within the city, town or village in which the registered office is situated if—

- (a) Such other place has been approved for this purpose, by a special resolution passed by the company in general meeting; and
- (b) The Registrar has been given in advance a copy of the proposed resolution. After such a special resolution is passed, a copy of the same has to be filed with the Registrar of Companies as required under Section 192 of the Companies Act, 1956.

As per provisions of Section 154 of the Companies Act, 1956, the register of members of a company can be closed, after giving not less than seven clear days' previous notice, by advertisement in a newspaper circulating in the district in which the registered office of the company is situated, for any period not exceeding in the aggregate forty five days in each year but not exceeding thirty days at any one time. The register of members is usually closed immediately prior to the Annual General Meeting for the purpose of finalising the list of shareholders to determine persons entitled to dividend, if declared at the annual general meeting and also for updating the list of shareholders as on the day of annual general meeting. The register of members is also closed for the purpose of determination of entitlement when rights or bonus shares are issued. Where the shares are listed the requirements as per the Listing Agreement should also be complied with.

The register of members is only *prima facie* evidence of membership and any person can say either (a) that his name should no longer appear or should never have been placed in the register at all, and (b) that his name has wrongfully been removed from the register, and (c) that his name should be entered as a member. The aggrieved person may apply to the Company Law Board* under Section 111A of the Companies Act, for rectification of the register. The Company Law Board* has full powers to decide any question relating to the title of any person entered or omitted from the register of members. It may either reject the application or order rectification of the register and also direct a company to pay damages if any, sustained by any party aggrieved. The Company Law Board* may also make such interim orders including any orders as to injunction of stay, as it may deem fit and just; such orders as to costs as it thinks fit; and incidental or consequential orders regarding payment of dividend for the allotment of bonus or right shares. If default is made in giving effect to the order of the Company Law Board* hereunder, the company, and every officer of company who is in default shall be punishable with fine which may extend to ₹ 10,000/- and with a further fine which may extend to ₹1000/- for every day after the first day for which the default continues. An application for rectification of the register of members shall be made by petition in writing and shall be accompanied by such fee as may be prescribed. The provisions of Sub-sections (5), (7), (9), (10) and (12) of Section 111 shall apply in respect of Section 111A. Section 111 applies in the case of a private company.

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

In the case of Joint shareholders, the particulars of each joint holder should be recorded in the register.

- True
- False

Correct Answer: True

* It shall be substituted by Tribunal after the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

(5) (b) Index of Members

Every company having more than 50 members must maintain an index of members, unless the register of members in itself constitutes an index. The index may be a card index or bound one. Any alterations or changes made in the register of members must be recorded in the index within 14 days. The provisions of inspection and getting copies of the register of members as discussed above are applicable to index of members also.

(6) (a) Register of Debenture holders

Section 152 (1) requires every company to maintain a register of debenture holders and enter therein the following particulars:

- (a) the name and address, and the occupations, if any, of each debenture holder;
- (b) the debentures held by each holder, distinguishing each debenture by its number, except where such debentures are held with a depository and the amount paid or agreed to be considered as paid on those debentures;
- (c) the date on which each person was entered in the register as debenture holder; and
- (d) the date on which any person ceased to be a debenture holder.

In the case of joint holding, the particulars of each joint holder should be kept in the register.

No notice of any trust, express, implied or constructive, should be entered in the register of debenture holders.

Except when the register is closed under the provisions of the Act as aforesaid, the register alongwith index should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members, debenture holders and trustees of debenture holders can inspect the register and the index without payment of any fee and any other person can inspect the register on payment of the requisite fee.

Copies of the register can be demanded by any person who inspects the register.

Entries in the register and index should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register and index should be preserved for a period of 15 years from the date of redemption of debentures and should be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.

Further, the provisions of Sections 111 and 111A shall apply in relation to the

rectification of the register of debentureholders as they apply in relation to the rectification of the register of members.

(6) (b) Index of Debenture holders

As in the case of a register of members, there must be kept an index of debenture holders where a company has more than 50 debenture holders. Similar provisions apply to it as to an index of members.

Choose the correct answer

Any alterations or changes made in the Register of Members must be recorded in the index within how many days?

- (a) 15 days
- (b) 7 days
- (c) 14 days
- (d) 10 days

Correct Answer: c

Choose the correct answer:

For how long from the date of redemption of debentures, the Register and Index of Debenture holders should be preserved?

- (a) 15 Days
- (b) 1 Year
- (c) 15 Years
- (d) 10 Years

Correct Answer: c

(7) Register and Index of Beneficial Owners

Section 152A of the Companies Act, 1956 was inserted by the Depositories Act, 1996 w.e.f. 20.9.1995, providing that the Register and Index of Beneficial Owners maintained by a depository under Section 11 of the Depositories Act, 1996 shall be deemed to be a register of members and debentureholders, as the case may be, for the purposes of this Act. The amendment was considered necessary as securities held in depository mode are fungible.

Section 11 of the Depositories Act, 1996 provides that every depository shall maintain a register and an index of beneficial owners in the manner provided in Sections 150, 151 and 152 of the Companies Act, 1956.

(8) Foreign Register of Members and Debenture Holders (Section 157-158)

The foreign register of members or debenture holders resident outside India, if maintained, shall be deemed to be a part of the register of members or debenture

holders of the company and should be maintained from the date of allotment of shares or debentures to foreigners, in an office located in the foreign country.

The company should, within 30 days from the date of the opening of any foreign register, file with the Registrar of Companies a notice of the situation of the office where such register is kept. In the event of any change in the situation of such office or of its discontinuance, the company should, within 30 days from the date of such change or discontinuance, file notice of such change or discontinuance with the Registrar of Companies [Section 157 (2)].

If a foreign register is maintained, a duplicate thereof should be maintained at the registered office of the company or at such other place where the register of members or debenture holders is kept.

The register should contain particulars in respect of each member or debenture holder in the same format as are contained in the register of members or debenture holders kept at the registered office of the company.

Where a company closes its foreign register of members or debenture holders, it should give not less than 7 days previous notice by advertisement in a vernacular newspaper circulating in the district where the foreign register is kept.

Except when the register is closed under the provisions of the Act as aforesaid, the register should be open for inspection during business hours, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day are allowed for inspection.

Members or debenture holders can inspect the register without payment of any fee and any other person can inspect the register on payment of the requisite fee.

Copies of the register can be demanded by any person who inspects the register.

Entries in the foreign register should be authenticated by the person in charge of the office in the foreign country, by appending his signature to each entry.

The register should be kept in the custody of the person in charge of the office in the foreign country.

The foreign register of members should be preserved until discontinued.

The foreign register of debenture holders should be preserved for a period of 15 years from the date of redemption of debentures.

(9) Annual Return

Annual Return is perhaps the most important document required to be filed by every company with the Registrar. Apart from the Balance Sheet and Profit & Loss Account, this is the only document to be compulsorily filed with the Registrar every year. The importance of this document can best be highlighted by comparing it with some other documents required to be filed under the Act.

Annual Return and Balance Sheet: While the Balance Sheet and Profit & Loss Account given information on the financial performance of a company, it is the Annual Return which gives greater insight into the company relating to the people behind a corporate entity – the Shareholders, who as a body, constitute its ownership, the Directors, who exercise control over the affairs of the company, the extent of dilution or concentration of ownership, the details of debentureholders, who have contributed to the loan funds, the extent of indebtedness, and last but not the least, the Company Secretary who is the conscience-keeper of the company.

Further it contains more up-to-date information than that of the latter. Section 210 of the Act, requires that normally, the Balance Sheet and the Profit and Loss Account should be placed before the Annual General Meeting within six months of the financial year ending, and section 220 provides that copies of Balance Sheet and Profit and Loss Account should be filed within 30 days from the date on which the balance sheet and the profit and loss account were so laid (whether adopted or not) or where the annual general meeting has not been held, within 30 days of the latest date on or before which the annual general meeting should have been held. This means that the information contained in the Balance Sheet is at least half an year old by the time it is open for public inspection. On the other hand, the Annual Return is made upto the date of the Annual General Meeting, and should be filed within 60 days from that date.

Thus, the Annual Return provides in a nutshell, every comprehensive information about various aspects of a company updated till the date of Annual General Meeting every year. It is not an exaggeration, therefore, to state that the study of Annual Return provides a bird's eye view of the capital structure, constitution and management of the company concerned.

Sub-section (1) of section 159 prescribes the details that should be furnished in the Annual Return of a company having a share capital.

They are:

- (a) The address of its Registered Office.
- (b) Register of Members and Debentureholders.
- (c) Summary of the details of its shares and debentures.
- (d) The indebtedness of the Company.
- (e) Details of its Members and Debentureholders, past and present.
- (f) Details of its Directors, Managing Directors, Managers and Secretaries, past and present.

In respect of details of past and present members it is necessary to give the full details only once in six years. For the intervening period of five years, it is adequate if only the details of changes are given.

The format of Annual Return is prescribed in Part II of Schedule V to the Act [Section 159(2)]. The same sub-section also allows certain amount of flexibility in the format by stating that Return should conform to the prescribed form or, –as near thereto as circumstances admit”. This means that if any information required to be given in the Annual Return does not fit into the format, necessary modifications may be made in the format by the company concerned.

The Annual Return should be made up to earlier of the following dates:

- (i) The date of the latest Annual General Meeting; or
- (ii) The latest date on which the Annual General Meeting of the company should have been held under the provisions of Section 166 of the Act.

The date under (ii) above is applicable only in case the company fails to hold the Annual General meeting within the time prescribed under Section 166 of the Act. In other words, if the company has not been able to hold the Annual General Meeting within the time prescribed under Section 166, it will be required, nevertheless to prepare the Annual Return made up to the latest allowed date for holding the Annual General Meeting under that section and file it with the Registrar.

The only exception to this rule is in case of an extension of time for holding the Annual General Meeting granted by the Registrar.

Annual Return is required to be attached with the e-form 20B with in 60 days from the date of the Annual General Meeting and if no Annual General Meeting is held then within 60 days from the date on which the AGM ought to have been held.

In case the Annual General Meeting is held and adjourned, the Annual Return should be made up to the date of the original meeting.

The Annual Return should be signed by two officers of the company consisting of:

- (i) The Manager or Secretary of the company; and
- (ii) A Director of the company.

If the company does not have a Manager or Secretary, the Annual Return should be signed by two Directors, one of whom should be the Managing Director, where there is one.

In addition to the above officers to the company, the proviso to Section 161(1) of the Act requires that the Annual Return should also be signed by a Secretary in whole-time practice, in the case of companies whose shares are listed on a recognized Stock Exchange.

When a Secretary in whole-time practice signs the Annual Return filed by a listed company with the Registrar, he thereby authenticates the Return as binding on him and certifies that the facts stated and the material furnished in the return are duly and fully (i.e. correctly and completely) stated and given.

As provided by Section 161(2) of the Act, the following certificates should be filed along with the Annual Return:

- (i) A certificate affirming that facts as stated in the Return are correct and complete; and
- (ii) A certificate conforming that transfers of all the shares and debentures received by the company since the date of the last Annual Return have been duly registered by the company.

In addition to the above, another certificate confirming that the whole of

amounts envisaged in clauses (a) to (e) of Sub-section (2) of Section 205C of the Companies Act, 1956 remaining unpaid or unclaimed for a period of seven years from the date they become payable by a company have been credited to Investor Education and Protection Fund.

Section 162 of the Act, prescribes penalty where a company fails to comply with any of the provisions contained in Sections 159, 160 or 161. Accordingly, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 500/- for every day during which the default continues.

Section 628 deals with penalty for false statements. According to this section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purposes of any of the provisions of the Act, any person makes a 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, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

Every company should maintain copies of all annual returns alongwith copies of certificates and documents required to be annexed thereto at the registered office of the company.

The copies of annual returns and certificates required to be annexed thereto should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members or debenture holders can inspect the annual returns without payment of any fee and any other person can inspect the annual returns on payment of the requisite fee.

Copies of the last 8 annual returns and all certificates and documents required to be annexed thereto should be preserved in the custody of secretary of the company or any other person authorized by the Board for the purpose.

Choose the correct answer:

In respect of details of past and present members, it is necessary to give the full details once in how many years?

- (a) One year
- (b) Six years
- (c) Two years
- (d) Five years

Correct answer: b

Multiple choice question

The Annual Return should be signed by which of the following officers of the company?

- (a) Manager/Secretary
- (b) Internal Auditor
- (c) Director
- (d) Shareholder

Correct answer: a and c The Annual Return should be signed by two officers of the company consisting of the Manager or Secretary of the company and a Director of the company.

(10) Minutes Books

Every company must maintain minutes books for recording the minutes of proceedings of all general meetings of the shareholders and of all proceedings of every meeting of its Board of directors or every committee of the Board (Section 193). The minutes must be entered in the minutes book within 30 days of the meeting. The pages of a minutes book must be consecutively numbered. Each page of the minutes book must be initialled and the last page of the record of proceedings of each meeting in the minutes books must be dated and signed:

- (i) in the case of minutes of Board or Committee meetings by the Chairman of the said meeting or of the next meeting; and
- (ii) in the case of minutes of general meetings by the Chairman of the same meeting within 30 days of the meeting and in the event of his death or inability of that chairman within that period, by any director so authorised by the Board for the purpose.

The minutes books should be kept at the registered office of the company. These are primary documents and an evidence of the proceedings recorded therein and when the minutes are duly drawn and signed, presumptions as specified in Section 195 of the Act may be drawn until the contrary is proved.

According to Sub-section (4) of Section 193, in the case of a Board meeting or of a Committee of the Board, the minutes shall also contain —

- (a) the names of the directors present at the meeting; and
- (b) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring in, the resolution.

Sub-section (5) of the section prohibits the inclusion in any minutes of any matter, which, in the opinion of the chairman of the meeting —

- (a) is or could reasonably be regarded as defamatory of any person;
- (b) is irrelevant or immaterial to the proceedings; or
- (c) is detrimental to the interests of the company.

It has been explained at the end of this Sub-section that the chairman shall exercise an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in this Sub-section.

Sub-section (6) imposes a fine of five hundred rupees for default in complying with the provisions of Section 193.

Section 193 of the Companies Act, 1956, envisages minutes to be kept in a book. However, the Department of Company Affairs has, by its letter No. 16047/TA/VII, dated 16th December, 1972, clarified that the minutes can be maintained by a company in the loose-leaf form, provided it complied with the other procedural requirements of the section and at the same time took all possible safeguards against manipulation or interpolation of the minutes and bound up the loose-leaves in books at reasonable intervals, say, six months.

Section 194 lays down that the minutes of meetings kept in accordance with the provisions of Section 193 shall be evidence of the proceedings recorded therein.

According to Section 195 of the Act, where minutes of proceedings of any Board/committee/general meeting have been kept in accordance with the provisions of Section 193 of the Act, then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and in particular, all appointments of directors or liquidators made at the meeting shall be deemed to be valid.

Section 196 requires that the minutes books or proceedings at general meeting must be kept open for inspection at the registered office of the company for at least two hours everyday. A member can ask for a copy of the minutes at a notice of 7 days on payment of such sum as may be prescribed for every hundred words or fraction thereof. The Central Government has vide notification dated 13.7.88 w.e.f. 15.7.88 prescribed a sum of Re. 1 for every 100 words for taking a copy of the minutes herein. However, the minute books of Directors' meeting cannot be inspected by the members.

In case of refusal, the company, and every officer of the company shall be liable to a fine up to ₹ 5000/- in respect of each offence. In case of such refusal, the Company Law Board* may, by order, compel an immediate inspection of the minute books or direct that the copy required shall forthwith be sent to the person requiring it. The minute books of directors' meetings are not available for inspection, except to directors.

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

The Minutes Books of Directors' Meetings are not available for inspection, except to directors.

- True
- False

Correct Answer: True

* It shall be substituted by Central Government after the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

(11) Register of Postal Ballot [Section 192A and the Companies (Passing of the resolutions by postal ballot) Rules, 2011]

As per section 192A, a listed public company shall, in the case of resolutions relating to such business as the central government may, by notification, declare to be conducted only by postal ballot, get such resolutions passed by means of a postal ballot, instead of transacting the business in general meeting of the company. In respect of resolutions not specified by the Central government, a listed company may at its discretion get the resolution passed by postal ballot.

Section 192A read with Rule 6(e) Companies (Passing of the resolutions by postal ballot) Rules, 2011, the scrutiniser shall maintain the register of postal ballot in which there shall be entered the following:

- (a) Particulars in respect of consent or dissent received, including electronic media
- (b) Name and address of shareholders
- (c) Folio number
- (d) Number of shares held
- (e) Nominal value of shares
- (f) Whether the shares have voting rights (differential voting or non-voting rights)

Scrutiniser shall also maintain record for postal ballot which are received in defaced or mutilated form.

In addition to aforesaid particulars the register of postal ballot should also be in conformity with the Companies (Passing of the Resolutions by Postal Ballot) Rules, 2011. The rules provide:

- (a) method of sending notice,
- (b) applicability of rules,
- (c) the list of businesses in which the resolutions shall be passed through postal ballot,
- (d) procedure to be followed for conducting business through postal ballot.

The register, postal ballot forms and all other related records are not available for inspection.

All postal ballot forms should be authenticated by the Scrutinizer. Entries in the register should be authenticated by the Scrutinizer.

Register of postal ballot should be kept at the registered office of the company and will be kept under the safe custody of the scrutiniser till the chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutiniser shall return the register to the company so as to preserve such register safely till the resolution is given effect to.

The Scrutinizer's report and office copies of the notices should be preserved in

good order until the resolution has been implemented or for a period of 10 years, whichever is later.

(12) Books of Account

Section 209 (1) of the Act states that every company shall maintain such books as will give a true and fair view in respect of:

- (a) all sums of money received and expended by the company and the matters in respect of which the receipts and expenditures takes place;
- (b) all sales and purchases of goods by the company;
- (c) all assets and liabilities of the company; and
- (d) such particulars regarding utilisation of material or labour or other items of cost as may be prescribed by the Central Government in respect companies which are required to keep cost accounts.

These books must be preserved for a minimum period of 8 years immediately preceding the current year. The books are open to inspection by directors. Under Section 209A the Registrar and officers authorised by the Central Government and such officers of the SEBI as may be authorised by it, can inspect the books of accounts and other books and papers of a company kept under Section 209 of the Act. These books are normally kept at the registered office of the company, but the Board of directors may decide to keep all books of account or any of them at a place other than the registered office provided the Registrar is informed in electronic Form No. 23AA of the Companies (Central Government's) General Rules and Forms, 1956 within seven days of its decision.

Sub-section (6) of Section 209 provides that the following persons shall be responsible for keeping the books of accounts and securing the compliance by the company with the requirement of the Act:

- (a) where the company has a managing director or manager, such managing director or manager and all officers and other employees of the Company; and
- (b) where the company has neither a managing director nor a manager, every director of the company.

Where a company has a branch office then the books of account can be kept at such branch also, but properly summarised returns made upto date, at intervals of not more than three months, have to be sent by the branch office to the company at registered office or to other place where books of accounts of the company as mentioned above are maintained. The purpose of this provision is that entire picture of the accounts of the company be available at one place for those who are inspecting the books of account.

The books of account together with vouchers, records and papers relevant to any entry in the books, should be preserved for a period of not less than 8 years immediately preceding the current accounting year.

The penalty for the contravention of this section is imprisonment upto 6 months

or fine up to ₹10,000/- or both to the persons responsible for the default as indicated in Sub-section (6) of Section 209 of the Act.

(13) Cost Record

As would be seen from sub-para (d) above under the head "books of account" a company is required to keep such particulars regarding utilisation of material, labour or other items of cost as may be prescribed by the Central Government. The Central Government so far has prescribed the maintenance of such records in some notified industries like cycles, refrigerators, caustic soda, vanaspati, bulk drugs, cotton textiles, milk food, fertilizers etc. For this purpose, separate Rules have been framed for each such industry. The cost records kept under Sub-section (1)(d) of Section 209 are governed by the same provision relating to maintenance, preservation, inspection and penalty etc. as are applicable to books of account.

(14) Register of Particulars of Contracts in which Directors are Interested (Section 301)

Every company must maintain the register to record the following particulars:

- (a) the date of the contract or arrangement in which directors are interested;
- (b) the names of the parties to such contracts or arrangements;
- (c) the principal terms and conditions thereof;
- (d) the date when the contract of this type was placed before the Board of directors; and
- (e) the names of the directors voting for or against the contract or arrangement and the names of those remaining neutral.

Entries relating to contract or arrangement requiring Board's approval must be made within seven days from the date on which the contract or arrangement is approved by the Board or in respect of any other contract or arrangement within 7 days (excluding public holidays) of receipt at Registered Office of the company of particulars of such other contract or arrangement or within 30 days of the date of the contract or arrangement whichever is later.

This is the only register which requires to be signed by all the directors present at the Board meeting following the meeting in which the contracts are considered. After the Board meeting, the register must be completed by showing the names of the directors who have voted for and against the contracts. The names of the directors remaining neutral must also be stated.

This register is also required to be maintained at the registered office of the company and it shall be open for inspection and extract and copies can be taken in the same manner by the members of the company as in the case of register of members. If default is made in the maintenance of this register, the company and every officer in default shall be liable for a fine up to ₹ 5000/- each and for refusal of inspection etc., fine up to ₹ 500/- per day of refusal or default.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(15) Register of Directors, etc.

As per Section 303 of the Companies Act, 1956, every company must keep at its registered office, a Register of Directors, Managing Director, Manager and Secretary. The necessary particulars regarding name, surname, father's/husband's name, nationality, business occupation, usual residential address, directorship, managerial position or office of secretary in other bodies corporate and date of birth in the case of a public company, must be entered in the register. Besides, the names and particulars of directors nominated have also to be included in the register. Every company, is required to send electronically a return giving the particulars contained in the register to the Registrar. Any changes in the managerial personnel should also be intimated to the Registrar. The time allowed for filing the returns is 30 days and so is for notification of a change in the managerial personnel. The register can be inspected by members free of charge, and by outsiders on payment of a fee of ₹1. However, there is no provision for supplying of copies or extracts from this register. Apart from this, the Registrar is also required to keep a register for entering particulars received in respect of directors. The register is also open to inspection on payment of prescribed fee. With the launch of MCA-21 project, users now have the facility for public inspection through electronic means.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

If default is made in the maintenance of this register, the company and every officer in default shall be liable for a fine up to ₹500/- for every day during which the default continues.

(16) Register of Directors' Shareholdings

This register is to be maintained according to Section 307. Every company shall keep a register showing, in respect of each director of the company, the number, description and amount of any shares in, or debentures of the company or any other body corporate, being the company's subsidiary or holding company, or a subsidiary of the company's holding company, which are held by him or in trust for him, or of which he has any right to become the holder whether on payment or not [Section 307(1)].

The purpose of maintenance of this register must be understood. The directors of the company during the course of their duties come to know about the present and the future policy of the company and the way in which it is going and it intends to go. In order to prevent any misuse of the position resulting in any dishonest financial gain by dealing in the shares of the company, and of its subsidiaries, it is

prescribed that all transactions relating to the Directors' shareholdings must be reported to the company and the same must be entered in the register.

The register containing these particulars must be kept open for inspection by members and debenture holders for a period of 17 clear days — 14 days before the annual general meeting and 3 days after it (Saturdays, Sundays and Public Holidays) should be disregarded for the purpose of counting this period). The register will always be open to inspection by the Registrar or any person authorised by the Central Government. Further, the Registrar or the Central Government can call for a copy of this register or any part thereof. However, members have not been given any such right of getting copies of this register or extracts thereof.

The most important part of the legal requirements in connection with this register is that the nature and extent of any interest or right in or over any shares or debentures recorded in respect of a director in the said register shall, if he so requires, be indicated in the register. These provisions are applicable to a manager as they apply to directors.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(17) Register of Investment, Loan Made, Guarantee Given or Security Provided to Other Body Corporate

The Companies (Amendment) Act, 1999 has inserted Section 372A in the Companies Act, 1956. As per Sub-section (5) of Section 372A of the Companies Act, 1956, every company shall keep a register showing the following particulars in respect of every investment made in the securities of other bodies corporate, all the loans given to other bodies corporate, guarantees given and security provided in connection with loans made by other persons to, or to any other persons by, the company:

- (i) the name of the body corporate;
- (ii) the amount, terms and purpose of the investment or loan or security or guarantee;
- (iii) the date on which the investment or loan has been made; and
- (iv) the date on which the guarantee has been given or security has been provided in connection with a loan.

The particulars as above shall be entered in the register in chronological order within seven days of the making of investment or loan or giving of guarantee.

The register shall be kept at the registered office of the company and shall be open to inspection at such office and extracts may be taken therefrom and copies thereof may be required by any member of the company in the same manner as in the case of register of members.

If default is made in the maintenance of this register, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and also with a further fine which may extend to rupees five hundred for every day during which the default continues.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

Within how many days, the particulars mentioned in Section 372A shall be entered in the register in chronological order?

- (a) Thirty days
- (b) Fifteen days
- (c) Twenty days
- (d) Seven days

Correct answer: d

The particulars mentioned in Section 372A shall be entered in the register in chronological order within seven days.

(18) Register of Renewed and Duplicate Certificates

Under the Companies (Issue of Share Certificates) Rules, 1960, companies are required to maintain the aforesaid register. The register should contain the following particulars:

- The name(s) of the person(s) to whom the certificates were issued.
- The number and date of issue of the share certificates in lieu of which the new certificates have been issued.
- The number and date of the new share certificate and the number of shares it covers.

The register should be maintained at the registered office of the company. The register is not open for inspection.

All entries in this register are required to be authenticated by the secretary or any other person authorised by the Board of directors.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(19) Register of records and documents destroyed [Section 163 and the Companies (Preservation and Disposal of Records) Rules, 1966]

As per Rule 4 of the Companies (Preservation and Disposal of Records) Rules,

1966, a company shall maintain a register of records and documents destroyed, which should indicate the following:

- (a) particulars of documents destroyed
- (b) date and mode of destruction with the initials of secretary or other authorised person

The register is not open for inspection. All entries made in the register shall be authenticated by the secretary or such other person as may be authorised by the Board for the purpose. Contravention of any of these rules shall be punishable with fine which may extend to five hundred rupees.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(20) Register of sweat equity shares [Section 79A and the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003]

The company shall maintain a register of sweat equity shares issued under section 79A in the form specified in Rule 5 of the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 in which there shall be entered the following particulars:

- (a) serial number
- (b) folio number or certificate number
- (c) date of passing of resolution
- (d) date of issue of sweat equity shares
- (e) name of the allottee
- (f) status of the allottee – whether director or employee
- (g) reference to entry in register of members
- (h) number of sweat equity shares issued
- (i) face value of the share
- (j) price at which shares issued
- (k) total consideration paid by employee / director
- (l) lock in period till which date

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members can inspect the register without payment of any fee. Copies of the register can be demanded by any person who inspects the register.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved for a period of 8 years from the financial year in which the latest entry is made and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

5. PROCEDURE FOR KEEPING REGISTERS AND RETURNS AT A PLACE OTHER THAN THE REGISTERED OFFICE

Pursuant to the provisions of Section 163 of the Companies Act, 1956, the Register of members/debentureholders, Index of members/debentureholders and copies of annual returns together with copies of certificates and documents required to be annexed thereto may, instead of being kept at the registered office of the company, be kept at any other place within the city, town or village in which the registered office is situate. The procedure is as under:

1. Call a meeting of the Board of Directors of the company by giving notice to all the Directors of the Company as per Section 286 of the Act;
2. Hold the Board Meeting and decide —
 - (a) to keep the registers and the returns at the place, other than the Registered Office of the Company, in the same city, village or town in which the Registered Office is situate;
 - (b) to recommend a special resolution to the shareholders of the company to consider and pass, with or without modifications at the general meeting (Annual or Extra-ordinary, as the case may be);
 - (c) to fix up date, time, place and agenda for convening a general meeting; and
 - (d) to approve draft notice of the general meeting and authorise the company secretary to sign and issue notice of the meeting in accordance with the provisions of the Act.
3. Send notice of the general meeting at least 21 clear days before the date of meeting.
4. Send three copies of the notice of the meeting to the stock exchanges where the company is listed.
5. Send a copy of the proposed special resolution to the concerned Registrar of Companies in advance to the passing of the special resolution.
6. Hold the general meeting and pass the special resolution as proposed or with such modification(s) as may be considered necessary by not less than 3/4th majority of the members presenting in person by show of hands (excluding of the proxy holder) and if on poll, by 3/4th majority of votes of the members including proxy holder present at the meeting entitled to votes.
7. File electronic Form No. 23 with a certified copy of the special resolution and the Explanatory Statement relating to them with requisite filing fees within 30 days from the date of passing the resolution with the concerned Registrar of Companies.

8. Paint or affix the name and address of the registered office on the outside of such office in the language(s) which is in general use in that locality. (Section 147 of the Act).

6. NON-STATUTORY REGISTERS

Besides the above mentioned statutory registers, which every company is required to keep, there are quite a few registers which are required to be maintained for the smooth, systematic and efficient functioning of the company. These registers have been established over a long period of time on the basis of experience as per requirements of companies. These registers are given below —

1. Director's attendance book.
2. Shareholders/proxies attendance register.
3. Register of documents executed under common seal.
4. Register of share applications and allotments.
5. Register of investors' complaint.
6. Register of share transfers/transmissions.
7. Register of Debenture transfers/transmissions.
8. Dividend register.
9. Register of powers of attorney/probate/letters of administration/death certificates/succession certificates.
10. Register of dividend mandates.
11. Register of Bank A/c particulars.
12. Register of electronic clearing service.
13. Register of fixed assets.
14. Register of Form No. 24AA from directors.
15. Register of nominations.
16. Register of share warrants.
17. Register of proxies.
18. Register of employee stock option.
19. Register under SEBI (Prohibition of Insider Trading) Regulations, 1992.
20. Register of inspection.

We shall discuss in detail the need for keeping these registers and the particulars that are usually entered therein.

(1) Directors' attendance book

A company must possess proof or evidence of the fact that at a particular Board meeting, the directors who were present, absent and who had sought leave of absence from the Board because of their inability to attend a meeting.

According to clause (g) of Sub-section (1) of Section 283 of the Companies Act, 1956, the office of a director becomes vacant if he absents himself from three

consecutive meetings of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board.

If at any stage, the Board declares vacant the office of any one of its directors, the company must have a proper record of attendance of its directors at each Board meeting to establish that the particular director had in fact absented, without leave of the Board, from the specified number of meetings or from all the meetings for the specified period of time.

In compliance with the provisions of sub-section (4) of Section 193 of the Companies Act, 1956, the minutes of each Board meeting contain the names of all the directors present at the meeting. In fact minutes of each Board meeting commence with the caption "Directors present at the meeting".

Articles of most of the companies contain a provision to the effect that the directors attending a Board meeting must sign in the book kept by the company for the purpose. This is based on regulation 71 in Table A of Schedule I to the Companies Act, 1956, which reads as: "Every director present at any meeting of the Board or a committee thereof shall sign against his name in a book to be kept for that purpose."

In view of the above provisions, a practice has been established with companies to keep a directors' attendance book, in which attendance of each director is marked by writing his name below details of the meeting. Signatures of all the directors attending Board meetings are obtained by the company secretary before the commencement of the meeting. Attendance of special invitees, like the solicitors, advocates, advisers, senior managers of the company etc. is also marked in the said register by writing names and designations.

The Director's attendance book is not open for inspection.

Some companies, instead of keeping a supplementary record in the form of a separate book for directors' attendance, get the signatures of the attending directors on the pages of the minutes themselves instead of keeping a separate book of directors' attendance. This is done by preparing the first page of minutes of each Board meeting in advance and at the time of the meeting, directors are requested to put their signatures against their names. The following specimen will make this clear:

(Name of the Company)

Minutes of the meeting of the Board of directors of the company held at..... Hrs. on (day), the day of 2003 at the registered office of the company at

Present:

<i>Sl. No.</i>	<i>Name</i>	<i>Designation</i>	<i>Signature</i>
1.	Shri	Managing Director	
2.	Shri	Wholetime Director	
3.	Shri	Director	
4.	Shri	Director	

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The book should be preserved for a period of 8 years and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(2) Shareholders'/Proxies' Attendance Register

For keeping proper record of the members attending every general meeting of a company, a register referred to as "shareholders' attendance register" is maintained.

The secretarial staff present at the venue of each general meeting of the company, take the signatures of the members/proxies coming for attending the meeting, before they enter the meeting hall.

The register has the following columns:

1. Name of the shareholder
2. Folio No. of the shareholder
3. No. of shares registered in his/her name
4. Name of the proxyholder and No. of shares for which proxy is given
5. Signature of the shareholder or proxyholder

The register should be maintained at the registered office of the company.

The register of Shareholders/proxies attendance in relation to a particular meeting should be open for inspection to every member entitled to vote at that meeting, during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting.

No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved for a period of 8 years from the date of the meeting and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(3) Register of Documents executed under Common Seal

Section 34 (2) of the Act provides that from the date of incorporation of a company, the subscribers to its memorandum shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up, as is mentioned in the Act.

Underlining the importance of the common seal of a company, Section 48 (1) of

the Act lays down that a company may, by writing under its common seal, empower any person, either generally or in respect of any specified matters, as its attorney, to execute deeds on its behalf in any place either in or outside India.

Sub-section (2) stipulates that a deed signed by such an attorney on behalf of the company and under his seal where sealing is required, shall bind the company and have the same effect as if it were under its common seal.

Whether attestation required for affixing common seal

In view of the provisions of Section 48 of the Act above, the affixing of the common seal of a company on the authority of a Board resolution, on a document is sufficient without its being witnessed. However, articles of association of most of the companies contain an article describing the mode and method of affixing common seal of the company, which also makes attestation by one or two directors and the company secretary, compulsory. A standard wording is –“The common seal of the company shall be affixed on a document on the authority of a Board resolution and in the presence of one or two directors and the company secretary, who shall also sign the same.”

Where the articles have such a provision, the signatures of the directors are not an attestation in the ordinary sense, but a part of the execution of the deed. [*Shears v. Jacob*, (1866) LR 1 CP 513; *Deffel v. White*, (1866) LR 2 CP 144.] Without such signatures, the execution is not complete, but there is no direct judicial decision to this effect.

With the forgoing importance of Common Seal, it should be kept in safe custody and its renewal/replacement should be through Board meeting.

Maintenance of the Register of Sealed Documents

In view of the importance of the common seal of a company, companies maintain a register of sealed documents, on which the following details of the documents on which the common seal of the company is affixed, are usually entered:

1. Serial number and date of the entry;
2. Particulars of the document on which common seal has been affixed;
3. Date of affixing the seal;
4. Name(s) of the director(s)/company secretary, in whose presence the seal has been affixed; and
5. Initials/signatures of the persons signing and making entries in the register and maintaining the register.

This Register should be maintained at the registered office of the company.

The register is not open for inspection.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(4) Register of Share Applications and Allotment

This register is usually prepared by the registrar to the public issue of a company, who feeds in their computers, each and every piece of information relating to all the applications for shares, which are received by the company in response to the prospectus issued by it, during the entire process of public issue.

This register, when complete, is placed before the Board of directors of a company at its meeting which is convened and held for allotment of shares. The Board considers all the particulars entered in the register alongwith the share applications and other relevant records, and passes a resolution for allotment of shares giving a reference of the register in the resolution.

The register usually contains the following columns:

1. Serial No. allotted to the application.
2. Name of the applicant/allottee.
3. Postal address of the applicant/allottee.
4. Occupation, if any, of the applicant/allottee.
5. Father's/husband's name of the applicant/allottee.
6. No. of shares applied for.
7. No. of shares allotted.
8. Amount received with the application.
9. Amount appropriated on allotment.
10. Amount to be refunded. A separate register/list of persons entitled for refund or details of refund made, Refund order no. and date.
11. Register of members' folio No. allotted to each allottee.
12. Total number of shares on each page (allotted).
13. At the end of the register are given:
 - (i) total number of allottees, and
 - (ii) cumulative total of the number of shares allotted with distinctive numbers;
 - (iii) total amount (a) collected, (b) adjusted on allotment (c) Refund amount (d) amount due on allotment.

Note: Each page of the register is initialled and the last page is signed by the chairman of the meeting with date of the Board meeting. The company secretary also signs below the signature of the chairman.

The register should be maintained at the registered office of the company.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by

its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members or debenture holders can inspect the register without payment of any fee.

No person is entitled to copies of the register or any portion thereof.

Various volumes of this register are to be preserved for at least eight years. However it is permanent record for a company.

(5) Register of Investors' Complaints

Every company should maintain a register of investor's complaints and enter therein the particulars of complaints received from depositors and holders of securities of the company.

The register should contain the following particulars in respect of each complaint received: date of receipt of complaint; nature of complaint; name of the person lodging the complaint; deposit receipt number or folio number/client ID number; date of interim reply, if any; date on which complaint was fully satisfied; time taken for resolving the complaint.

Entries in the register should be made forthwith in chronological order of date of receipt of the complaint.

The register should be maintained at the registered office of the company or, where the company has appointed a Registrar and Transfer Agent (RTA), at the office of RTA.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Any investor can inspect the register without payment of any fee.

No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved for a period of 8 years from the date of the last entry and should be kept in the custody of the secretary of the company or any other person authorised by the Board for the purpose.

(6) Register of share transfer/transmissions

Every time share transfers/transmissions are received in the office of a company or in the office of the Share Transfer Agents/Registrar of a Companies, their details are entered in this register and on specific intervals, this is placed before the Board or a Committee of the Board looking after the share transfer/transmission work, which is pursued alongwith the share transfer/transmission applications and the relevant share certificates. When the registration of

transfer/transmission of the shares is approved by the Board or the Committee or Share Transfer Agent or Company Secretary if authorised by the Board of Directors, the register is initialled by the chairman of the meeting and the last page of the register is signed with date by the chairman of the Board/Committee or the person authorised in this regard.

Usual columns in this register are:

1. Serial No. of share transfer/transmission.
2. Date of registration of transfer.
3. Date of Board Meeting at which the transfer was passed.
4. Name and address of transferor.
5. The amount paid on each shares, if shares are partly paid.
6. The number of shares transferred with distinctive numbers.
7. The name, address and description of transferee.

The register is not open for inspection

The register of should be preserved for a period of 8 years from the date of the last entry and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(7) Register of Transfer/Transmission of Debentures

Every company that allots debentures should maintain a register of debenture transfer/transmission and enter therein particulars of every debenture transferred/transmitted.

The register should contain the following particulars: transfer serial number; date of lodgement of transfer application; total number of debentures; consideration; transferor's name and folio number; number of debentures; certificate number(s), distinctive numbers; transferee's name and folio number, address, occupation, father's/husband's name; date of Board/committee resolution approving transfer; new certificate number, if any; date of dispatch of the certificate.

In case of transmission, transmission serial number; date of lodgement of transmission etc.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register should be preserved permanently and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(8) Dividend register

Whenever a company pays dividend, interim or final, this register is used. Details of every dividend are entered in the register. This register is to be maintained as a permanent record. The register contains the following columns:

1. Name of the company.

2. Registered office address of the company.
3. On top of the register a label is affixed with its title written on it, e.g.,
 - (a) Name of the company
 - (b) Registered Office address of the Company
 - (c) Register of Dividend/Interim Dividend for the year/period
4. Name of the shareholder
5. Register of members' Folio No.
6. Number of shares held
7. Amount of dividend/interim dividend payable

Remarks column for initials of the authenticating officer of the company.

Entries in the register should be made within 7 working days of the date of payment of dividend.

The register should be maintained at the registered office of the company.

The register is not open for inspection.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature thereto.

The register should be preserved for a period of 8 years from the date of payment and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

Dividend reconciliation statement should be preserved as long as any dividend remains unclaimed.

(9) Register of powers of attorney/probate/letters of administration/death certificates/succession certificates

This register is meant to register certain legal representations viz.,

- (i) power of attorney executed by a member of the company on a non-judicial stamp paper of the appropriate value as is required in the State wherein the same is executed in favour of another person authorising him to deal with the company on his behalf;
- (ii) probate, which is a duly certified copy of the Will of a deceased member of the company, and is sent to the company by the legatee of the Will, with a request that the company to proceed on the basis of the contents of the probate in respect of the shares held by the deceased member;
- (iii) letter of administration is a term broadly applied to denote the authorisation issued in favour of a person appointed by an authority of law to take charge of and manage the estate of another person. In the case of a company, this estate is the shares registered in the name of a member of the company. The holder of a letter of administration requests the company to register his authority in respect of the shares held by the registered member of the company; and

- (iv) death certificate is a document issued by the Registrar of Births and Deaths which certifies the time, date and place of death of a person. The heirs of a deceased member obtain such a certificate in order to have the shares registered in the name of the deceased member transmitted in their names.

On receipt of the above-mentioned documents by the company, their particulars are entered in the register kept for the purpose. A registration number is allocated to each such document, which is communicated to the person from whom such a request has been received, so that if on the basis of the same document a share transfer/transmission is lodged with the company in future and the person who has lodged the same, quotes the registration number of the document allotted to it by the company, he need not send the original document to the company again and again.

For the first time, such a document is sent to the company along with a photocopy of the same. The photocopy of the document is certified by a responsible officer of the company, preferably by the company secretary, and the original is returned to the sender along with a covering note intimating that the document has been registered in the office of the company under a certain registration number and all future correspondence on the strength of the same document should bear a reference of the registration number of the document and the original need not be sent to the company.

Usual columns in the register are:

1. Serial No. of registration of the document
2. Name and address of the person who has lodged the document with the company for registration
3. Type of document, its No. and date
4. Issuing authority
5. Name, Folio No. and address of the shareholder to whom the document pertains and also number of shares.

Any other important information may be recorded in the register. This is also a very important register and must be preserved as a permanent record.

(10) Register of Dividend Mandates

Section 206(1)(a) of the Companies Act, 1956, lays down that no dividend shall be paid by a company in respect of any share therein, except, *inter alia*, to the registered holder of such share or to his order or to his bankers.

Pursuant to the above provision, a member of a company may write to the company and request that the dividends on the shares, which are registered in his name, be paid to a particular person, whose name, address, specimen signature and other required particulars be communicated to the company. This request by a shareholder is known as "dividend mandate".

As and when such dividend mandates are received by a company, their particulars are entered in the register of dividend mandates and at the time of mailing of the dividend warrants, this register is referred to and the dividend warrants of the requesting members are mailed to their mandates.

The following columns may be made in this register:

1. Name, address and folio No. of the member
2. Number and type of shares (with their distinctive numbers) registered in the name of the member
3. Name, full postal address of the person to whom the dividend warrant is required to be sent.

This register is to be maintained on continuous basis. The company has to update this register on regular basis with the request for variations in earlier mandate cancellation thereof and registration of new mandate.

(11) Register of Bank A/c Particulars

In order to avoid fraudulent encashment of dividend/interest warrants, the Bank account particulars i.e. the Bank A/c No. (saving/current A/c), name of the bank, Branch address and folio No. are being obtained from the shareholders/debenture holders/depositors. These particulars are incorporated on the warrant in addition to the name of payee. Such practice discourage fraudulent practice of encashing warrants by other than payees. The company has to keep and maintain this register in addition to the Register of mandate. These particulars are desirable to be incorporated in case of payment is to be made to mandatee. In case of mandatee, the bank A/c particulars of the mandatee are to be collected and incorporated in the dividend/interest warrant. This register is required to be updated regularly and annually. The columns are the following:-

1. Serial No., 2. Date, 3. Folio No., 4. Name of Shareholder/debenture holder/depositor, 5. Bank A/c no., 6. Bank's Name, 7. Branch address.

(12) Register of Electronic Clearing Service

For better services to and protecting interest of corporate investors, the Reserve Bank of India has introduced a new method of payment of dividend/interest through Electronic Clearing Service (ECS). Under this system, the payee can collect dividend/interest directly through his/her bank account rather than receiving them through post. His/her bank account is directly credited through ECS and an advice thereof would be issued by paying company after the transaction is effected. Initially this mechanism covers each of the transactions upto ₹ 1,00,000 and is presently available at sixteen selected centres. The benefits of this scheme are—

1. Instant credit to the investors bank A/c at no extra cost;
2. Exposure to delays in postal service avoided;
3. No loss in transit of the instrument avoids issue of duplicate instrument;
4. Prompt credit of dividend/interest is assured;
5. No chance of fraudulent encashment of instrument.

A company which provides such facility to its investors, shall have to keep and maintain a separate register for the investors who opts this ECS mechanism. Its columns are the same which are given for the Register of Bank A/c Particulars.

(13) Register of Fixed Assets

Under the Companies (Auditors' Report) Order 2003 (CARO), the Auditors have to include a statement in their report which *inter alia* specify whether the company is maintaining proper records to show full particulars including quantitative details and situation of fixed assets. Hence, this register is a statutory register. Each company should keep and maintain this register. Maintenance of such register shall help the management to fix accountability and detect misuse, misappropriation and fraud about the assets of the company. The following may be the columns of this register:—

1. Serial No., 2. Date of entry, 3. Particulars of assets, 4. Quantity, 5. Cost price, 6. Date of purchase, 7. Situation, 8. Details of disposal, 9. Remarks.

(14) Register of Form No. 24AA from Directors

Under Section 299 of the Companies Act 1956, every director of a company has to give a general notice in Form No. 24AA prescribed under the Companies (Central Government's) General Rules and Forms 1956, to the Board of Directors of the Company to the effect that he is a director or a member of a specified body corporate or is a member of a specified firm and is to be regarded as concerned or interested in contracts or arrangements with them. This form is to be given initially at the time of appointment and also it is required to be renewed every year. This notice expires at the end of the financial year in which it is given. It is to be renewed every year before it expires.

Failure to comply with the provisions of this section by a director, makes him punishable with fine which may extend to fifty thousand rupees. Besides, the office of such defaulting director shall become vacant under Section 283(1) (i) of the Companies Act, 1956.

In view of the above, a company secretary has to keep and maintain this register as to ascertain the director whose office shall fall vacant and who shall be punishable for non-compliance. Its columns may be the following:

1. Serial No. 2. Name of director, 3. Date of appointment, 4. Details of Form 24AA received (i) Date of receipt, (ii) Date of Board meeting where it was read and recorded, (iii) Date of validity.

(15) Register of Nomination

Under Section 109A of the Companies Act 1956, every holder of shares in, or holder of debentures, of a company may, at any time, nominate in the prescribed manner, a person to whom his shares in, or debentures of, the company shall vest in the event of his death.

Under Rules 4CCC and 5D of the Companies (Central Government's) General Rules and Forms, 1956, Form No. 2B has been prescribed.

In view of the above, every company should keep and maintain a Register of Nominees for each class of shares, and debentures separately. Simultaneously, the details of the nominee should be recorded in the respective folio of the Register of Members and Register of Debenture holders. The following may be the columns of

this register:–

1. Serial No., 2. Date of entry, 3. Date of receipt of Nomination Form, 4. Name & address of nominee, 5. Date of birth (minor), 6. Name & address of guardian of nominee (minor), 7. No. of shares/debentures, 8. Remarks.

This register is required to be maintained permanently.

(16) Register of Share Warrants

When a company issues share warrants, this register is required to be maintained. The name of the warrant holder is struck off from the register of members after making an appropriate reference there. His name and other relevant particulars are entered in the register of share warrants.

The register must have, *inter alia*, the following columns:

1. Name of share warrant holder
2. Address of share warrant holder
3. No. and date of issue of share warrant
4. His register of members folio no.
5. No. of shares, with distinctive numbers, in lieu whereof share warrants have been issued
6. Remarks (for any other information and for signature of the Company Secretary, who must authenticate each entry in the register).

(17) Register of Proxies

For keeping record of valid proxies received for attending a general meeting of a company, which may be required at any point of time, this register is maintained for each meeting. It has the following columns:

1. Name and address of the member whom the proxy represents.
2. No. and type of shares registered in the name of the member, with distinctive numbers.
3. Folio No. of the member.
4. Name of the proxy.
5. No. of shares for which proxy is given.

The register should be maintained at the registered office of the company.

The register of proxies in relation to a particular meeting should be open for inspection to every member entitled to vote at that meeting, during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting.

No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register of proxies should be preserved for a period of 8 years from the date of the meeting and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(18) Register of Employee Stock Options

Every company which issues employee stock options should maintain a register of employee stock options and enter therein particulars of options granted.

The register should contain the following particulars in relation to each scheme: date of special resolution approving the scheme; category of employees entitled to participate in the scheme; total number of options granted; market price per share on the date of grant; name of the grantee; number of options granted; vesting period; options vested; exercise period; options exercised; exercise price and market price per share; number of shares arising as a result of exercise of option; options lapsed, if any; any variation of terms of the scheme; date of special resolution passed for variation; lock-in-period; money realized by exercise of options; total number of options in force; amount adjusted towards allotment and amount refunded.

The register should be maintained at the registered office of the company or at such other place as the Board may decide.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members can inspect the register without payment of any fee. No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register of should be preserved for a period of 15 years from the date of exercise of options and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(19) Register in Respect of SEBI (Prohibition of Insider Trading) Regulation, 1992

Every listed company should maintain year-wise, a register in terms of SEBI (Prohibition of Insider Trading) Regulation, 1992.

The register should contain the following particulars: name of the companies officer; date of initial and continual disclosures made by directors, officers and designated employees; disclosures made by the company to the Stock Exchange; date of opening and closing of trading window; whether in ESOSs exercise of option was allowed when trading window was closed; date of application made by director/designated employees/relatives of director to the compliance officer for pre-clearance of trades; date of approval; date of clearance of trade(s) or reasons for non-clearance of trade(s); reasons for waiver of holding period of 30 days.

Entries in the register should be made forthwith.

The register should be maintained at the registered office of the company or at such other place as the Board may decide.

The register should be open for inspection during the business hours of the company, subject to such reasonable restrictions as the company may impose by its articles or in general meeting so that not less than 2 hours in each working day of the company are allowed for inspection.

Members can inspect the register without payment of any fee. No person is entitled to copies of the register or any portion thereof.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register of should be preserved for a period of 5 years and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

(20) Register of Inspection

Every company should, from the date of its registration, maintain a register of inspection in which particulars of inspection of registers or records of the company should be entered.

The register should contain the following particulars in respect of each inspection: date and time of inspection; name and address of the person who inspected the registers and records; particulars of registers and records inspected; copies, if any, taken; fees, if any, received; and signature of the person who inspected the registers and records.

Entries in the register should be made forthwith.

The register should be maintained at the registered office of the company.

The register is not open for inspection.

Entries in the register should be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose, by appending his signature to each entry.

The register of should be preserved for a period of 8 years and should be kept in the custody of the secretary of the company or by any other person authorized by the Board for the purpose.

7. ELECTRONIC FORMS

The Companies (Amendment) Act 2006, has introduced, inter alia, new provisions relating to filing of applications, documents, inspection etc. through electronic form. The said provisions are contained in newly inserted Section 610B, which reads as under:

“Provisions relating to filing of applications, inspection of documents, etc., through electronic form.

610B. (1) Notwithstanding anything contained in this Act, and without prejudice to the provisions contained in section 6 of the Information Technology Act, 2000 (21 of 2000), the Central Government may, by notification in the Official Gazette, make rules so as to require from such date as may be specified in the rules, that—

- (a) such applications, balance sheet, prospectus, return, declaration, memorandum of association, articles of association, particulars of charges, or any other particulars or document as may be required to be filed or delivered under this Act or rules made thereunder, shall be filed, through the electronic form and authenticated in such manner as may be specified in the rules;
- (b) such document, notice, any communication or intimation, required to be served or delivered under this Act, shall be served or delivered under this Act through the electronic form and authenticated in such manner as may be specified in the rules;
- (c) such applications, balance sheet, prospectus, return, register, memorandum of association, articles of association, particulars of charges, or any other document and return filed under this Act or rules made thereunder shall be maintained by the Registrar in the electronic form and registered or authenticated, as the case may be, in such manner as may be specified in the rules;
- (d) such inspections of the memorandum of association, articles of association, register, index, balance sheet, return or any other document maintained in the electronic form, which is otherwise available for such inspection under this Act or rules made thereunder, may be made by any person through the electronic form as may be specified in the rules;
- (e) such fees, charges or other sums payable under this Act or rules made thereunder shall be paid through the electronic form and in such manner as may be specified in the rules;
- (f) the Registrar shall, register change of registered office, alteration of memorandum of association or articles of association, prospectus, issue certificate of incorporation or certificate of commencement of business, register such document, issue such certificate, record notice, receive such communication as may be required to be registered or issued or recorded or received, as the case may be, under this Act or rules made thereunder or perform duties or discharge functions or exercise powers under this Act or rules made thereunder or do any act which is by this Act directed to be performed or discharged or exercised or done by the Registrar, by the electronic form, in such manner as may be specified in the rules.

(2) The Central Government may, by notification in the Official Gazette, frame a scheme to carry out the provisions specified under sub-section (1) through the electronic form:

Provided that the Central Government may appoint different dates in respect of different Registrar of Companies or Regional Directors from which such scheme shall come into force.”

The Companies (Amendment) Act, 2006 has also introduced few other provisions in the Act which support the maintenance of records in electronic form, electronic filing and eGovernance. These are contained in new Section 610C, Section 610D and Section 610E. The same are reproduced below:

“Power to modify Act in relation to electronic records (including the manner and form in which electronic records shall be filed).

610C. (1) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act, so far as it is required for the purpose of electronic record specified under section 610B in the electronic form,—

- (a) shall not apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of section 610B, as may be specified in the notification; or
- (b) shall apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of section 610B only with such consequential exceptions, modifications or adoptions as may be specified in the notification:

Provided that no such notification which relates to imposition of fines or other pecuniary penalties or demand or payment of fees or contravention of any of the provisions of this Act or offence shall be issued under this sub-section.

(2) A copy of every notification proposed to be issued under sub-section (1), shall be laid in draft 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, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

Providing of value added services through electronic form.

610D. The Central Government may provide such value added services through the electronic form and levy such fees as may be prescribed.

Applicability of Information Technology Act, 2000 in relation to Electronic Records

610E. All the provisions of the Information Technology Act, 2000 relating to the electronic records (including the manner and format in which the electronic records shall be filed), in so far as they are not inconsistent with this Act, shall apply, or in relation, to the records in electronic form under Section 610B."

The Ministry of Corporate Affairs has amended the Companies (Central Government) General Rules and Forms 1956 to enable electronic filing of documents. The amended rules have been notified vide GSR No 56(E) dated 10th February 2006. New electronic forms are made operational from 18th February, 2006. Wherever the word 'electronic form' is used in this study material, it signifies the new electronic forms as notified by the Ministry of Corporate Affairs, from time to time. Wherever the word 'electronic form' is not used, it signifies that the Ministry

has not yet notified electronic form for the same. However, the Ministry is in the process of notifying few more electronic forms. Students are, therefore, advised to keep themselves updated on new electronic forms being notified by the Ministry from time to time. It may also be noted that all electronic forms requires documents and attachments to be in standard 'pdf format'.

8. FILING OF VARIOUS FORMS/RETURNS WITH REGISTRAR OF COMPANIES

(A) Forms, Returns etc. filed with ROC for Registration

The following forms etc. prescribed under the Companies Act, 1956 and the Companies (Central Government's) General Rules and Forms, 1956, are required to be filed with the Registrar of Companies for the purpose of getting the company incorporated:-

Documents:

- (i) A printed copy of memorandum and articles of association duly stamped, signed and dated.

It may be noted that in the case of a public limited company, registration of articles of association with the Registrar is optional, but in the case of a private limited company, registration of articles of association with the Registrar is compulsory [Refer Section 3(1) (iii)] of the Companies Act, 1956].

- (ii) Any agreement that the company on incorporation proposes to enter into with any person for appointment as its managing director or whole-time director or manager.
- (iii) General power of attorney on a non-judicial stamp paper of the appropriate value as applicable in the State in which the document is executed, duly signed by all the subscribers to the memorandum, in favour of one of them or any other person, for making alterations etc., on their behalf, in the memorandum and articles of association and other documents/forms filed with the Registrar of Companies, if suggested by the Registrar.
- (iv) A certified true copy of the letter received from the Registrar of Companies intimating about the name availability.

Forms:

- (i) A statutory declaration in electronic Form No. 1 as prescribed in the Companies (Central Government's) General Rules and Forms, 1956, executed by an advocate of the Supreme Court or of a High Court, an attorney or a pleader entitled to appear before a High Court, or a secretary, or a chartered accountant in whole time practice in India, who is engaged in the formation of the company, or by a person named in the articles as a director, manager, or secretary of the company, to the effect that all the requirements of the Act and the rules thereunder have been complied with in respect of registration of the company and matters precedent and incidental thereto [Refer Section 33 (2)].
- (ii) Electronic Form No. 18 containing notice of situation of the registered office of the company.

- (iii) Electronic Form No. 32 containing prescribed particulars of directors including Managing/Whole-time Director/Manager/Secretary, if any as well as consent to act as director of the company, by each proposed director including the Managing/Wholetime Director, if any. This form also contains an undertaking to take and pay for the qualification shares, if any, prescribed in the articles of the company.

It may be noted that it is not a statutory requirement to file the above-mentioned forms except electronic Form No. 1 alongwith the memorandum and articles of association for registration of a company. However, it has become a practice with the Registrars to insist on filing these forms along with the memorandum and articles for registration of the company.

(B) Filing of Various Forms>Returns with the ROC after Incorporation

Every company registered under the Companies Act, 1956, is required by various provisions of the Act to file, deliver, submit to the Registrar of Companies various types of notices, returns, reports, copies of resolutions and other documents, subsequent to their incorporation. (For a list of such form, returns, etc. please see Annexure VI).

Special Resolutions for Registration with ROC

Every company is required to file with the ROC, electronic Form No. 23 along with a certified copy of every resolution passed and explanatory statement relating thereto for the following purposes and under the sections given against each, within thirty days of the passing of the resolution, along with the filing fee:

- altering the provisions of the company's memorandum of association, to change the objects clause in the company's memorandum of association and to change the place of a company's registered office from one state to another – Section 17;
- for changing the name of a company – Section 21;
- for changing the name of a charitable or other non-profit company by omitting the word "Limited" or the words "Private Limited" – Section 25(3);
- for altering the articles of association of a company – Section 31;
- for authorising buy-back of securities of the company;
- for authorising issue of sweat equity shares;
- for issuing shares without pre-emptive rights – [Section 81(1)] – to non-members [Section 81(1-A)] or to convert loans or debentures into shares – Section 81(3);
- for determining that any portion of the share capital of a company not already called up shall not be called up except in the event of, and for the purpose of, its winding up – Section 99;
- for reduction of share capital of a company, subject to authorisation by its articles and confirmation by Court – Section 100;
- for approval of variation of rights of special classes of shares in a company – Section 106;

- for removal of the registered office of a company outside the local limits of the village, town or city in which it is situated – Section 146;
- for commencement of any new line of business by a company – Section 147(2A);
- for keeping registers and returns at any other place within the city, town or village in which the registered office of a company is situated – Section 163;
- for authorising the payment of interest on the paid-up amount of share capital raised for the purpose of defraying the expenses of construction of any works or building or for the provision of any plant that cannot be made profitable for a long period of time – Section 208(2);
- for appointing auditors in the case of a company in which the Central and/or any State Government, and/or public financial institution or institutions together hold twenty-five per cent or more of its subscribed capital – Section 224A;
- for requesting the Government to investigate the affairs of a company and for appointing inspectors for the purpose – Section 237;
- for appointing sole selling or buying or purchasing agent in the case of companies having paid-up share capital of rupees fifty lakhs or more – Section 294AA;
- for fixing remuneration of directors other than managing director where the articles require such a resolution – Section 309(1);
- for sanctioning remuneration to directors other than the managing or whole-time director on percentage of profit basis in certain instances – Section 309(4) and renewal under Sub-section (7);
- for according consent to a director or his relative or partner or firm or private company holding an office or place of profit, except that of the managing director, manager, banker or trustee for debenture-holders of the company – Section 314;
- for making the liability of any director or manager unlimited, where so authorised by the articles – Section 323;
- for making loans or acquiring securities of other bodies corporate or providing guarantee or security to other companies beyond the prescribed overall limit of sixty per cent of the company's paid up share capital and free reserves or hundred per cent of free reserves, whichever is higher – Section 372A;
- for applying to a Court for winding up of the company – Section 433(a);
- for winding up of a company voluntarily – Section 484(1)(b);
- for winding the company by arrangement made under Section 517;
- for various other matters pertaining to the winding up of a company – Sections 433(a), 494(1)(b), 507, 512(1), 546(1)(b), 550(1)(b);
- for altering the constitution of a company registered under part IX of the Act – Section 579(1).

9. PREPARATION AND FILING OF RETURNS WITH THE REGISTRAR OF COMPANIES

As stated above, a company has to file certain returns and statements with the Registrar of Companies from time to time. These returns can be classified into two categories, namely:

- (a) Returns on occurrence of certain events.
- (b) Periodical Returns.

The first type of returns are those returns which are required to be filed as and when contingency arises. Whereas periodical returns have to be filed after a specified period. Among the first type of returns the important ones are, the creation of charge, return of allotment, change of directors, change in the registered office, passing of a special resolution, etc. (The classification of returns is given for facility of understanding and has no legal or statutory basis).

Periodical Returns

There are three important periodical returns. These are:

- (i) Annual Return under Section 159 or 160,
- (ii) Balance Sheet and Profit and Loss Account under Section 220; and
- (iii) Compliance Certificate under Section 383A.

(1) Annual Return

Sections 159 to 161 deal with annual return. Section 159 provides that every company having a share capital must within 60 days from the day on which each of the annual general meeting is held, prepare and file with the Registrar (annual return contains the particulars specified in Part I of Schedule V), regarding:

- (a) registration details
- (b) its registered office
- (c) the register of its members
- (d) the register of its debenture holders
- (e) its shares and debentures
- (f) its indebtedness
- (g) its members and debenture holders, past and present
- (h) its directors, managing director, manager and secretary, past and present.

In the case of big companies, preparation of correct annual return is a crucial task. Help of Electronic Data Processing Section of the Company must be taken. The Register of members is usually maintained alphabetically. If the company is maintaining "off and on book" which contains transactions of additions and deductions during the year, there should not be any difficulty in reconciling the number of shares stated in the new annual return.

The contents of annual return are to be given in the form prescribed in Part II of Schedule V to the Companies Act, 1956. New electronic form no. 20B has been notified, for filing annual return by a company having share capital

and electronic form no. 21A for filing annual return by a company not having share capital.

The annual return filed with the Registrar must be signed both by a director and by the manager or secretary of the company or where there is no manager or secretary, by two directors of the company, one of whom shall be the managing director where there is one. In case of listed company, it shall also be signed by a secretary in whole-time practice.

As per provisions of Section 163, copies of all the annual returns prepared by the company under Sections 159 and 160 together with the documents required to be annexed thereto under Sections 160 and 161 shall be kept at registered office of the company and are to be made available for the inspection of the members of the company and copies thereof supplied to them on request in the same manner as those of Register of members highlighted earlier in this study under the main head Statutory Registers Elaborated.

If the Annual Return is not kept, prepared or filed, the company and every officer in default shall be punishable with a fine of ₹ 500/- per day during which the default continues. Where inspection is refused or extracts and copies are not supplied, the fine would be up to ₹ 500/- per day.

(2) Balance Sheet and Profit and Loss Account

As per the provisions of Section 210 and 211 read with Schedule VI, a company has to prepare a Balance Sheet and Profit and Loss Account, get it audited and place it before the shareholders for adoption in the annual general meeting which is required to be held as per provisions of Section 166. Under Section 220, three copies of the Balance Sheet and Profit and Loss Account, Auditors' Report and Directors' Report have to be filed within 30 days of the date on which the balance sheet and profit and loss are laid at the annual general meeting (A.G.M.) or if the A.G.M. is not held, within 30 days of the last day on which the same meeting ought to have been held.

New electronic forms no. 23AC and 23ACA has been notified w.e.f. 10.2.2006, for filing balance sheet and profit & loss account respectively.

(3) Compliance Certificate

As per the newly inserted proviso to Sub-section (1) of Section 383A of the Act every company not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar, a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all the provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in Section 217. In terms of this proviso, the Central Government has prescribed the Companies (Compliance Certificate) Rules, 2001 for issue of Compliance Certificate by a secretary in whole-time practice. These rules have come into force w.e.f. 1st February, 2001. Sub-rule (2) of Rule 3 of aforesaid rules specifies that the compliance certificate shall be in form appended to the rules or as near thereto as

circumstances admit. Certain amount of flexibility in the form has, therefore, been provided which means that if any information required to be given in the certificate does not fit into the format, necessary modifications may be made in the format by secretary in whole-time practice.

Guidelines for issuing compliance certificate and signing Annual Returns issued by ICSI in 2007 prescribe that a member of the Institute in practice who is entitled to issue compliance certificate pursuant to the proviso to Sub-section (1) of Section 383A of the Companies Act, 1956 shall be deemed to be guilty of professional misconduct if he issues compliance certificates for more than eighty companies in aggregate, in a calendar year. However, in the case of a firm of Company Secretaries, the ceiling of eighty companies aforesaid would apply to each partner therein. These Guidelines are effective from 1st January, 2008. [ICSI Guideline No.1 of November, 2007]

Every company to which these rules apply is required to file with the Registrar the compliance certificate within 30 days from the date on which its annual general meeting is held or from its due date. In case of adjourned annual general meeting this certificate should be filed with the ROC within 30 days from the date on which such adjourned general meeting was held provided such adjourned meeting is held within the statutory limit. New electronic Form No. 66 has been notified, for filing compliance certificate and the same needs to be filed with ROC electronically by converting the compliance certificate into 'pdf format'.

Sub-rule (3) of Rule 3 provides that the secretary for the purpose of issue of compliance certificate shall have right to access at all times to the registers, books, papers, documents and records of the company, whether kept in pursuance of the Act or any other Act or otherwise or whether kept at the registered office of the company or elsewhere. He shall also be entitled to require from the officers or agents of the company, such information and explanations as he may think necessary for the purpose of such certificate.

The Central Government in exercise of the powers conferred under Section 642 and Section 383A of the Companies Act, 1956 has amended the Companies (Appointment and Qualifications Of Secretary) Rules, 1988 vide Notification No. G.S.R. 11 (E), dated 5-1-2009.

As per this amendment, every company having a paid-up share capital of not less than rupees five crore shall be required to appoint a whole-time secretary who is a member of the Institute of Company Secretaries of India.

Also, under the amended rules a company having a paid up share capital of two crore rupees or more but less than five crore rupees may appoint any individual who is a member of the Institute of Company Secretaries of India as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956.

Further, where a company has appointed a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in whole-time practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001.

The said amendment has come into force from 15th March, 2009.

Where a company fails to comply with the requirement of filing the compliance certificate with the ROC or attaching the copy of such certificate with Board's report, in terms of Sub-section (1A) of Section 383A, the company, and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 500 for every day during which the default continues.

However, in any proceedings against a person in respect of an offence under this sub-section, it shall be a defence to prove that all reasonable efforts to comply with the provisions were taken.

Returns on Occurrence of Certain Events

A Detailed list of the returns and other documents which are required to be filed with the Registrar of Companies along with the period upto which these are to be filed and the relevant sections has been given as Annexure I.

We shall discuss here about the returns required to be filed under the Companies Act:

(a) Returns as to Allotment

By virtue of Section 75 of the Act, whenever a company having a share capital makes any allotment of its shares, it must, within 30 days, file with the Registrar a return of allotment stating the number and nominal amount of the shares comprising the allotment, the names, addresses and occupations of the allottees and the amount, if any, paid or due on each share. In case of shares allotted for consideration other than cash, all particulars must be entered in the return. The return must also state in case of bonus shares the number and nominal amount of such shares, and the names, addresses, etc., of the allottees and a copy of the resolution authorising the issue of such shares. The return is to be filed in electronic Form No. 2 of the Companies (Central Government's) General Rules and Forms, 1956. If the shares are allotted for consideration other than cash, and there is no written agreement, then electronic Form No. 3 is also required to be filed giving full details of the arrangements.

(b) Returns of Directors

A company is required to maintain a register of its directors, managing director, manager and secretary to comply with the provisions of Section 303. This section further provides that the company must send to the Registrar a return in the prescribed form containing the particulars specified in the said register and a notice, in the prescribed form of any change among its directors, managing director, manager or secretary, specifying the date of the change. The return must be filed and the other documents be sent within 30 days from the date of the appointment of the first directors of the company and within thirty days from the date of any change in the composition of the Board of directors, in electronic Form No. 32 of the Companies (Central Government's) General Rules and Forms, 1956 and also in respect of change in the appointment of Manager, and Secretary if any.

(c) Return as to Alteration of Memorandum

When a company alters its memorandum by special resolution for which

confirmation by the Company Law Board on the alteration is required, then the company must file within 3 months, a certified copy of the order of the Company Law Board together with a printed copy of the memorandum as altered, with the Registrar who shall register the same and certify the registration within one month from the date of filing such documents. This has to be filed in electronic Form No. 21. Students shall also note that as per Companies (Amendment) Act, 1996, the alteration of the objects can be made by a special resolution and no confirmation by CLB is required.

(d) Return as to Alteration of Share Capital

A company, if authorised by its articles, can alter its share capital in the manner laid down in the Act. When a company does alter its share capital, it must, within 30 days after doing so, give notice to the Registrar in electronic Form No. 5 of the Companies (Central Government's) General Rules and Forms, 1956.

Increase in the authorised share capital of the company or of members requires a resolution of the shareholders and electronic Form No. 5 is to be filed with the Registrar of Companies along with filing fee based on the increased share capital within 30 days of passing the resolution. In case the company wants to issue bonus shares and the authorised share capital is, required to be increased to implement the decision, it can be done in the same General Meeting at which issue of bonus shares is approved. First the resolution for increase in the authorised share capital will be required to be passed and thereafter resolution for issue of bonus shares out of the increased authorised share capital can be passed.

(e) Return of Charges

Under Section 125 and Section 127, the following charges require registration with the Registrar of Companies:

- a charge for the purpose of securing any issue of debentures;
- a charge on uncalled capital of the company;
- a charge of any immovable property, wherever situate, or any interest therein;
- a charge on any book debts of the company;
- a charge, not being a pledge, on any movable property of the company;
- a floating charge on the undertaking or any property of the company including stock in trade;
- a charge on calls made but not paid;
- property acquired which is already subject to charge;
- a charge on a ship or any share in a ship;
- a charge on goodwill, on a patent or a licence under a patent, on a trade mark, or on a copyright or a licence under a copyright.

All modifications of charges are also required to be filed with the Registrar. The charges or modifications thereof are required to be filed in electronic Form No. 8. Similarly, satisfaction of charges are also required to be filed in electronic Form No. 17 within 30 days of satisfaction. Requirement of filing Form 13 (alongwith a fee of

₹10) alongwith Form 8 or Form 17 is discontinued after commencement of electronic filing of forms.

Electronic Form No. 10 shall be filed for issue of debentures (Section 128).

(f) Return of Resolutions and Agreements

Under Section 192 of the Act, the following resolutions/agreements have to be filed with the Registrar of Companies:

- Special Resolutions;
- Resolutions of the Board of directors regarding appointment of Managing Director; (Section 269);
- Resolution regarding disposal of property; [(Section 293(1)(a)]
- Agreement regarding appointment of Managing Director; (Section 269)
- Resolution regarding borrowing limit; [Section 293(1)(d)]
- Resolution regarding limit on donations; [(Section 293(1)(e)]
- Resolution regarding appointment of sole selling agents; (Sections 294 and 294AA)
- Agreement with sole selling agent and sole agent for buying; (Sections 294 and 294AA)
- Resolution regarding voluntary winding-up (Section 484).

These resolutions/agreements have to be filed in electronic Form No. 23, of the Companies (Central Government's) General Rules and Forms, 1956, within 30 days after passing of the resolution or entering into agreement as the case may be, and together with the filing fees.

(g) Return of Foreign Companies

The obligation cast on a foreign company in regard to filling of various returns and particulars, as required under Part XI of the Companies Act, 1956, have been discussed herein below very briefly:

1. Within 30 days after establishing a place of business in India, a foreign company has to file the information as required under Section 592 in electronic Form No. 44 of the Companies (Central Government's) General Rules and Forms, 1956 to the ROC, New Delhi and send a copy to the ROC of the State in which the company has its place of business. Refer also Section 597 and Rule 17 of the Companies (Central Government's) General Rules and Forms, 1956.
2. If a foreign company makes any alteration in any of its documents, its director or secretary, or the principal place of business in India, then the company must deliver to the Registrar, returns containing the prescribed particulars of the alteration as follows:
 - (a) Return in respect of the matters specified in clauses (a), (b) & (c) of Section 593 of the Act should be made in electronic Form No. 49 of the Companies (Central Government's) General Rules and Forms, 1956, to the Registrar for registration on or before 31st January of the year

following the year in which the alteration was made or occurred — See Rule 18(1).

- (b) Return in respect of the matters specified in Section 593(d) and (e) should be made to the Registrar for registration in electronic Form No. 52 of the Companies (Central Government's) General Rules and Forms, 1956, within one month from the date on which the alteration was made or occurred — See Rule 18(2).
3. The documents to be delivered to the Registrar under Section 594 (1) (a) and 594 (3) of the Act should be delivered to the Registrar within a period of 9 months of the close of the financial year of the foreign company to which documents relate. However, the Registrar may for any special reason and on application made in writing by the foreign company concerned, extend the said period by a period not exceeding 3 months — See Rule 18A.
 4. Where a foreign company ceases to have a place of business in India, it should forthwith give notice of the fact in electronic Form No. 52 to the Registrar having jurisdiction over New Delhi, as well as to the Registrar of the State in which the principal place of business of the company was situate. The obligation of the company to deliver documents to the Registrar shall cease as from the date on which notice was so given, provided it has no other place of business in India — Refer Section 597(3).

Note: According to Section 597 of the Act, any document which a foreign company is required to deliver to the Registrar should be delivered to the Registrar having jurisdiction over New Delhi and to the Registrar of the State in which the principal place of business is situate.

According to Rule 19 of the Companies (Central Government's) General Rules and Forms, 1956, where any document or any portion of any documents required to be filed by or registered with the Registrar or containing any fact required to be recorded by him, in pursuance of any provisions of the Companies Act, 1956 contained in any Part of the Act (except Part XI) is not in English or in Hindi, a translation of that document or portion either in English or in Hindi certified by a responsible officer of the company to be correct, shall be attached to every copy of the document which is furnished to the Registrar.

5. The provisions of Part V (Sections 124 to 145) of the Companies Act, 1956 apply *mutatis mutandis* to a foreign company. (Refer Section 600). Therefore, a foreign company:
 - (i) has to file within 30 days of the creation of charge on properties in India in electronic Form No. 8 of the Companies (Central Government's) General Rules and Forms, 1956, to the Registrar of Companies for Registration of Charges;
 - (ii) within 30 days of acquiring properties in India, a foreign company has to file in electronic Form No. 8, the particulars of charges subject to which the property in India has been acquired;
 - (iii) the particulars of an issue of debentures in a series should be filed with the Registrar in electronic Form No. 10 within 30 days of execution of

Debenture Trust Deed or after the issue of debentures, where no Debenture Trust Deed is executed. The particulars of series of debentures containing, or giving by reference to any other instrument, any charge, the benefit of which the debenture holders of the said series are entitled *part passu* created by a foreign company should be filed within 30 days of execution of the deed or issue of debentures in electronic Form No. 10.

- (iv) A foreign company has to file particulars of modification of charge in electronic Form No. 8 within 30 days of modification of charge. However, modification of charge can be filed with the Registrar, if the property is situated outside India, within 30 days after the date on which the original instrument or a copy thereof if despatched with due diligence by post should reach India.
- (v) Memorandum of complete satisfaction of charge should be filed in electronic Form No. 17 within 30 days of satisfaction of the charge.

10. FILING FEE FOR COMPANIES REGISTERED IN INDIA

Filing fee is to be paid to the Registrar on all the documents filed with him as prescribed under Schedule X to the Companies Act. The filing fee varies with the authorised capital of the company. It is ₹ 100/- per document for a company having authorised capital of less than one lakh, ₹ 200/- where authorised capital is one lakh but less than five lakhs, ₹ 300/- where authorised capital is five lakhs but less than twenty five lakhs and ₹ 500/- where authorised capital is twenty five lakhs and above.

In case, where Central Government has delegated the powers to Registrars, such as under the Sections 21, the fee payable to him would be prescribed under the Companies (Fees on Applications) Rules, 1968.

Filing Fee by Foreign Companies

For Foreign Companies the filing fee is ₹ 5000/- per document. Fees is payable only when document is filed with the ROC, New Delhi. No fee is payable when copy is delivered to the ROC of the jurisdiction where the foreign company has its place of business [Refer also Section 601].

Payment of fees

Under electronic filing system, the payment can be made in one of the following ways:

- Credit Card (online)
- Internet Banking (online)
- Challan (offline)
- NEFT (National Electronic Fund Transfer)

User can make the payment by challan/offline by taking the printout of pre-filled challan generated by MCA21 system and visiting any of the authorized bank branches to make the payment through Cash/demand draft/Local Cheque. The user can find the list of authorised bank branches accepting payment on behalf of MCA on MCA portal <http://www.mca.gov.in>.

However, the Ministry of Corporate Affairs vide its Circular dated 9th March,

2011 has decided to accept payments of value upto ₹50,000, for MCA 21 services, only in electronic mode w.e.f 27th March, 2011. For the payments of value above ₹ 50,000, stakeholders would have the option to either make the payment in electronic mode, or paper challan. However such payments would also be made in electronic mode w.e.f.1st October 2011. This will improve the service delivery time and lead to speedier disposal of an application/e-form leading to convenience of stakeholders.

However, in partial modification of above circular, Central Government has allowed the payment for amount less than ₹50000/- under challan mode in the following cases w.e.f. 29.05.2011:

- (a) Payment to 'Investor Education and Protection Fund' through 'pay misc. fee' functionality
- (b) Any payment made by Official Liquidator (OL) office
- (c) Any payment made by MCA employees

Change in additional fee to be levied for delays in filing forms

The Ministry of Corporate Affairs (MCA) vide its Circular No. 4/2010 dated 22nd November, 2010 has made some changes in additional fee to be levied for delay in filing forms other than form 5.

In partial modification of the earlier Circular No. 14/3/87-CL-V Vol.III dated 21.3.1995, the following table has been applicable for additional fee to be levied for delays in filing Forms other than Form 5:-

Period of Delay	Fixed rate of additional fee
Upto 30 days	Two times of normal fee
More than 30 days and upto 60 days	Four times of normal fee
More than 60 days and upto 90 days	Six times of normal filing fee
More than 90 days	Nine times of normal filing fees

The above table has been applicable from 5-12-2010.

11. COMPANY SECRETARY'S ROLE IN FILLING AND FILING RETURNS AND FORMS

Filing and filing of forms is an important part of the secretarial function of a company secretary. Normally, where company appoints a company secretary, he is designated as the officer responsible for compliance under the Companies Act and other allied legislations. Therefore, for any lapse in complying with the various provisions of the Companies Act or such other legislations, the compliance of which has company secretary been entrusted with, he becomes liable as "officer in default".

Filing and filing of forms, returns and applications demand intimate knowledge of substantive as well as procedural law. The Registrar of Companies registers the documents if found in order and filed within the prescribed time. Often, a large number of documents filed with the Registrar of Companies are not taken on record due to technical lapses which result in avoidable correspondence, frequent visits to the office of the Registrar. In order to avoid such errors, every care should be taken to ensure that the forms filled in and filed should be proper.

Company Secretaries, under electronic filing system is required to be

acquainted, *inter alia*, with using computer, internet, MCA21 electronic filing system, pdf files and using digital signatures.

12. GUIDELINES FOR PREPARING/FILING FORMS, DOCUMENTS, RETURNS, ETC.

While preparing the forms, documents, returns to be filed with the Registrar, the following points are to be kept in view:

- (a) The company master data, which can be accessed from MCA21 portal, <http://www.mca.gov.in>, must be thoroughly verified. If the master data of the company is not update, the same must be updated with the ROC office.
- (b) The company Corporate Identification Number (CIN) with which it has been registered should be correctly entered. The CIN can be found for the company from the MCA21 portal by entering name and the registration number given in the 'Certificate of Incorporation'. Indication of the proper CIN number is essential. Upon filling CIN in electronic form, the name and the registered office of the company is automatically filled up in the electronic form. This helps in ascertaining the fees to be paid by the company. For all the electronic forms, help file associated with the form shall be read for correct filing of the form.
- (c) All electronic forms require, the date of board meeting to be specified under the head 'verification'. In the said column, the date of the board meeting at which the person is authorised to sign and submit form shall be specified. Where the document, form is required to be signed by specific persons or number of persons, it should be so digitally signed. For example, electronic Form No. 1 may be completed and signed by an Advocate, an attorney or pleader entitled to appear in High Court or a Secretary or a Chartered Accountant in whole-time practice in India who is engaged in the formation of the company or by person who is named as a director, manager or secretary, Annual Return by such persons as prescribed in Section 161(1) and other forms usually (unless otherwise indicated) by a director, Managing Director, Manager or Secretary. However, in the case of resolutions passed for winding up, the liquidator is also competent to file the resolution etc., and other connected papers.
- (d) While filling up forms care should be taken to fill up each and every column properly. All the columns marked with asterisk (*) are compulsory fields. .
- (e) Regulation 19 of the Companies Regulations, 1956 provides that on every document registered, recorded or filed with the Registrar the number of the company, its serial number and the date on which it is registered, recorded, filed should be properly endorsed.
- (f) All documents/forms/returns, etc., are to be submitted in English or Hindi and where a document is in any language other than English and Hindi, a translation of that document or portion into either English or Hindi certified by a responsible officer of the company to be correct, shall be attached to each copy of the document which is furnished to the Registrar. All such documents shall be converted into electronic form in pdf format.
- (g) The amount of filing fee for registration of a company or for filing any documents is to be ascertained by reference to Schedule X to the Act-Table of fees to be paid to the Registrar.

- (h) For all the electronic forms only one copy is required to be filed.
- (i) All the documents/forms should be filed at MCA21 portal <http://www.mca.gov.in>
- (j) For every filing through MCA21 portal, Service Request Number (SRN) is generated by the system. This SRN number is to be noted for future reference. SRN number can be found on Challan (offline payment method) and also on filing receipt (online payment method).
- (k) There are certain forms which needs to be delivered for registration in physical form, in such cases, those forms should preferably be free from corrections and erasure. If there is any correction or erasure, it should be duly authenticated by the person signing the document or the return.
- (l) In certain cases the Act requires copies of certain documents also to be filed with certain forms. (In case of e-filing, there is no need for any number of copies of document.)

A return is deemed to be incomplete where the required documents are not enclosed.

13. DEFECTIVE FORMS/DOCUMENTS

A form or document is defective for any one of the following reasons:

- (i) the form or document does not contain the necessary enclosures;
- (ii) certain particulars in the document or form have been left unfilled;
- (iii) certain particulars apparent on the face of it seem false;
- (iv) the document is not filed in proper time or is not accompanied by the requisite filing fee;
- (v) the document is not properly signed or certified.

If a document is found to be not in order for any of the reasons stated above the Registrar will not register the document until the particulars left unfilled are filled or the error is rectified by the company. For this purpose, facility of resubmission is available under MCA21 portal. However resubmission can be made, only when the ROC requires that the company resubmit the form with corrections. If within the date document is required to be filed, the blank is not filled in or the apparent error is not corrected then the Registrar is at liberty to launch prosecution against the company and its officers for default in filing the document. If the defect is one which requires filing of a revised document, then, in certain cases, the Registrar of Companies may accept the revised form on payment of additional fee which he may determine in terms of Section 611(2) of the Act, which should not be more than ten times of the specified fee. However additional fees have been standardised by the Central Government.

Condonation of Delay

Under Section 637-B of the Act the Central Government may for reasons to be recorded in writing, condone the delay where any document required to be filed with the Registrar under any provision of the Act is not filed within the time specified therein. As already stated earlier in this study, the Registrar of Companies has

been given the power to condone a delay of 30 days in filing electronic Form No. 8 relating to charges under Section 125 or modification of charges under Section 135. He has, however, no such power relating to satisfaction of charges. Delay of more than 30 days in filing electronic Form No. 8 and satisfaction of charges in electronic Form No. 17, can be condoned only by Company Law Board under Section 141.

Procedure for Condonation of Delay by Central Government in Relation to Filing of Documents with Registrar of Companies

Following procedure should be followed in this respect:

- (1) Convene a Board Meeting and pass a resolution for seeking condonation of delay in filing the document.
- (2) Submit an application to the Central Government, in pdf format, as attachment to electronic form no. 65, to this effect indicating alongwith the reasons for such delay. The application should be accompanied by a copy of the Board Resolution seeking condonation of delay, latest audited balance sheet and profit and loss account, certified copy of the memorandum and articles of association and filing fees.
- (3) The Central Government may for reasons to be recorded in writing, condone the delay.

14. PENALTY FOR FILING FALSE DOCUMENTS/STATEMENTS WITH THE REGISTRAR

According to Section 628 if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purposes of any of the provisions of this Act, any person makes a statement which is false in any material particular, knowing it to be false; or which omits any material fact, knowing it to be material, he shall, except when otherwise expressly provided in this Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

ANNEXURE I

RETURNS, PAPERS AND DOCUMENTS TO BE FILED OR DELIVERED TO THE REGISTRAR

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
5(f) and 5(g)	Where a person or director is entrusted for complying certain provisions, electronic Form 1AA and 1AB be filed. Revocation of consent to be filed in electronic Form 1AA.
18(1) and 18(3)	Certified copy of order of Company Law Board confirming the alteration of the memorandum of association within 3 months from the date of the orders on electronic Form No. 21.
31(2A)	Printed copy of the altered Articles within 30 days of obtaining the approval of the Central Government for converting a public company into a private company.
33(1) and 33(2)	Memorandum, articles or agreements mentioned in Clause (c) of Section 33(1) and Declaration of compliance with the application for registration of company in electronic Form 1.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
43A(2A)	Intimation that the deemed company has become a private company.
44(1)(b)	If a private company alters its articles in such a manner that it ceases to be a private company – a prospectus or a statement in lieu of prospectus as specified in Section 44(2) within 30 days from the date of alteration.
58A read with Rule 10 of Companies (Acceptance of Deposits) Rules, 1975	Return of deposit made-up to 31st of March each year by non-banking non-financial companies, before the 30th June every year on a prescribed Form under the Rules.
58A read with Rule 4 and 4 A of Companies (Acceptance of Deposits) Rules, 1975	Advertisement/statement in lieu of advertisement inviting fixed deposits, before it is published before deposits accepted.
60(1)	Copy of prospectus in compliance with Section 60 on Form prescribed under Schedule II to the Companies Act, 1956.
70(1)	A statement in lieu of prospectus in compliance of Section 70 three days before the first allotment of any share or debenture on Form prescribed in Schedule III to the Act.
75(1)(a)	Return of allotment of shares only within 30 days from the date of allotment or within such extended date as the Registrar of Companies has allowed, on electronic Form No. 2.
75(2)	Particulars of contract relating to shares (not being bonus shares) allotted otherwise than in cash where such contract is not reduced in writing within 30 days from the date of allotment, on electronic Form No. 3.
75(1)(c)	Copy of resolution for issue of bonus shares/shares at a discount alongwith a copy of the Court* order.
76(1)	Statement of particulars of underwriting commission for underwriting shares or debentures, before payment of commission on electronic Form No. 4. Copy of contract for payment of commission, at the time of registration of prospectus.
77A	Declaration of solvency before making buy-back of securities in Form No. 4 A.

* It shall be substituted by Tribunal on the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
79 read with rule 37(2) of Company Law Board (Bench) Rules, 1975	A certified copy of the Company Law Board** Order sanctioning the issue of shares at a discount within one month, on electronic Form No. 21.
94A (3)	Return for increase in share capital under Section 81(4) within 30 days of the receipt of the order from the Central Government, on electronic Form No. 5.
95	Notice of Consolidation, conversion, division, cancellation, etc. of shares, within 30 days of doing so, on electronic Form No. 5.
97	Notice of increase of share capital beyond the authorised capital, or increase in the number of members beyond the registered number, within 30 days of passing the resolution in this regard on electronic Form No. 5.
103	Order of the Court*** confirming reduction of share capital along with certified copy of the order and minutes approved by the Court***, on electronic Form No. 21. No time specified. Order of reduction effective from the date it is registered by the Registrar.
107(5)	A copy of the order of Court*** passed under Section 107(3) within 30 days of serving the order on the company, on electronic Form No. 21.
108(1A)	Share Transfer Form
108(1D)	Application for extending validity of transfer deed.
125/127	Registration of charges created by a company registered in India/subject to which property has been acquired by a company registered in India, within 30 days, on electronic Form No. 8.
128	Particulars of entire series of debentures giving <i>pari passu</i> rights in terms of any instruments, deeds etc. within 30 days after execution of the deed, on electronic Form No. 10.
129	Particulars in case of commission etc. on debentures within 30 days.
134	Registration of charge created by the company and of every issue of debentures.
135	Particulars of modification of charges within 30 days of such modification, on electronic Form No. 8.

** It shall be substituted by Central Government on the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

*** It shall be substituted by Tribunal on the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
137(1)	Notice of appointment of receiver or manager within 30 days of the appointment/passing order, on electronic Form No. 15.
137(2)	Notice of ceasing of receiver or manager, forthwith in electronic Form No. 15.
138	Memorandum of complete satisfaction of charge within 30 days from the date of such payment or satisfaction, on electronic Form No. 17
141	Order of the Company Law Board* extending the time for filing the charge or modification of the Register of Charges, on electronic Form No. 21.
146(2)	Situation/change of registered office within 30 days from the date of incorporation/change on electronic Form No. 18.
149(1)(d)	Duly verified declaration of compliance with the provisions of electronic Section 149(1)(a), (b) and (c) — where prospectus has been issued, before commencement of business, on electronic Form No. 19.
149(2)(c)	Duly verified declaration of compliance with the provisions of Section 149(2)(b), before the commencement of business, on electronic Form No. 20.
149(2A)(ii)	Duly verified declaration of compliance with the provisions of Section 149(2A)(i), or 149(2B), as the case may be, before commencement of new business, on electronic Form No. 20A.
157(2)	Notice of the situation of the office where foreign register is kept, within 30 days from the date of opening of foreign register or change of situation of such or its discontinuance.
159	Annual return for companies having a share capital within 60 days from holding of annual general meeting or if the AGM is not held within 60 days when it ought to have been held (Form prescribed in Schedule V, Part II to the Companies Act). [to be attached with electronic Form 20B]
159 read with Application of Section 159 to Foreign Companies Rules, 1975	Modified Annual Return within 60 days from the last day of financial year by a foreign company having a share capital. [to be attached with electronic Form 20B]

* It shall be substituted by Tribunal on the commencement of Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
160	Annual Return of a company not having a share capital within 60 days from holding of annual general meeting, on electronic Form No. 21A.
165	Statutory Report, in electronic Form 22, immediately after sending the report to the members.
187C(4)	Filing of declarations received within 30 days on electronic Form No. 22B. It replaced Form No. III prescribed under the Companies (Declaration of Beneficial Interest in Shares) Rules, 1975.
192	Copy of every resolutions and agreements mentioned in Section 192(4), within 30 days after the passing or making the same in electronic Form No. 23.
205A(6)	Statement (in duplicate) of unpaid or unclaimed dividend transferred from the unpaid dividend account of the company to the fund established under Sub-section (1) of Section 205C.
209(1)	Keeping books of account at any place other than the registered office within 7 days of the decision of the Board in Form No. 23 AA.
220	A copy of the Balance Sheet and the Profit and Loss Account within 30 days from the date of holding the Annual General Meeting or if AGM is not held within 30 days when it ought to have been held. (In case of private companies copies of Balance Sheet and Profit & Loss Account are to be filed separately). To be filed with electronic Form No. 23AC and 23 ACA
224(1A)	Information regarding acceptance or refusal of appointment as auditor of a company within 30 days of the receipt of the intimation from the company. This is to be filed by the auditor in Form No. 23B.
234	Information or explanation required by the Registrar under Section 234(1) or 234(3A) to be filed within such time as may specified in the Registrar's order.
264(2)	Consent to act as director and/or undertaking to pay for qualification shares within 30 days of appointment of director. Now the consent is covered by new electronic Form No. 32 itself.
269 read with Sch. XIII	Intimation about appointment of managing or whole-time director or manager having complied with the provisions of Part I and II of Schedule XIII in electronic Form No. 25C.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
303(2)	Particulars of directors, managing directors, manager and secretary and changes among them within 30 days from the appointment/change in electronic Form No. 32.
383A(1) proviso	Compliance certificate within 30 days of the annual general meeting in Form No. 66.
391(3)	Certificate copy of an order sanctioning the compromise or arrangement under Section 391(2), on electronic Form No. 21.
394(3)	Certified copy of an order passed by the Court under Section 394(1) within 30 days after the making of the order, on electronic Form No. 21.
395(4A)(a)(i)	Circular containing offer of a scheme or contract involving the transfer of shares, before issuing to the shareholders, on electronic Form No. 35A.
404(3)	Certified copy of every order of the Court under Section 397 or 398 within 30 days after the making of the order, on electronic Form No. 21.
421/424	Abstracts of receipts and payments of receivers or managers, once in every half year and also on ceasing to act as receiver or manager, on electronic Form No. 36.
445(1)	Copy of the order of winding up made by the Court within 30 days from the date of the order, on electronic Form No. 21.
462(4)	One copy of the audited account of liquidator.
466(3)	Copy of the order of the Court staying the winding up proceedings under Section 466(1), on electronic Form No. 21.
481(2)	Copy of the Court's order dissolving the company within 30 days of the order, on electronic Form No. 21.
488(2)(a)	Declaration of solvency within five weeks immediately preceding the date of passing the resolution for voluntary winding up on Form No. 149 of the Companies (Court) Rules, 1959.
493	Notice of appointment of liquidator within 10 days.
497(3)	Copy of the account and a return of the final meeting in a members' voluntary winding up within one week after the meeting.
501(1)	Notice of resolution passed by the creditors' meeting in a creditors' voluntary winding up within 10 days of the passing of the resolution.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
509(3)	Copy of the account and a return of the holding of the final meeting in a creditors' voluntary winding up within one week after the date of the meeting.
516(1)	Notice of appointment of liquidator in the prescribed form in a voluntary winding up within 30 days after the appointment.
518(5)	A copy of order staying proceeding in voluntary winding up under Section 518, forthwith, on electronic Form No. 21.
551(1) and (2)	Particulars of information as to the pending liquidation within 2 months of the expiry of such year.
555(3)	Statement of unclaimed dividend or undistributed assets paid into the company's liquidation account in the Reserve Bank of India, when making credit into the account.
559(2)	A certified copy of the order declaring the dissolution of a company void within 30 days after the order.
560(7)	Copy of the order passed by the Court under Section 560(6) restoring the company to register, on electronic Form No. 21.
565, 566 and 567	Application for registration as a limited/unlimited company by an existing joint stock company, before registration, on electronic Form No. 37 and electronic Form No. 39 for Section 565(1) proviso.
565, 568	Application for registration as a limited/unlimited company by an existing company other than joint stock company, before registration, on electronic Form No. 37.
567(a)	Registration of an existing company – list of members, before registration, on electronic Form No. 39.
567(c)	Registration of an existing company as a limited company – Statement specifying certain particulars before registration, on electronic Form No. 39.
568(a)	Lists of names, addresses and occupation of the directors etc., before registration on electronic Form No. 39.
592	Documents to be delivered for registration by a foreign company, within 30 days of the establishment of the place of business within India, on electronic Form No. 44.

<i>Section</i>	<i>Particulars of Returns, Papers and Documents</i>
593(a)(b)(c)	Particulars of any alteration specified in Section 593 within prescribed time from the date of alteration, on electronic Form No. 49.
593(d)(e)	Particulars of any alteration specified in Section 593 within 30 days from the date of alteration, on electronic Form No. 52.
594	A copy of the documents specified in Sub-section (1) and the documents mentioned in Section 594(3) in Form No. 52.
597(3)	Notice of cessation of business by a foreign company, on electronic Form No. 52.
600 read with Section 125, 127, 128, 129, 135 and 138	Registration of charges, satisfaction of charges and appointment of receiver in respect of foreign company, within 30 days, on electronic Form No. 15 and 17.
605	A copy of prospectus before issue.

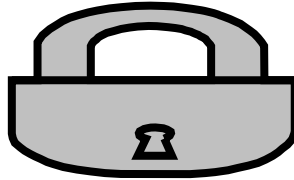
LESSON ROUND-UP



- Every company incorporated under the Act is required to keep at its registered office various books and registers in accordance with the various provisions under the Companies Act.
- The Institute has issued Secretarial Standard (SS-4) on registers and records.
- The Companies (Amendment) Act, 2006 has introduced *inter alia* new provisions relating to filing of applications, documents, inspection etc. through electronic form vide section 610B.
- Annual Return provides very comprehensive information about various aspects of a company like capital structure, constitution and management of the company concerned updated till the date of Annual General Meeting.
- Instead of being kept at the registered office of the company registers of members/debenture holders the index of members and debenture holders and copies of all annual returns together with the copies of documents required to be annexed thereto may be kept at any other place within the city in which registered office of company is situated in accordance with the provisions of Section 163 of the Act.
- Non-statutory books are required to be maintained for smooth and efficient functioning of the company.

- For the purpose of incorporation of company, the forms required are e-forms 1A, 1, 18, 32, 19, 20, 20A etc.
- Compliance related filing (Annual or event based) include e-forms 2, 3, 4, 4C, 20B, 21A, 22, 23, 23AC etc.
- Change services i.e. those pertaining to any change in the capital structure, increase in authorized capital, increase in number of members, change in situation of registered office of company, e-forms required for these purposes are e-form 1A, 32, 5, 18, 1B etc.
- Registration of modification, satisfaction of charges are to be filed in e-forms 8, 17, 10, etc.
- E-forms 24, 25A, 25B, DD-C relate to the managerial personnel.
- For getting approval from MCA, various other forms are 23AAA, 65, 63, 24B, 24AB, 23C, 23AAB, DD-C, 1AD, 64, 24A, 1B, 61 etc.
- For Annual filing, e-forms are 23AC, 23ACA, 20B, 21A, & 66.
- Under the electronic filing system, company secretaries and other officers are required to be acquainted with computer, internet, MCA21 electronic filing system and using digital signatures.

SELF-TEST QUESTIONS



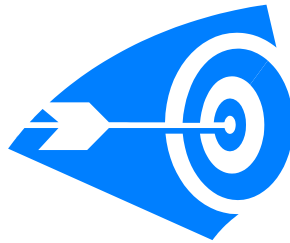
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Write the provisions of maintenance, preservation and signing of the following registers:
 - (a) Register of Directors
 - (b) Minute Book
2. What are the particulars to be entered in the
 - (i) Register of Securities bought back
 - (ii) Register of Fixed Deposits
 - (iii) Register of Charges
 - (iv) Register of Postal Ballot.
3. What is the procedure for keeping the Register and Returns at a place other than the Registered office?
4. Briefly explain the important returns which are required to be filed with the Registrar of Companies.

5. Write a short note on
 - (i) Compliance Certificate
 - (ii) Annual Returns
 - (iii) Register of Postal Ballot.
 6. What are the statutory books and registers to be kept and maintained by the company incorporated under the Companies Act, 1956?
 7. What are the particulars to be recorded in the register of members? Where is the register to be maintained and who has to maintain it? Can a member access to this register?
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STUDY XXVI
INSPECTION AND INVESTIGATION
INSPECTION

LEARNING OBJECTIVES



This lesson explains the provisions for inspection under the Companies Act. It also describes the nature of inspection and rights of directors and members to make inspection along with powers of inspectors. The lesson also gives provisions for investigation, its meaning and its kinds. It also explains preparation by a company secretary to face inspection and investigation.

At the end of the lesson, you should be able to understand:

- Nature of inspection and who can make it.
- Director's right and members' right to make inspection.
- Time, place and notice for inspection.
- Powers of inspector and inspection report.
- Penalty for default.
- Preparation by company secretary to face inspection.
- Meaning and objective of inspection.
- Kinds of investigation and investigation of affairs of a company by the Central Government.
- Powers of inspectors and inspector's report.
- Expenses of investigation.
- Preparation by company secretary to face investigation.
- Investigation of ownership of company.
- Restrictions on shares and debentures.
- Protection of employees of the company during investigation.

1. INTRODUCTION

Section 209A of the Companies Act, 1956 contains provisions in respect of inspection of books of account and other books and papers of every company. This section provides exhaustive powers to the Registrar or Officers authorised by the Central Government or Securities and Exchange Board of India, as the case may be, to conduct inspection in order to ascertain that all transactions have been validly entered into and recorded in appropriate books and that applicable laws, rules and

procedures have been complied by the company. Section 209A does not specify the circumstances or pre-conditions which must be satisfied for invoking these provisions. The cardinal objectives of conducting such inspections may be thus:

1. To detect concealment of income by falsification of accounts.
2. To secure knowledge about the mismanagement of the business of a company and transactions entered into with an intent to defraud creditors, shareholders or otherwise for fraudulent or unlawful purposes.
3. To ascertain whether the statutory auditors have discharged their functions and duties in certifying the true and fair view of a company's accounts and their proper maintenance.
4. To enable the Government to take effective remedial measures to protect the company against liquidation and thus to save the industry or trade and prevent distress to the employees of company.
5. To enable the Government to ascertain the quantum of profits accrued but not adequately accounted for.
6. To detect misapplication of funds leading a company to a state of perpetual financial crisis.
7. To keep a watch on the performance of the company.
8. To detect misuse of fiduciary responsibilities by the company's management for personal aggrandisement.

Inspection is intended to be a routine and not an ad hoc or special affair. However, if sufficient evidence of the company's affairs being mismanaged and/or managed in fraudulent way is revealed, the inspection can lead to orders for investigation into the affairs of the company.

Note on Strategy on Inspection*

Inspection under Section 209A is neither audit of books of account, nor investigation into the affairs of a company. It can only be an appraisal of the overall activities of a company, except in complaint cases. Such appraisal cannot be done merely by inspecting the records on 'as is where is' basis but certain amount of verification and cross verification of the records, on the style of auditing, is necessary. The following points may be useful for conducting inspection of accounting records:

- (1) It is always better for an inspecting officer to go through the documents filed by the company with the Registrar. In case certain documents are not filed/taken on record (for any reason), efforts should be made to get the records made up-to-date.
- (2) An inspecting officer may find it useful to acquaint himself with the basic information about the industry concerned. In particular, attention may be drawn to the special type of accounting records maintained by the industry, production process involved, etc. The previous inspection reports, if any, may also be looked into. It may avoid wastage of time later on.
- (3) The following broad guidelines/general approaches may lead to finding out

* Excerpts from the Institutes publication "Inspection and Investigation", Study IX.

the acts of mismanagement, including the channels of syphoning of funds:

- (a) Ask for and go through monthly trial balances and profit and loss accounts prepared by the company. This will give an idea about the volume of activity and the monthly profitability, with which the company's activity for the whole year can be assessed. Significant variation, if any, in the estimates and the entries in the books may, then, come to the notice of the inspector.
- (b) Ask for and go through unit/product-wise and division wise monthly profit and loss accounts. This would give an idea about the unit/divisions making profits and contributing for recoveries of fixed costs, and others which are not contributing. This kind of comparison will be absolutely necessary for multi-unit/multi-product companies.
- (c) The existing Management Information System, at least in the areas of accounts and finance, should be reviewed. Cashflow analysis can show the details of sources and application of cash. Funds-flow analysis exhibits the details of sources and application of funds. Analyse revenue and capital expenditure. Month-wise analysis of capital expenditure may also reveal useful information. In this process, wrong or mis-classification of capital and revenue expenditure (with a view to understating or overstating the profits, and the reasons therefore) may be found out.
- (d) Revenue items of sales and purchases must be checked, bearing in mind the overall activity of the company. Month-wise analysis of purchases and sales will show the quantum of variance. The reasons therefore should be looked into. At the end of the year, to ensure that there is no inflation or deflation of sales or purchases, basic documents should be checked as on the "Cut-Off" date. For example, if the year end falls on 31st December, the basic documents (i.e. delivery challans for sales) falling within that period should have been accounted for within that year. Similarly, in respect of purchases, goods inward notes falling within the period should have been accounted for in the same period. This exercise would reveal attempt, if any, of deflation or inflation of purchases/sales. The turnover figures can be cross checked with sales tax return, excise duty records, returns submitted to banks for borrowings, etc.
- (e) In a manufacturing company, the 'consumption' figures should be examined. A brief industry-wise study of input (raw material) output (finished products) ratios should be made and particularly, the company's performance should be evaluated in that background. This evaluation may lead to other concomitant areas like under-production, production not being shown on records, excess scrap, unsatisfactory scrap accounting, etc.
- (f) At the time of inspection, it would be difficult to decide as to what should be inspected as regards the revenue and expenditure of the company. For this purpose, the expenditure of the company should be classified under 8 to 10 broad heads. Percentage of the sales expenditure to sales and also to the total expenditure should be calculated. This would reveal whether any type of expenditure has increased in real terms when compared to other expenditure, and to the income of the company.

- (g) As regards the books to be inspected, it is preferable to go through the cash book for cash and cheque books for non-cash payments for the last month of the year. It should be seen whether the company keeps heavy cash at the end of the year, if so, for what purpose. Besides, the journal entries should also be inspected for the last month of the year, since all adjustments are made at the year-end through such entries. After covering cash and non-cash transactions on random basis, entries relating to provisions for liabilities for expenses, depreciation, etc., should be seen. Provision for expenses is a sensitive area leading to over-statement or under-statement of expenses. In the same context, 'debits relating to prior periods' and 'excess provision written back', if any, should also be analysed.
- (4) In respect of a manufacturing company, another area to be looked into is capacity utilisation. The percentage of capacity utilised for different products for the last three years should be worked out. Any under-utilisation of capacity means non-recovery of fixed overheads to a certain extent, resulting in losses. If, in spite of full utilisation of capacity, there are losses, then it may be presumed that either the machines need modernisation or there is mismanagement.
- (5) As regards diversion of funds by companies, the main modes of diversion may be—(i) through their distributors or selling agents by paying huge commission; (ii) giving loans to sister companies without stipulations regarding repayment (and companies write them off as bad debts); (iii) huge advances to parties for purchases without any actual (or without even an intention to) purchase; (iv) payment of huge donations to Trusts coming under the group, etc. The inspecting officer can look into all these areas. In this process, both 'diversion of funds' and 'diversion of profits' will come to notice.
- (6) **Working capital analysis:** The current ratio should be worked out for the last three years to see the trend. On the basis of ratios, the current assets should be analysed to see if their structure is simply hyperbole. For instance, bills receivable and sundry debtors may relate to very old periods to the point of becoming 'bad'. Similarly, the inventory position should also be analysed to see the 'age' of inventory. Any mismanagement of 'receivables' and 'inventory' can lead a company to financial crisis. Heavy and constant working capital deficits, in spite of good sales and profits, mean sundry debtors are not realised in time. Thus, an analysis of working capital will help in identification of the causes of sickness of the company concerned.
- (7) **Stock verification and valuation:** Manipulation of quantity and value of inventory can change the entire complexion, since it would affect both profit and loss account and balance sheet. In an inspection, it is not possible to physically verify stock. However, very costly items of inventory can be test-checked. Here, stock declarations made to banks for obtaining cash credits, consumption figures of the previous years, etc., would be of some help to assess the situation. As regards valuation, the application of the maxim "cost or market price whichever is lower" should be checked. Very often, discrepancies arise at the time of valuation of finished products. For example, for the purpose of valuation of finished product, an expenditure like

'depreciation' is not taken into account for determining the 'cost' on the ground that the company has not charged depreciation in the books for want of profits. This is sometimes done, in spite of the fact that the depreciation is an important element of cost, with intention to undervalue finished products. Such blatant departures from accepted accounting practices should be brought out in the inspection report.

- (8) **Investments:** As regards the purchase and sale of investments, it should be seen that the timing of such purchase and sale is appropriate so as to benefit the company. How the company managed funds, or what the company did with the sale proceeds, should also be looked into. Some companies may have the practice of advancing heavy amounts to certain sharebrokers to enable them to buy and sell shares to incur huge losses. At other times, the same brokers buy the company's shares at high prices just on the eve of annual general meeting to boost the image of the company. Such questionable practices should also be brought out in the report.
- (9) **Fixed assets:** The fixed assets schedule should be gone through to see if there is any substantial change by way of purchase or sale of fixed assets. This will also be reflected in the capital reserve account. Here again, the 'timing' of sale or purchase, necessity for such sale or purchase, etc., should be inquired into, besides looking into the fact as to what the company did with sale proceeds.
- (10) **Analysis of subsidiary ledgers:** An analysis of subsidiary ledgers for sundry debtors and sundry creditors will reveal the extent of company's funds blocked with others. Advances given for purchase of materials, etc., should be analysed to see—(i) if the parties are suppliers prima facie; (ii) whether any interest is charged on the outstanding balance, etc. This exercise may also help to find out compliance or otherwise of Sections 372A and 295 of the Act.
- (11) **Loans utilisation:** The borrowings of a company are from commercial banks, financial institutions, fixed deposits, etc. In respect of these borrowings, besides checking compliance with company law, it should be seen whether the loans are utilised for the purpose for which they were obtained; whether the borrowings from public financial institutions are utilised to give loans to group companies or to invest in group company shares, etc.
- (12) **Importance should also be given to contingent liabilities** (since the liabilities might have been actual liabilities), events occurring after balance sheet date and the statutory auditor's report to see if the auditors have correctly applied "materiality concept" while making the audit report, and internal audit reports. Sometimes, income-tax assessment orders also give clue about irregular transactions.
- (13) **New projects:** In respect of new projects/ventures commenced by a company, the 'Pay Back Period' and the 'Internal rate of Return' as prepared by the company can be reviewed to see if projections in this regard would materialise. Similarly, the technique of inter-firm comparisons can also be applied to assess the comparative performance of the company.

The above steps may not only help expeditious completion of inspection, but also ensure that any important area is not omitted during the course of inspection.

2. NATURE OF INSPECTION

The inspection under Section 209A of the Companies Act, 1956, is not an investigation, though it may lead to one, in case any wrong or objectionable or fraudulent practice in the affairs of company is detected by the Inspector. In *Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate* (1974) 44 Com. Cases 106, it was held that on a perusal of the inspection report, the Central Government may lay the information to the police for the purpose of investigation under the Criminal Procedure Code instead of proceeding under Section 235 and 237 of the Companies Act, 1956. It is not necessary for the Registrar or Central Government to disclose to the company, reasons for conducting the inspection, nor is it necessary to come to any conclusion regarding existence of certain circumstances as is necessary before ordering investigation into the affairs of Company under Section 237(b) of the Act.

3. INSPECTION BY WHOM

According to Section 209A(1) of the Act, the inspection of books of account and other books and papers of every company may be conducted by the Registrar or by such officers of Central Government or Securities and Exchange Board of India, as may be authorised in this behalf, at any time during business hours. Such inspection may be made without giving any previous notice to the company or any officer thereof. Any inspection by the officers of the Securities and Exchange Board of India shall be made in respect of matters specified in Section 55A i.e. provisions relating to issue, transfer of securities and non-payment of dividend. Such power of inspection by the officers of Securities and Exchange Board of India can be exercised only in respect of Listed public companies or those public companies which intend to get their securities listed on any recognized stock exchange in India.

Most of the inspections are carried out by the officers authorised under clause (ii) of Section 209A(1) *ibid*, such as Joint Directors (Inspection), Deputy Directors (Inspection) and Asstt. Directors (Inspection). These officers are posted in the offices of the Regional Directors of the Ministry of Corporate Affairs at Kanpur, Calcutta, Bombay and Madras and Head Quarters of the Ministry at New Delhi. Officers at Kanpur inspect companies in North India comprising U.P., Delhi, Rajasthan, Haryana, Punjab, Himachal Pradesh, Jammu and Kashmir and Chandigarh. Officers at Calcutta inspect companies in East India, officers at Bombay, companies in West India and officers at Madras, companies in South India. Officers at Headquarters can be ordered to inspect companies anywhere in India, but, generally, they are ordered to inspect companies at or near Delhi.

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

Section 209A of the Companies Act, 1956, contains provisions in respect of inspection of books of account and other books and papers of every company.

- True
- False

Correct answer: True

4. DIRECTOR'S RIGHT TO MAKE INSPECTION

As per Section 209(4) of the Companies Act, 1956, the books of account and other books and papers shall be open to inspection by any director during business

hours. The right of inspection given under said sub-section is not so restricted that it can only be exercised personally by the director. In *Vakharia v. Supreme General Film Exchange Co. Ltd.* (1948) 18 Com. Cases 34: AIR 1948 Bom. 301 it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilize the information obtained by him for any purpose other than the purpose of his principal.

As the right of inspection is a statutory right given under sub-section (4), a director, who is prevented from or refused inspection may enforce his right through Court. The right, however, is not an absolute right. Where on the facts and circumstances it is clear in any case that there is reason to believe that the inspection is sought for supplying information to rival in business of the company or for any purpose which is prejudicial or injurious to the interests of the company, the inspection may properly be refused.

5. RIGHT OF MEMBERS TO MAKE INSPECTION

Neither Sections 209, 209A nor any other section of the Companies Act gives any statutory right of inspection of books of account to a shareholder. However articles of a company may give such a right to the shareholders. As per Regulation 95 of Table A of Schedule I to the Companies Act, 1956, the Board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations, the accounts and books of the company or any of them, shall be open to the inspection of members not being directors. Further no member (not being a director) shall have any right of inspecting any accounts or books or documents of the company except as conferred by law or authorized by the Board or by the general meeting of company. Thus in the absence of any such right in the articles, a shareholder has no right to inspect the books of account of the company.

In order to prove allegations made in a petition under Section 397 and 398 the shareholders are also entitled to be allowed inspection of the books of account and other relevant papers of the company. Where there are allegations and counter allegations in the petition regarding misuse of the funds of the company in an arbitrary manner it is only with the help of the books of account that the matter can be investigated and the parties should, in such a case, be at liberty to look into the books of account. Where, under an order of the company judge in an application, inspection of the company's books had already been completed, it was held that there could be no valid reason for refusal to supply Xerox copies of the said documents which in fact would facilitate trial of the main petition. (*Rajdhani Roller Flour Mills Pvt. Ltd. v. Mangilal Bagri*, (1991) 70 Com. Cases 788 (Del-DB).

In case of Section 25 companies, members of such company have a right to inspect its books of account. As per format of memorandum of association prescribed under the Companies Regulations, 1956, subject to any reasonable restrictions as to the time and manner of inspecting the same that may be imposed in accordance with the regulations of the company for the time being in force, the accounts shall be open to the inspection of the members.

6. TIME AND PLACE OF INSPECTION

In terms of Section 209A of the Companies Act, 1956, inspection may be made without giving any previous notice to the company or any officer thereof. Thus no

previous notice is required to be given for making inspection of the books of account and other books and papers of a company. The books of account are required to be kept either at the registered office of the company or at some other place, after intimation to the Registrar. Therefore the books of account can be inspected at such other place also. Further in terms of Section 209A(5)(iii), inspection of any books, registers and other documents may be made at any place. Thus it is within the powers of the inspecting officer to demand inspection of the books of account at his office. (*Indra Prakash Karnani v. ROC* (1985) 57 Comp. Cas. 62).

7. INSPECTION OF BOOKS OF ACCOUNT AND OTHER BOOKS AND PAPERS

The Registrar or officers of Central Government or Securities and Exchange Board of India (SEBI), as the case may be, are authorised under Section 209A(1) of the Act to inspect the books of account and other books and papers of every company. According to section 209A (1) (iii) of the Act, SEBI has power of inspection for listed companies or companies intending to get listed, through such officers as may be authorised by it. The SEBI power is confined to sections specified in section 55A of this Act, relating to issue and transfer of securities or non-payment of dividend. As per Section 2(8) of the Act, the terms 'book and paper' and 'book or paper' include accounts, deeds, vouchers, writings and documents. Thus all books of account, vouchers, writing and documents and other records of the company are open to inspection under Section 209A of the Act. However, a Division Bench of Kerala High Court in *Karuppunni (C.V.) v. Joint Director, Inspection, Company Law Board*, (1986) 59 Com. Cases 814 (Ker), held that the principles of *ejusdem generis* has to be applied in deciding as to the type of books and documents, inspecting officers were entitled to inspect. The documents and papers mentioned in Sub-section (1) must be those which have the character of books of account.

Ejusdem Generis

It means "of the same kind," and used to interpret loosely written statutes. Where a law lists specific classes of persons or things and then refers to them in general, the general statements only apply to the same kind of persons or things specifically listed. Example: if a law refers to automobiles, trucks, tractors, motorcycles and other motor-powered vehicles, "vehicles" would not include airplanes, since the list was of land-based transportation.

8. NOTICE FOR INSPECTION

As per proviso to Section 209A(1) of the Act, the inspection may be made without giving any previous notice to the company or any officer thereof.

9. DUTIES OF DIRECTORS, OTHER OFFICERS AND EMPLOYEES W.R.T INSPECTION OF BOOKS OF ACCOUNTS AND OTHER BOOKS/PAPERS OF COMPANY

Section 209A(2) of the Companies Act, 1956 casts a duty on every director, other officer or employee of the company—

- (i) to produce to the person making inspection, all such books of account and other books and papers in his custody or control; and
- (ii) to furnish him with any statement, information or explanation relating to the affairs of the company as the said person may require of him within such time and at such place as he may specify.

Section 209A(3) of the Act requires every director, other officer or employee of the company to give to the person making inspection under this section, all assistance in connection with the inspection which the company may be reasonably expected to give.

Select the blank

_____ of the company has a right to take inspection of the books of account during business hours.

- (a) Managing Director
- (b) Any Director
- (c) Executive Director
- (d) Independent Director

Correct answer: b

10. POWERS OF INSPECTOR

Section 209A(4) empowers the person making the inspection to make or cause to be made copies of books of account and other books and papers or place or cause to be placed any marks of identification thereon in token of inspection having been made. Further, if the Inspecting Officer, considers it necessary, for the completion of inspection to summon and enforce the attendance of any directors, other officer and/or employee of the company and examine them on oath, he is empowered to do so under sub-section (5) of Section 209A which lays down that the Inspecting Officer shall have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 while trying a suit in respect of following matters:

- (i) the discovery and production of books of account and other documents at such place and such time as may be specified by such person;
- (ii) summoning and enforcing the attendance of persons and examining them on oath;
- (iii) inspection of any books, registers and other documents of the company at any place.

11. INSPECTION REPORT

In accordance with Section 209A(6) of the Act, the person making an inspection is required to make a report to the Central Government after inspection of books of account and other books and papers of the company. However, no time limit has been prescribed under the Companies Act, 1956 for completion of inspection or submission of report. Where the inspection is carried out by an officer of the Securities and Exchange Board of India, the report should be submitted to the SEBI.

It was decided in case of Central Government v. Premier Automobiles Ltd. and others [2005] 64 CLA 157 (CLB) that Central Government could not refuse to supply a copy of the report to affected persons. When a reference is made by the Central

Government against the managerial personnel, the Company Law Board (CLB) has to record a decision on a case stated by the Central Government. The records of the Central Government forming an opinion to state the case need not be disclosed.

12. FOLLOW-UP ACTION ON THE REPORT OF INSPECTING OFFICER

The officer who supervises the work of the Inspecting Officer(s) forwards a copy of the Inspection Report to the Regional Director and the Registrar concerned as well as to the Ministry. Officers dealing with follow-up of inspection reports in the offices of the Registrar, Regional Directors and the Ministry of Corporate Affairs go through the Report and take appropriate action including prosecution of the company and its responsible officers on the grounds of violations of the provisions of Companies Act etc., and other irregularities revealed in the Report which fall within their respective jurisdiction. If further clarifications are required from the company, the same are generally called for by the Registrar. The information obtained from the company are sent to the Regional Directors. The Regional Director then sends the report to the Ministry of Corporate Affairs.

In some cases, information and evidence revealed in the Inspection Report, and, subsequently collected may lead to orders for investigation under Section 235 or Section 237 of the Act, or orders for special audit under Section 233A or appointment of Government directors under Section 408.

At times, the information contained in the Report may be of use to other Government Departments and organisations such as Department of Industry, Income Tax Department and Department of Banking etc. and accordingly, the same is communicated to them for necessary action.

Except as aforesaid, there is no provision in the Act for furnishing a copy of the Report or enabling its inspection to anyone, including the company. However, if Government launches prosecution against the company and its responsible officers on the basis of information contained in the Inspection Report, the defendants can ask for a copy of the Inspection Report as a matter of natural justice, or, alternatively, the court may ask the Government to produce the Report for its inspection, and Government shall have to produce the Report for inspection of the Court to avoid any adverse conclusion by the Court.

13. PENALTY FOR DEFAULT IN COMPLYING SECTION 209A

According to Section 209A(8), if a default is made in complying with the provisions of this Section, every officer of the company, who is in default, shall be punishable with fine which shall not be less than fifty thousand rupees and also with imprisonment for a term not exceeding one year. It must be noted that offence under Section 209A is not compoundable under Section 621A of the Act. In *State v. S. Seshamal Pandia* (1986) 60 Com Cases 889 (Mad.), it was held that the offence under this section is not a continuing offence and is deemed to be committed on a particular date. Limitation begins to run on that date. A prosecution launched more than one year after the date of offence, is barred by Limitation.

14. PREPARATION BY COMPANY SECRETARY TO FACE INSPECTION

The Company Secretary should take all possible steps to comply with the provisions of the Act and other laws. When inspection of books (by the Registrar or

an officer of the Central Government or SEBI) is anticipated, he/she should make sure that the following statutory registers and records are being maintained upto date by the company:

1. Register of Investments in shares or securities owned by the company, but not held in its name pursuant to provisions contained in Sub-sections (2), (3), (4) or (5) of Section 49 in compliance with Section 49(7).
2. Register of Charges as required in Section 143. Provisions contained in Section 125(4)(e) exempting pledge(s) on any moveable property of the company from registration, with Registrar of Companies do not apply to maintenance of Register of Charges, and, therefore, even particulars of pledges should be recorded in the Register of Charges.
3. Register of Members as required in Section 150 read with the Appendix to the Companies (Issue of Share Certificates) Rules, 1960.
4. Index of Members, if the number of members exceeds fifty, and the Register of Members is not maintained alphabetically or otherwise in a form as in itself to constitute an index as per Section 151.
5. Register of Debenture holders as required in Section 152(1).
6. Index of Debenture holders, if the number of debenture holders exceeds fifty and the Register of Debenture holders is not in such a form as to itself constitute an index as required in Section 152(2).
7. Foreign Register of Members, and of Debenture holders if required to be maintained under Section 157(1).
8. Minutes Books of the proceedings of meetings of Board of directors and its Committees required to be maintained under Section 193(1).
9. Minutes Books of proceedings of general meetings as per Sections 193(1).
10. Books of Account, and Cost Records if prescribed under Section 209(1)(d).
11. Register of Contracts, Companies and Firms in which directors of the company are interested as per Section 301.
12. Register of Directors, Managing Director, Manager and Secretary as required in Section 303.
13. Register of Shareholdings and Debenture holdings of Directors as required in Section 307.
14. Register of loans made, guarantees given and securities provided by a public company to, and investments made in shares and debentures of other companies in terms of Section 372A.
15. Register of Deposits as required in Section 58A read with the Companies (Acceptance of Deposits) Rules, 1975.
16. Register of Renewed and Duplicate Share Certificates as required in Rule 7(2) of the Companies (Issue of Share Certificates) Rules, 1960.
17. Register of Fixed Assets containing particulars of each asset acquired by a company including its price and location to meet stipulations specified in Section 209 and the Manufacturing and Other Companies (Auditors' Report) Order, 1988.
18. Register of buy-back of securities [Section 77A(9)].

Rule 7(3) of the Companies (Issue of Share Certificates) Rules, 1960 requires that all entries made in the Register of Members and the Register of Renewed and Duplicate Share Certificates shall be authenticated by the secretary or such other person as may be appointed by the Board of Directors for sealing and signing the share certificates.

If the company maintains the following registers, they should also be maintained up-to-date:

1. Share Transfer Register.
2. Directors' Attendance Register for Board Meetings.
3. Members' Attendance Register for General Meetings.
4. Proxy Register.

15. POWERS OF REGISTRAR TO CALL FOR INFORMATION OR EXPLANATION

A company has to file with the Registrar, its Memorandum of Association and Articles of Association as required in Section 33, its Annual Report as required in Section 220, and certain resolutions and agreements as required in Section 192 and other sections of the Act. Where on perusing such documents, the Registrar is of the opinion that any information or explanation is necessary with respect to any matter to which such documents purport to relate, he is empowered under Section 234(1) of the Act, to call, by a written order, on the company submitting the documents to furnish in writing, such information or explanation, within such time as he may specify in the order. On receipt of such order, it shall be the duty of the company, and of all persons who are officers of the company, to furnish such information or explanation to the best of their power vide Sub-sections (2) and (3) of Section 234 of the Act.

If no information or explanation is furnished within the specified time, or if the information or explanation furnished is, in the opinion of the Registrar, inadequate, the Registrar is empowered under Sub-section (3A) of Section 234 to call on the company by another written order, to produce before him for his inspection, such books and papers as he considers necessary within such time as he may specify in the order and it shall be the duty of the company and of all persons who are officers of the company, to produce such books and papers. In case of any default in complying with these requirements, the company and each such person shall be punishable with fine up to five thousand rupees for each such offence and for continuing default, five hundred rupees per day during such default. Further, the court trying the offence may, on the application of the Registrar and after notice to the company, make an order on the company for production before the Registrar of such books and papers as may be required by Registrar. On receipt of the required information, or explanation, or of any book, or paper the Registrar may annex that writing to the document to which it relates and the matters, thus annexed, may be inspected, and extracts thereof may be taken as the document itself.

If it is represented to the Registrar on materials placed before him by any contributory or creditor or any other person interested, that the business of a company is being carried on to defraud its creditors or persons dealing with it, or otherwise for a fraudulent or unlawful purpose, the Registrar, after giving the company an opportunity of being heard, is empowered under Sub-section (7) of

Section 234 of the Act, to call upon the company by a written order, to furnish in writing any information or explanation on matters specified in the order, within such time as he may specify.

Default to comply with any of these requirements, renders the company and every officer in default as per Section 629A, liable to fine up to ₹ 5,000 for each offence and for continuing default, ₹ 500 per day during such default.

It is not necessary that the sole object of the operations complained of should be fraudulent and unlawful. It is sufficient if one of the objects is fraudulent or unlawful. Where a company is consistently violating the provisions of the Act and is yet carrying on substantial business, the Registrar is competent to take steps for investigation of the affairs of the company. (*Re. Standards Brand Ltd.* (1980) 50 Comp. Cas. 75).

Under Sub-section (7) of Section 234, the representation of the complainant must be supported by sufficient materials to show that there is a *prima facie* case for the Registrar to ask for the information. If the Registrar is of opinion that the allegations might be true, he would take further actions in the matter. But the Registrar need not come to a finding or be satisfied that the company is guilty of the allegation. (*Coimbatore Spinning and Weaving Company Ltd. v. N.S. Srinivasan* AIR (1959) 29 Comp. Cas. 97).

Only a person interested can make representation to the Registrar and not any stranger, for instance, a rival company or its directors or members as such cannot be said to have any interest. Further as the sub-section refers to "business being carried on", the fraud alleged must be a present and continuing fraud. It does not apply to a case of past fraud.

Section 234(7) can not be invoked by a decree holder for Court's direction to Registrar to recover the decretal amount on his behalf. It was for the decree holder to execute the decree at the address given by the Registrar. Therefore, the proper mode of recovering a decretal amount from the company is by executing the decree at the correct address of the company, or as the case may be, by seeking winding up. The claim amount cannot be enforced by resorting to section 234 of the Companies Act, 1956. *C. Hamsa Koya v. Sakthi Automobiles (P) Ltd. & another* (1992) 73 Comp. Cases (Mad)

Reports by Registrar to Central Government

The Registrar can report in writing the circumstances of the case to the Central Government as per Sub-section (6) of Section 234 if information or explanation called for under Sub-sections (3A) and (4) of Section 234 is not furnished within the specified time or if after perusal of such information or explanation, he is of the opinion that the documents together with such information or explanation or such books and papers discloses an unsatisfactory state of affairs or does not disclose a full and fair statement of any matter to which the document purports to relate.

Seizure of documents by Registrar

As per Section 234A, where upon information in his possession or otherwise, the Registrar has reasonable grounds to believe that books and papers of, or relating to, any company or other body corporate or managing director or manager of such

company or other body corporate may be destroyed, mutilated, altered, falsified, or secreted, the Registrar may make an application to the Magistrate of the First Class or as the case may be, the Presidency Magistrate having jurisdiction, for an order for the seizure of such books and papers, and after considering the application and hearing the Registrar, if necessary, the Magistrate may, by order, authorise the Registrar to enter, with necessary assistance, the place(s) where such books and papers are kept, search the place(s), and seize such books and papers as he considers necessary.

The Registrar may take copies or extracts from them or place identification mark on them or any part thereof or deal with them in such manner as he considers necessary, and shall within thirty days of the seizure, return those books and papers to the company or the other body corporate or, as the case may be, to the managing director or the manager or any other person, from whose custody they were seized and inform the Magistrate accordingly.

INVESTIGATION

16. MEANING AND OBJECT

Shareholders have been vested with various rights including the right to elect directors under the Companies Act, 1956. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered, the shareholders are, by and large, sleeping and passive partners, and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Sections 235 to 251 of the Companies Act, 1956, contain provisions relating to investigation of the affairs of company.

Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken. The said expression also includes investigation of all its business affairs—profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too [*R. v. Board of Trade, Ex parte St. Martin Preserving Co. Ltd.*, (1964) 2 All. E.R. 561 (Q.B.D.)].

17. KINDS OF INVESTIGATION

The Companies Act, 1956 provides for carrying out the following kinds of investigation:

1. Investigation of the affairs of the company whose business is being conducted in fraudulent or unlawful manner or in a manner oppressive of any member (Section 235 and Section 237);

2. Investigation of the affairs of related companies (Section 239);
3. Investigation of ownership of the company for the purpose of determining the true persons who are or have been able to control or materially influence the policy of the company or who are or have been financially interested in the success or failure, whether real or apparent of the company. (Section 247).

18. INVESTIGATION OF THE AFFAIRS OF A COMPANY BY THE CENTRAL GOVERNMENT

The Central Government has been empowered to conduct investigation into the affairs of the company in the following circumstances:

(i) On the Report of Registrar

Section 235(1) of the Companies Act, 1956 empowers the Central Government to order investigation into the affairs of the company on the report of the Registrar. Accordingly, the Central Government may, where a report has been made by the Registrar under Section 234(6) and (7), appoint one or more Inspectors to investigate the affairs of the company and to report thereon in such manner, as the Central Government may direct.

As per Section 234(6), the Registrar shall report in writing, the circumstances of the case, to the Central Government in the following cases:

- (a) where the information or explanation required by the registrar has not been furnished to him within the specified time.
- (b) where, after perusal of such information or explanation or of the books and papers produced before him, the Registrar is of the opinion that the state of affairs of the company is unsatisfactory.
- (c) where, after perusal of such information or explanation or of the books and papers produced before him, the Registrar is of the opinion that the required documents do not disclose a full and fair statement of any matter.

(ii) On the application of Members

Under Section 235(2) of the Companies Act, 1956, the Company Law Board may, on the application from a specified number of shareholders and after giving the parties an opportunity of being heard, declare that the affairs of the company ought to be investigated by an inspector or inspectors and on such declaration being made, the Central Government shall appoint one or more competent persons as inspectors to investigate the affairs of company and to report thereon in such manner as the Central Government may direct. The shareholders competent to make an application to the Company Law Board are:

- (a) in case of company having a share capital, not less than two hundred members or members holding not less than one-tenth of the total voting power therein, and
- (b) in case of company having no share capital, not less than one-fifth of the persons on the company's register of members.

In terms of Section 236 of the Companies Act, 1956 the aforesaid application

by members of a company must be supported by such evidence as may be required by Company Law Board for the purpose of showing that applicants have good reasons for requiring the investigation and the Central Government may before appointing an Inspector, require the applicants to give security, for such amount not exceeding one thousand rupees, as it may think fit, for meeting the expenses of the investigation.

Petition moved by a non-member for investigation of the affairs of company will not be maintainable. [*Narinder Jeet Kanwar v. Appollo Tyres Ltd.* (CLB)].

(iii) On the passing of special resolution or Order of the Court

According to Section 237(a)(i) and (ii) of the Act, if the company, by special resolution, or the Court by order, declares that the affairs of the company ought to be investigated by an Inspector appointed by the Central Government, then it is obligatory for the Central Government to appoint one or more competent persons as Inspectors to investigate the affairs of company and to report thereon in such manner as the Central Government may direct.

It may be noted that the type of the general meeting in which the resolution is passed and the number of persons (members as well as proxies) present at such meeting (as compared to the total number of members of the company) are immaterial so long as the meeting is validly called and constituted, and the resolution is passed in accordance with the provisions of the Companies Act, 1956.

The order of the court in respect of investigation of the affairs of the company may be passed in any proceeding in which the Court is seized of the company's affairs or in independent proceedings for investigation of the company's affairs. The Court has no power to appoint an inspector; it can only make an order directing the Central Government to do so. The power of the Court in this regard is not subject to the conditions stipulated in Section 235 or Section 237(b) of the Act. "The Legislature in its wisdom has not thought fit to circumscribe the discretion or jurisdiction of the Court in any manner". [In *Re. Alembic Glass Industries Ltd.*, (1972) 42 Comp. Cas. 63 (Guj.)]. See also in *Re. Delhi Flour Mills Co. Ltd.*, (1975) 45 Comp. Cas. 33 (Del.).

It had been contended in several cases that the power and discretion of the Court were uncontrolled and the Court could direct an investigation whenever it suspected that all was not well with the company, and it was not necessary for the petitioner to prove his allegations before the Court for, he could prove them before the Inspectors. For instance, in *Mrs. U.A. Sumathy v. Dig Vijay Chit Fund (P) Ltd.*, (1983) 53 Comp. Cas. 493 (Ker.), the contention was on the above lines. While dismissing the contention, the Kerala High Court observed:

"No doubt, clause (a)(ii) of Section 237 does not lay down what circumstances are to be proved before the Court and on what materials, the Court could act. But that does not mean that mere allegations are sufficient. A Court can act only on the materials placed before it, and those materials should at least be such as to satisfy the Court that a deeper probe into the Company's affairs is desirable in the interest of the company itself." [See also *P. Sreenivasan v. Yoosuf Sagar Abdulla & Sons (P) Ltd.*, (1983) 53 Comp. Cas. 485].

In proceedings under Section 237(a)(ii), the Court will look into only those

allegations which have a bearing on the fiduciary obligation of the majority to abide by law. The Court has also to satisfy itself that the petitioner has come to Court bona fide. An isolated instance of mismanagement already remedied may not justify the passing of an order under Section 237(a)(ii). *Kusumasursi v. Mathru Bhumi Printing & Publishing Co. Ltd.*, 1982 Tax. L.R. 2431 (at p. 2434); (1983) Comp. Cas. 370 (Ker.).

The jurisdiction of the Court is only confined to passing of the order to declare that affairs of company require an investigation. Thereafter, it is for the Central Government to do the rest, namely to appoint Inspector and to take up the matter in its hand after receiving the investigation report and do such other things as are necessary and expedient in public interest.

**Special Resolution under Section 237(a)(ii) to
investigate the affairs of the Company**

“RESOLVED THAT, pursuant to Section 237(a)(ii) of the Companies Act, 1956, the affairs of the company ought to be investigated by one or more competent inspector(s) and that the Board of Directors be and is hereby authorised to approach the Central Government in this behalf.

RESOLVED FURTHER THAT Mr. X, Company Secretary be and is hereby authorised to make the necessary application and to do all such acts in this regard.”

Explanatory Statement

The company has been suffering losses for the last two years and no dividend could be declared. Numerous complaints have been made by shareholders that the creditors and members are being defrauded by the management and that the managing director is being paid commission without the knowledge and approval of the shareholders. This has had the effect of tarnishing the image of the management which had been running the company efficiently and effectively. In order to regain the confidence of the shareholders and to maintain the company's image in the industry, the directors recommend the proposed resolution for investigation of the affairs of the company by an inspector to be appointed by the Central Government. No director is interested in the resolution except as a member. On passing of this resolution, the Board will take the necessary steps to approach the Central Government in this behalf.

The clarifications issued by the Department of Company Affairs in respect of Registrar's power under Section 234 and Guidelines for ordering investigation into the affairs of company are given hereunder:

**Clarifications with respect to Sections 234, 235, 237 and 241
of the Companies Act, 1956**

Companies file balance sheets within six months to a year after the close of the financial year. The scrutiny work is undertaken only after the receipt of the accounts. The cases may be disposed of more promptly. The Registrar of Companies calls for information relating to balance sheet for due performance of his responsibilities or when any complaints are received from the shareholders, or in certain cases, the information so obtained disclosed other aspects on which further scrutiny becomes

necessary. The suggestion that in the absence of a complaint, the Registrar should not ask questions, is not acceptable. *The point that the inquiry should not be roving and there should be greater circumspection on the part of the scrutinising officer is legitimate and will be kept in view.*

Source: *Clarification given by Department of Company Law Administration.*

Section 234: Registrar—Power to call for information—Whether information or explanation called for under the section should have some bearing on items mentioned in balance sheet, profit and loss account, annual return, etc.

Query: The power of the Registrar under Section 234 to call for information or explanation is interpreted by the Administration to extend to calling for information or explanation in respect of purchases, etc., even where such purchases are not made from associates or organizations in which relatives of directors are interested. It appears to us that such interpretation is likely to interfere with, and delay, the day-to-day working of industries and other organisations.

Answer: The Department's view on the subject is that the information or explanation called for under Sub-section (1) of Section 234 should have some bearing on items mentioned in the balance sheet, profit and loss account, annual returns, etc. However, in case of complaints from creditors or contributories of a company, the Registrar has also the power to call for information or explanation on the allegations made against the company.

Source: *Company News and Notes, July 1, 1963 issue.*

Section 235/237: Investigation—Guidelines for ordering investigations into company's affairs

The powers conferred on the Central Government for ordering investigation of the affairs of companies are discretionary, while those conferred by Section 237(a) by virtue of the provisions of Section 235, 237(b) and 247 are obligatory. In exercising the discretionary powers under Sections 235 and 237(b), the Central Government, while examining each case on its merits, applies certain tests which are calculated to ensure that a substantial and worthwhile basis exists, warranting investigation. Where the allegations are more of a recriminatory nature arising out of factional fights between two or more predominant groups of shareholders, the Government will not ordinarily lend itself to be a party to such disputes. In other cases, attracting the relevant provisions of Company Law or any other law in force, *the following objectives may generally form the prerequisites for the ordering of an effective investigation:*

1. Whether an inspector can bring to light any major contravention of Company Law or any other law on the basis of which necessary corrective or remedial measures can be applied?
2. Whether the application of such measures alone will be enough to lend succour to the aggrieved parties, where necessary, or to set right the affairs of companies so as to bring them in conformity with the accepted principles and standards of good and efficient management?
3. Whether the allegations bring out clearly or, by implications, a charge of irregular accounting, the truth of which can be established only by the analysis of the books by a qualified chartered accountant?

Source: *Clarification issued by Department of Company Affairs.*

Section 241: Investigation—Criteria for publishing Inspector's report

It has been decided by the Company Law Board that in important cases where the reports of investigation into the affairs of ownership of companies by Inspectors appointed for the purpose are *likely to be of interest to the general public, such reports will be published*. The criterion selection would be the size, the extent of public interest and participation, the nature of industry engaged in, the extent of consumer creditor's interests and the relationship, if any, with other companies fulfilling these requirements.

Source: *Company News and Notes, August 7, 1964.*

(iv) On the opinion of Company Law Board

According to Section 237(b) of the Companies Act, 1956, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of company and to report thereon, in such manner as the Central Government may direct, if in the opinion of Company Law Board there are circumstances suggesting that—

- (i) the business of the company is being conducted with intend to defraud its creditors, members or any other persons or for a fraudulent or unlawful purpose or in a manner oppressive of any of its members or that the company was formed for any fraudulent or unlawful purpose;
- (ii) persons concerned in the formation of company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or
- (iii) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director or the manager of company.

It is important to note that these three grounds limit the jurisdiction of the Company Law Board. Before ordering an investigation under Section 237(b) of the Act or forming an opinion for investigation, the Company Law Board must satisfy itself whether the circumstances of case fall under any one or more of the above grounds and it has no jurisdiction to go on a fishing expedition to find evidence

(Barium Chemicals Ltd. and Another v. Company Law Board, (1966) 2 Comp LJ 151 (SC). In this case, the Secretary of the Company Law Board (CLB) issued an Order under Section 237(b) appointing four persons to investigate the affairs of company, which was challenged. The Chairman of the Company Law Board in his affidavit alleged that there was delay, bungling and faulty planning of the project entailing double expenditure, continuous losses resulting in one third of the share capital being wiped out, shares being quoted at half their face value and severance of their connection by some eminent persons. The Court held that these circumstances cannot by themselves suggest an intent to defraud or fraudulent management. Mere bungling or faulty planning cannot constitute either misfeasance or misconduct.

It was, therefore, held that “there must exist circumstances which in the opinion of the Authority suggest what has been set out in clauses (i), (ii) or (iii) of Section 237(b) of the Act. If it is shown that the circumstances do not exist or that they are such that it is impossible for any one to form an opinion therefrom suggestive of the aforesaid things, the opinion is challengeable on the ground of non-application of mind or perversity or on the ground that it was formed on collateral grounds and was beyond the scope of the statute.”

This view has been followed in subsequent cases including “*Rohtas Industries Ltd. v. S.D. Agarwal and Another*, (1969) 1 Comp. L.J. 350 (S.C.): A.I.R. 1969 S.C. 707, where it was held that the existence of circumstances suggesting that the company’s business was being conducted as laid down in Sub-clause (i) or the persons mentioned in Sub-clause (ii) of Section 237(b) were guilty of fraud or misfeasance or other mis-conduct towards the company or towards any of its members, is a condition precedent for the Central Government to form the required opinion, and if the existence of those conditions is challenged, the Courts are entitled to examine whether those circumstances were existing when the order was made. In other words, the existence of the circumstances in question are open to judicial review though the opinion formed by the Central Government is not amenable to review by the Courts. [In *Re. Barium Chemicals Ltd. (Supra)* and In *Re. Rohtas Industries Ltd. (Supra)*].

In a petition filed under section 237 of the Companies Act, 1956, a bank sought an order directing investigation into the affairs of the company on the ground that the business of the company was conducted for a fraudulent and unlawful purpose with intent to defraud the general public and the bank. The bank also sought suppression of the board of directors of the company and appointment of an administrator and special officer to take charge of the management as well as its assets and properties. The company raised an objection that the petition was not maintainable in terms of the Limitation Act, 1963, and that since inspection of the company had already been ordered under section 209A of the Act, there was no scope for ordering investigation. Allowing the petition of the bank, it was held that the petition is not barred by limitation as the provisions of the Limitation Act, 1963, do not apply to proceedings before a quasi-judicial authority. Further, an order of investigation is not an end by itself; it is only a means to find out the full facts of the acts complained of. It is nothing but an exploratory measure to be proved or disproved with reference to the facts later on ascertained. The discretionary power of the Company Law Board has to be exercised in good faith. Unless proper grounds exist for investigation of the affairs of the company, investigation cannot be ordered. Though inspection under section 209A of the Companies Act, 1956, had already been ordered in the case of the company, the scope of inspection was different from the scope of investigation. Further, investigation alone could reveal the true state of affairs of the company. So, the court was of the view that as per the facts and circumstances of the case it is a fit case for ordering investigation under section 237(b) of the Act. - *Bank of Rajasthan Ltd. v. Rajasthan Breweries Ltd & Ors.* [(2007) 140 Comp Cas 622 (CLB)].

Some of the significant judicial decisions relevant on the matter are briefly indicated below:

- (1) The expression “if in the opinion of the Company Law Board, there are circumstances suggesting” means ‘if it appears (to the CLB) that there is

likelihood' of the existence of mal-practices envisaged in clauses (i) to (iii). In forming its prima facie opinion, the CLB must proceed reasonably, must not be actuated by bad faith or dishonesty, must exclude from consideration matters which are irrelevant and must act according to law and justice [*New Central Jute Mills Ltd. v. Dy. Secretary, Ministry of Finance* (1970) 40 Com. Cases 102, (DB) (Cal.)].

- (2) Where as a result of an inspection of accounts by a Government agency, the Government came to know of embezzlement and other misconduct on the part of persons in management, it was held that it was not necessary for the Government to order an investigation of the affairs before making a police complaint of the offences. [*B.M. Bajoria v. Union of India* (1972) 42 Com. Cases, 338 (Del.)].
- (3) The nature of power conferred on the Central Government under Section 237(b) makes it clear that unless proper grounds exist for investigation of the affairs of company, such investigation will not be lightly undertaken. An investigation may seriously damage a company and should not be ordered without proper material gathered in the manner provided in the Act. The power of investigation has been conferred on the Central Government on the faith that it will be exercised in a reasonable manner [*Rohtas Industries Ltd. v. S.D. Agarwal*, (1969) 39 Com. Cases 781, AIR 1969 SC].
- (4) Where the order of the Central Government is challenged, the Central Government must prove the existence of *prima facie* circumstances leading to investigation. Sufficiency or adequacy of the evidence is not questioned at the stage of ordering the investigation [*Sahu Jain Ltd. v. Dy. Secretary, Ministry of Finance* (1966) 36 Comp. Cas. 543 (Cal.)]. The Court will not test the opinion of the Central Government whether the investigation is necessary, but may examine the basis of opinion.
- (5) Economic workings of the company can't be a matter for investigation. There must be allegation of illegal acts of malpractices, misfeasance etc. to sustain an order of investigation [*Re. Delhi Flour Mills Company Ltd.* (1975) 45 Comp. Case 33[DEL].
- (6) Where the conclusion of CLB was not sustained by the facts, the Court quashed the order appointing the inspectors as it had an adverse effect on the reputation and credibility of the company. [*Hariganga Cement Ltd. v. CLB* (1988) 64 Comp. Cas. 603[BOM].

Delegation of powers of Central Government under section 240 to Director, Serious Fraud Investigation Office

Ministry of Corporate Affairs vide its notification No. SO 1548(E) dated 25.06.2010 provides that in exercise of the powers conferred by sub-section (1) of section 637 of the Companies Act, 1956, the Central Government hereby delegates its powers under -

- clause (a) of sub-section (1) of section 240 which provides that the Central Government may authorize the inspector to have access to the books and papers of the company,

- sub-section (1A) of section 240 which provides that the Central Government may authorize the inspector to have access to the books and papers of a body corporate other than a body corporate mentioned in section 240(1),
- clause (b) of sub-section (2) of section 240 which provides that the Central Government may authorise the inspector to examine on oath any person in relation to the affairs of the company,
- and sub-section (3) of section 240 which provides for penalty for failure to comply with the above mentioned provisions of the Companies Act, 1956,

to the Director, Serious Fraud Investigation Office only in respect of those cases wherein the Central Government appoints officers of Serious Fraud Investigation Office as inspectors, to investigate into the affairs of a company under section 235 or section 237 of the Companies Act, 1956.

Multiple choice question

What is the number of persons required to make an application under sections 235 of the Companies Act, 1956?

- (a) where the company has a share capital, 200 members,
- (b) where the company has a share capital, one/tenth of the total voting power,
- (c) where the company has a share capital, 200 members or one/tenth of the total voting power, whichever is less,
- (d) both a & b.

Correct answer: d.

19. ONLY INDIVIDUAL TO BE APPOINTED AS INSPECTOR

Section 238 of the Companies Act, 1956 prohibits the appointment of any firm, body corporate or other association as an inspector under Section 235 or 237 of the Act. Thus only an individual or individuals may be appointed as Inspector(s) to conduct the investigation into the affairs of the company and to report thereon in the prescribed manner.

20. POWERS OF INSPECTORS

The Inspectors, appointed by the Central Government to investigate into the affairs of the company, have been given wide powers under the Companies Act, 1956. The powers can be described under the following heads:

(i) To carry investigation into the affairs of related companies

According to Section 239(1) of the Companies Act, 1956, an inspector may also investigate the affairs of following body corporates or persons, if the inspector thinks that such investigation is necessary for the purpose of his investigation:

- (a) any other body corporate which is, or has at any relevant time, been the company's subsidiary or holding company or a subsidiary of its holding company or a holding company of its subsidiary;

- (b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is or was at the relevant time, the managing director or the manager of the company; or
- (c) any other body corporate which is or has at any relevant time been managed by the company or whose Board of Directors comprises of nominees of the company or is accustomed to act in accordance with the directions or instructions of:
 - (i) the company; or
 - (ii) any of the directors of the company; or
 - (iii) any company, any of whose directorships is held by the employees or nominees of those having control and management of the first mentioned company; or
- (d) any person who is or has at any relevant time been the company's managing director or manager.

However, as per sub-section (2) of Section 239, the inspector must obtain prior approval of Central Government before taking up investigation into the affairs of the body corporate and persons referred to in (b), (c) or (d) above, and before granting such approval, the Central Government shall give such body corporate or persons, a reasonable opportunity to show cause why such approval should not be accorded.

(ii) To compel production of documents and obtain information

According to Section 240(1) of the Act, it shall be the duty of all officers and other employees and agents of the company including all officers and other employees and agents of such body corporate whose affairs are being investigated under Section 239, to preserve and to produce to an inspector or any person authorised by him in this behalf, with the previous approval of Central Government, all books and papers of, or relating to, the company or, as the case may be, or of relating to other body corporate, which are in their custody or power, and otherwise to give to the Inspector all assistance in connection with the investigation which they are reasonably able to give.

Further, as per Section 240(1A), the Inspector may with the previous approval of the Central Government require any body corporate other than the body corporates referred in Sub-section (1), to furnish such information to, or produce such books and papers before him or any person authorised by him in this behalf with previous approval of the Central Government, as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purpose of conducting his investigation.

(iii) To keep books and papers

According to Section 240(1B) of the Companies Act, 1956 the Inspector may keep in his custody any books and papers produced before him under sub-section (1) or sub-section (1A) for six months and thereafter shall return the same to the company, body corporate, firm or individual by whom or on whose behalf such books and papers are produced. Further the Inspector may call for the books and papers if needed again. He shall return those books and papers to the body corporate concerned if certified copies of the same are furnished to him.

(iv) To examine on oath

According to Section 240(2) of the Act, an Inspector may examine on oath, any officer, other employees and agents of the company or other body corporate whose affairs are being investigated under Section 239 and with the previous approval of the Central Government, any other person, in relation to the affairs of the company or other body corporate, as the case may be, and may administer on oath accordingly and for that purpose may require any of those persons to appear before him personally. Notes of such examination shall be taken down in writing and shall be read over to or by, and signed by, the person examined, and may thereafter be used in evidence against him.

(v) To seize the documents

According to Section 240A of the Act where in the course of investigation under Section 235 or Section 237 or Section 239 or Section 247, the Inspector has reasonable grounds to believe that books and papers of, or relating to any company or other body corporate or managing director or manager of such company or other body corporate may be destroyed, mutilated, altered or falsified or secreted, the Inspector may make an application to a Magistrate of the First Class or, as the case may be, the Presidency Magistrate having jurisdiction for an order for seizure of such books or papers. After considering the application and hearing the Inspector, the Magistrate may by order authorise an Inspector to enter, with such assistance, as may be required, the place(s) where such books and papers are kept; to search that place(s) in the manner specified in the order and to seize the books and papers he considers necessary, for the purpose of his investigation. The Inspector shall keep in his custody the books and papers seized by him, for such period not later than the conclusion of investigation as he considers necessary and thereafter shall return the same to the company or as the other body corporate or as the case may be, to the managing director or manager or any other person from whose custody or power those books were seized. However before returning such books and papers the Inspector may place identification marks on them or on any part thereof. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1898 relating to search or seizures made under that code.

21. PENALTY FOR DEFAULT W.R.T INVESTIGATION

According to Section 240(3) of the Companies Act, 1956, if any person fails without reasonable cause or refuses—

- (a) to produce to an Inspector or any person authorised by him in this behalf with the previous approval of the Central Government, any book or paper which it is his duty under Sub-section (1) or (1A) to produce; or
- (b) to furnish any information which it is his duty to furnish under sub-section (1A) to furnish; or
- (c) to appear before the Inspector personally when required to do so under sub-section (2) or to answer any question which is put to him by Inspector in pursuance of that sub-section; or
- (d) to sign the notes of any examination taken down in writing after investigation,

he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to twenty thousand rupees or with both and also with a

further fine which may extend to two thousand rupees for everyday after the first day during which the failure or refusal continues.

22. INSPECTORS' REPORT

According to Section 241(1) of the Companies Act, 1956, the Inspector may, and if so directed by the Central Government, shall make interim reports to that Government and on the conclusion of the investigation, shall make a final report to the Central Government.

Any such report shall be written or printed as the Central Government may direct. As per Section 241(2) of the Act, the Central Government :

- (a) shall forward a copy of any report other than an interim report made by the Inspectors to the company at its registered office and also to any body corporate dealt within the report by virtue of Section 239 of the Act;
- (b) may, if it thinks fit, furnish a copy thereof on request and on payment of prescribed fee to any person who is a member of the company or other body corporate dealt with in the report by virtue of Section 239 or whose interests as a creditor of the company, other body corporate aforesaid appear to the Central Government, to be affected;
- (c) shall, where the inspectors are appointed under Section 235(2), furnish at the request of the applicants for the investigation, a copy of the report to them;
- (d) shall, where the inspectors are appointed under Section 237 in pursuance of an order of the Court, furnish a copy of the report to the Court;
- (e) shall, where inspectors are appointed in pursuance of provisions of Section 235(2) of the Act, furnish a copy of the report to the Company Law Board; and
- (f) may also cause the report to be published.

23. FOLLOW-UP ACTION ON THE REPORT

On receipt of the report of the Inspectors appointed to investigate the affairs of Company, the Central Government may take any one or more of the following actions:

(i) Prosecution for Criminal Offence

As per Section 242 of the Act, if from any report made under Section 241, it appears to the Central Government that any person has, in relation to the company or in relation to any other body corporate, whose affairs have been investigated by virtue of Section 239, been guilty of any offence for which he is criminally liable, the Central Government may, after taking such legal advice as it thinks fit, prosecute such person for the offence and it shall be the duty of all officers and other employees and agents of the company or body corporate, as the case may be (other than the accused in the proceedings), to give the Central Government all assistance in connection with the prosecution which they are reasonably able to give.

(ii) Winding up of the Company or Relief by the Court

According to Section 243 of the Act, if any such company or other body corporate is liable to be wound up under the Act and it appears to the Central Government from any such report as aforesaid that it is expedient so to do by reason

of any of the circumstances suggesting that:

- (i) the business of the company is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive of any of its members, or that the company was formed for any fraudulent or unlawful purpose;
- (ii) the persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members,

the Central Government may, unless the company or body corporate, is already being wound up by the Court, cause to be presented to the Court by any person authorised by the Central Government in this behalf:

- (a) a petition for the winding up of the company or body corporate on the ground that it is just and equitable that it should be wound up;
- (b) an application for an order under Section 397 or 398; or
- (c) both the petition and application as aforesaid.

Though the report of the inspector does not have any evidentiary value in the ordinary sense of the term, but if the company does not challenge the contents of the report, or does not appear to resist a winding up order, the Court can treat it as sufficient evidence to order a winding up of the company. In *Re. Travel & Holiday Club Ltd.*, (1967) 37 Comp. Cases 673, (1967) 2 All E.R. 606: In *Re. S.B.A. Properties Ltd.*, (1967) 37 Comp. Cases 618 (1967) 2 All E.R. 615.

The inspector's report can be used to support a contributory's petition for winding up of the company on the just and equitable ground. In *Re. St. Piran Ltd.*, (1981) 3 All E.R. 270 (Ch.D).

Even if on the report of inspectors appointed under Section 235 or 237, it appears to the Central Government that it is expedient to apply for winding up on the ground that it is just and equitable to do so or to apply for an order under Section 397 or 398, the Central Government should not take any steps if the Court is already seized of proceedings to wind up the company [*Mool Chand Gupta v. Jaganath Gupta & Co. (P) Ltd.*, A.I.R. 1979 S.C. 1038].

(iii) Recovery of Damages or Property

According to Section 244(1), if from any report of Inspectors, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated under clauses (a), (b) and (c) of Section 239:

- (a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation or the management of its affairs, of such company, or body corporate; or
- (b) for the recovery of any property of such company, or body corporate, which has been misapplied or wrongfully retained;

the Central Government may itself bring proceedings for that purpose in the name of the company or body corporate.

The Central Government shall indemnify such company or body corporate

against any costs or expenses incurred by it in, or in connection with, any proceedings brought by virtue of Sub-section (1). Whilst Section 242 is related to an offence, Section 244 pertains to tortious act and civil action for recovery of damages. However, for any such action to be successful in prosecution, there must be a clear proof that the act concerned amounts to "fraud, misfeasance or other misconduct" in the management of the affairs of the company. In an English decision, it has been held that the expression 'or other misconduct' should not be interpreted *ejusdem generis* with fraud and misfeasance but may be taken to include also misconduct not involving moral turpitude [*Selangor United Rubber Estates Ltd. v. Cradock* (1968) 1 Comp. L.J. 26: (1968) 2 All E.R. 1073 (Ch.D.)].

As per Section 246, a copy of any report of any inspector(s) appointed under Section 235 or 237 authenticated in such manner, if any, as may be prescribed, shall be admissible in any legal proceeding as evidence of the opinion of the inspector(s) in relation to any matter contained in the report.

24. EXPENSES OF INVESTIGATION

According to Section 245, the expenses of and incidental to an investigation by an inspector appointed by the Central Government under Sections 235 or 237 shall be defrayed in the first instance by the Central Government, but the following persons shall, to the extent mentioned below, be liable to reimburse the Central Government in respect of such expenses:

- (a) any person who is convicted on a prosecution instituted in pursuance of Section 242, or who is ordered to pay damages or restore any property in proceedings brought by virtue of Section 244, may, in the same proceedings, be ordered to pay the said expenses to such extent as may be specified by the court convicting such person or ordering him to pay such damages or restore such property as the case may be;
- (b) any company or body corporate in whose name proceedings are brought as aforesaid shall be liable, to the extent of the amount or value of any sums or property recovered by it as a result of the proceedings; and
- (c) unless, as a result of the investigation, a prosecution is instituted in pursuance of Section 242:
 - (i) any company, body corporate, managing director or manager dealt with by the report of the Inspector shall be liable to reimburse the Central Government in respect of the whole of the expenses, unless and except in so far as, the Central Government otherwise directs; and
 - (ii) the applicants for the investigation, where the inspector was appointed in pursuance of the provisions of sub-section (2) of Section 235, shall be liable to such extent, if any, as the Central Government may direct.

The afore-mentioned expenses shall be recoverable from that company, body corporate, managing director or manager, as an arrear of land revenue. Further any costs or expenses incurred by the Central Government in or in connection with proceedings brought by virtue of Section 244 (including expenses incurred by virtue of Sub-section (2) thereof) shall be treated as expenses of the investigation giving rise to the proceedings.

25. PREPARATION BY A COMPANY SECRETARY TO FACE INVESTIGATION

Before an inspector commences investigation into the affairs of a company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence. The aspects which should be considered by the secretary include:

1. Basic information about the company—Name of the company; date of incorporation; location of the registered office, branches, factories and other offices; status of the company—public or private; objects of the company—capital structure; voting rights attached to the shares; shareholding pattern of the company.
2. Business activities—Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so the names of other companies falling within the same group.
3. Debentures, bank finance and deposits.
4. Foreign collaboration agreements.
5. Management—Brief history of past management set up; existing management set up; composition of Board of Directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to an office or place of profit.
6. Whether all the statutory registers including minutes books are being maintained up-to-date?
7. Whether the internal checks and internal control system is being properly followed?
8. Working results and financial position—General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
9. Compliance by the company and its officers with the provisions of the Companies Act, 1956.
10. Compliance with the provisions of other Acts applicable to the company.
11. Accounts—The compliance with Accounting Standards and compliance with the provisions of Schedule VI of the Act; Whether adequate provisions were made for provident fund, gratuity, taxes, bonus, dividend etc.; Whether the system of periodical reporting to the top management on the financial performance is followed; whether the income-tax assessments are up-to-date; Whether the provisions of Sections 215, 217, 219 and 220 have been complied with; whether the cost accounting records are maintained.

12. Whether the loans taken and loans advanced to Directors, the firms in which they are partners or companies in which they are Directors are in accordance with the provisions of the Act.
13. The investments made by the company.
14. Sole selling agency agreement.
15. Instance of mismanagement and other irregularities.
16. Acquisition/disposal of substantial assets.
17. A scrutiny of abnormal/heavy expenditure items.
18. Complaints, if any, against the company and its management and steps taken to redress them.
19. Brief particulars of the litigations against the company and the reasons thereof.
20. Management's relations with the employees and labour.
21. Shareholders—Instance of oppression of minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc. and steps taken to redress Investors, complaints.
22. Auditors—Name and address of statutory auditors, compliance as per the provisions of Sections 224, 227 and 229.
23. Qualifications in Auditors' Report and Directors' Comments thereon under Section 217. Instances of concealment of income by falsification of accounts; an mismanagement of the company, transactions entered into with intent to defraud the creditors, shareholders and government; and whether these instances have been reported in the Auditors' Report.

Follow-up Action

After the above-mentioned information is compiled, the next step should be to list out the action points and pursue them vigorously. This may rectify many aspects which would otherwise lead to serious problems to the company and its management.

26. INVESTIGATION OF THE OWNERSHIP OF COMPANY

In the public interest it may become necessary for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it. For this reason, the Central Government has been empowered under Section 247(1) of the Companies Act, 1956, to 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, whether real or apparent, of the company; or
- (b) who are or have been able to control or materially to influence the policy of the company.

As per sub-section (1A) of Section 247, the Central Government shall appoint one or more inspectors under sub-section (1), if the Company Law Board, in the course of any proceedings before it, declares by an order that the affairs of the company ought to be investigated as regards the membership of the company and

other matters relating to the company for the purpose of determining the true persons who are or have been financially interested in success or failure whether real or apparent of the company; or who are or have been able to control or materially to influence the policy of the company.

The Central Government may define the scope of investigation by the Inspector in respect of matters or the period to which it is to extend or otherwise and may also limit the investigation to matters connected with particular shares or debentures.

Subject to the terms of an inspector's appointment, the powers of Inspector as per Section 247(3) of the Act, shall extend to the investigation of any circumstances, suggesting the existence of any arrangement or understanding which though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purpose of his investigation.

The provisions of Sections 239, 240 and 241 shall apply *mutatis mutandis* to the investigation under Section 247, in relation to all persons (including persons concerned only on behalf of others) who are or have been or whom the Inspector has reasonable cause to believe to be or to have been, financially interested in the success or failure, or the apparent success or failure of the company or of any other body corporate whose membership or constitution is investigated with that of the company or able to control or materially influence the policy of such company, body corporate, as they apply in relation to officers and other employees and agents of the company, of other body corporate, as the case may be.

On completion of investigation, the Inspector is required to submit his report to the Central Government. However, the Central Government, is not bound to furnish the company or any other person with a copy of report, if it is of the opinion that there is good reason for not divulging the contents of report or part thereof. However, the Central Government shall cause to be kept by the Registrar, a copy of any such report or as the case may be, of the parts thereof, as respects which, it is not of that opinion. The expenses of the Investigation shall be defrayed by the Central Government out of moneys provided by Parliament unless it directs that the expenses or any part thereof should be paid by the persons on whose application the investigation was ordered.

27. RESTRICTIONS ON SHARES AND DEBENTURES

According to Section 250(1) of the Companies Act, 1956 if it appears to the Company Law Board, whether on a reference made to it by the Central Government in connection with any investigation under Section 247, or on a complaint made by any person in this behalf that there is good reason to find out the relevant facts about any shares (whether issued or to be issued) and the Company Law Board is of the opinion that such facts cannot be found out unless the restrictions specified in sub-section (2) are imposed, the Company Law Board may, by order direct, that shares shall be subject to the restrictions imposed by sub-section (2) for such period not exceeding three years as may be specified in the order.

The restrictions as mentioned in Sub-Section (2) of Section 250 which may be imposed upon shares and debentures are as follows:

- (i) Any transfer of those shares shall be void;
- (ii) Where those shares are to be issued, they shall not be issued and any issue thereof or any transfer of the right to be issued therewith, shall be void;

- (iii) No voting rights shall be exercisable in respect of those shares;
- (iv) No further shares shall be issued in right of those shares or in pursuance of any offer made to the holder thereof and any issue of such shares or any transfer of the right to be issued therewith, shall be void; and
- (v) Except in Liquidation, no payment shall be made of any sums due from the company on those shares, whether in respect of dividend, capital or otherwise.

Where a transfer of shares in a company has taken place and as a result thereof a change in the composition of the Board of directors of the company is likely to take place and the Company Law Board is of the opinion that any such change would be prejudicial to the public interest, the Company Law Board may, by order, direct that:

- (i) the voting rights in respect of those shares shall not be exercisable for such period not exceeding three years as may be specified in the order,
- (ii) no resolution passed or action taken to effect a change in the composition of the Board of Directors before the date of the order shall have effect unless confirmed by the Company Law Board.

Where the Company Law Board has reasonable ground to believe that transfer of shares is likely to take place where by a change in the composition of the Board of Directors of the company is likely to take place and the Company Law Board is of the opinion that any such change would be prejudicial to the public interest, the Company Law Board may, by order, direct that, any transfer of shares in the company during such period not exceeding three years, as may be specified in the order, shall be void.

In the matter of Shaw Wallace & Company Ltd. and in the matter of *Ajaib Singh and Others v. R.G. Shah & Co. Ltd.*, the Company Law Board vide its Order No. 6/3 C.IX/85 dated 13.10.85 has held that Sub-section (3) of Section 250 can be invoked if and only if the following three links in a chain are satisfied. What is more important is that the first link in the chain should give rise to the second and the second to the third. That is, there must exist a casual relationship in the said chain.

These links are:

- (i) There must be a transfer of shares;
- (ii) The transfer of shares should be likely to result in change in the composition of the Board of directors; and
- (iii) Such change should be prejudicial to the public interest.

It is clear, therefore, that unless the contemplated chain reaction takes place the provisions of Section 250(3) cannot be applied. It will be seen from the provisions extracted above that the stimulation for the reaction has to start from transfer of shares. Thus, transfer of shares is *sine qua non* for setting the machinery of Sub-section (3) in motion.

Sub-sections (9) and (10) of Section 250 prescribe penalties for contravention of any order passed by the Company Law Board or the restrictions imposed by it under Sub-section (2). Any person who contravenes the provisions of Sub-sections (2), (3) and (4) shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees or with both. Further, if shares in any company are issued in contravention of provisions of Sub-section (2), the

company and every officer of the company who is in default shall be punishable with fine which may extend to fifty thousand rupees. A prosecution shall not be instituted under this section except, by, or with the consent of, the Central Government.

All the aforementioned provisions of Section 250 shall apply to debentures as they apply to shares. Provisions in Section 250 have been made to render cornering of shares by unscrupulous persons more difficult.

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

The Central Government has been empowered under Section 247(1) of the Companies Act, 1956, to appoint one or more inspectors to investigate and report on the membership of any company.

- True
- False

Correct answer: True

28. SAVING FOR DISCLOSURE BY LEGAL ADVISOR OR BANKER

Section 251 grants professional immunity to legal advisors and bankers. It provides that—

Nothing in Sections 234 to 247 and 250 shall require the disclosure to the Company Law Board or to the Central Government or to the Registrar or to an Inspector appointed by the Central Government—

- (a) by a legal adviser, of any privileged communication made to him in that capacity, except as respect the name and address of his client; or
- (b) by the bankers of any company, body corporate or other person referred to in the sections aforesaid, as such bankers of any information as to the affairs of their customers other than such company, body corporate or person.

29. PROTECTION OF THE EMPLOYEES OF COMPANY DURING INVESTIGATION

Under Section 635B of the Act, the employees of the company under investigation, who make disclosure during the course of investigation, are protected against dismissal, discharge, removal, etc. The section provides that if during the course of any investigation of the affairs and other matters of, or relating to the company, body corporate or persons under Sections 235, 237 or 239; or of the membership and other matters of or relating to the company, or the ownership of shares in or debentures of a company or body corporate or the affairs and other matters of or relating to company, body or person under Sections 247 or during the pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company, any such company, or body, or person proposes to discharge or to punish any employee whether by way of dismissal, removal or reduction in rank or otherwise, then the company, the body corporate or the person concerned must send to the Company Law Board a previous intimation in writing of the action proposed to be taken against the employee.

If the Company Law Board has any objection to the action proposed to be taken, it must send by post a notice thereof in writing to the company, body or person concerned. The Board is not bound to hear the company or any other person before

issuing the notice of its objection [*Ashoka Marketing Ltd. v. Company Law Board*, (1968) 38 Comp. Cas. 519]. If the company, body corporate or the person concerned does not receive any notice of objection from the Board within thirty days of the sending of the intimation by it, then and only then, the company, body corporate or person concerned may proceed to take the proposed action against the employees. If the company, body corporate or person concerned is dissatisfied with the objection raised by the Company Law Board, it may, within thirty days of the receipt of notice, prefer appeal to the Court in the prescribed manner and on payment of prescribed fees. The decision of the Court on such appeal shall be final and be binding on the Company Law Board and on the company, body corporate or person concerned.

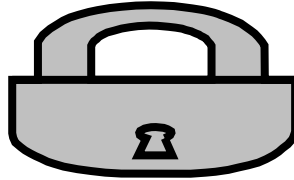
The aforesaid provisions of Section 635B are without prejudice to the provisions of any other law for the time being in force.

LESSON ROUND-UP



- The Act provides exhaustive powers to the Registrar or Officers authorized by the Central Government or Securities and Exchange Board of India, as the case may be, to conduct inspection in order to ascertain that all transactions have been validly entered into and recorded in appropriate books and that applicable laws, rules and procedures have been complied with by the company.
- Also, the books of account and other books and papers shall be open to inspection by any director during business hours. The Companies Act does not give any statutory right of inspection of books of account to a shareholder. However articles of a company may give such a right to the shareholders.
- No previous notice is required to be given for making inspection of the books of account and other books and papers of a company. The books of account are required to be kept either at the registered office of the company or at some other place, after intimation to the Registrar.
- The Act requires every director, other officer or employee of the company to give to the person making inspection under this section, all assistance in connection with the inspection.
- The Act empowers the person making the inspection to make or cause to be made copies of books of account and other books and papers or place or cause to be placed any marks of identification thereon in token of inspection having been made.
- The person making an inspection is required to make a report to the Central Government after inspection of books of account and other books and papers of the company.

- If a default is made in complying with the provisions of inspection, every officer of the company, who is in default, shall be punishable with fine and imprisonment.
- In respect of inspection, the Company Secretary should take all possible steps to comply with the provisions of the Act and other laws. When inspection of books (by the Registrar or an officer of the Central Government or SEBI) is anticipated, he/she should make sure that the prescribed statutory registers and records are being maintained up to date by the company.
- Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and see if any illegal acts or offences are disclosed and then decide the action to be taken.
- The Companies Act provides for carrying out investigation of the affairs of the company whose business is being conducted in fraudulent or unlawful manner or in a manner oppressive of any member or of the affairs of related companies or of ownership of the company for the purpose of determining the true persons who are or have been able to control or materially influence the policy of the company or who are or have been financially interested in the success or failure, whether real or apparent of the company.
- The Central Government has been empowered to conduct investigation into the affairs of the company in circumstances specified under the Act.
- Only an individual or individuals may be appointed as Inspector(s) to conduct the investigation into the affairs of the company and to report thereon in the prescribed manner. Inspectors have been given wide powers under the Companies Act.
- The inspector may, and if so directed by the Central Government, shall make interim reports to that Government and on the conclusion of the investigation, shall make a final report to the Central Government.
- On receipt of the report of the Inspector appointed to investigate the affairs of the Company, the Central Government may undertake prosecution for criminal offence, winding up of company or relief by the court, recovery of damages or property.
- Before an inspector commences investigation into the affairs of the company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged.
- In the public interest it may become necessary for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it. For this reason, the Central Government has been empowered under the Act to appoint one or more Inspectors to investigate and report on the membership of any company and other matters relating to the company.
- Under the Act, the employees of the company under investigation, who make disclosure during the course of investigation, are protected against dismissal, discharge, removal, etc.

SELF-TEST QUESTIONS

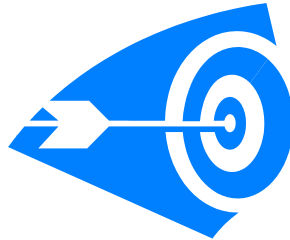
(These are meant for recapitulation only. Answer to these Questions are not to be submitted for revaluation)

1. Discuss the provisions of Companies Act, 1956 with respect to investigation of the affairs of company by the Central Government.
2. What are the powers of Inspectors appointed under Section 235 or 237 of the Companies Act, 1956?
3. As a company secretary what steps would you take in order to face Investigation.
4. Draft a resolution for the investigation of the affairs of company.
5. Company Law Board may by order direct that the shares of company shall be subject to certain restrictions. What are those restrictions and when can they be imposed?
6. Discuss the provisions of Companies Act, 1956 which protects the employees of company during investigation.
7. Discuss the powers of Registrar to call for information or explanation.

STUDY XXVII

SHAREHOLDERS' DEMOCRACY; MAJORITY POWERS AND MINORITY RIGHTS; AND PREVENTION OF OPPRESSION AND MISMANAGEMENT

LEARNING OBJECTIVES



This lesson explains the concept of shareholders' democracy, the majority powers and minority rights. The lesson describes the principle of non-interference in detail along with its justifications and advantages. It also gives provisions for protection of minority rights and shareholder's remedy. Provisions under the Companies Act for prevention of oppression and mismanagement have also been discussed herein.

At the end of the lesson, you should be able to understand:

- Concept of shareholders' democracy.
- Powers of majority.
- Principle of non-interference or Rule in *Foss v. Harbottle* along with its justification and advantages.
- Exceptions to the rule-Protection of minority rights and shareholders' remedies.
- Actions by shareholders in common law.
- Statutory remedy under the Companies Act.
- Meaning of oppression and its prevention.
- Winding up order under just and equitable clause.
- Prevention of mismanagement.
- Persons entitled to apply.
- Powers of the Company Law Board and Central Government to prevent oppression or mismanagement.
- Consequences of termination or modification of agreements.
- Powers to prevent changes in Board.

1. SHAREHOLDERS' DEMOCRACY

Introduction

The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.

Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by the shareholders, and for the shareholders in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Under the Companies Act the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through General Meetings. Although constitutionally all the acts relating to the company can be performed in General Meetings but most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Under Section 291 of the Companies Act a general power has been conferred on the Board of directors. The section provides that "Subject to the provisions of this Act, the Board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do."

Proviso to this section restricts the power of the Board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association.

Thus the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

Some of the businesses which can be transacted at meetings of shareholders are:

1. Alteration of Memorandum of Association and Articles of Association.
2. Further issue of share capital.
3. To transfer some portions of uncalled capital to reserve capital to be called up only in the event of winding up of the company.
4. To reduce the share capital of the company.
5. To shift the registered office of the company outside the state in which the registered office is situated at present.
6. To decide a place other than the registered office of the company where the statutory books, required to be maintained under Sections 159 and 160 may be kept.
7. Payment of interest on paid-up amount of share capital for defraying the expenses on Construction when plant cannot be commissioned for a longer period of time.
8. To appoint auditors in case of companies where 25% or more of the paid-up share capital is held by Central/State Government or public financial institutions or any of their constituents.

9. To approach Central Government for investigation into the affairs of the company.
10. Appointment of sole selling agents where paid-up share capital is beyond ₹ 50 lakhs and confirmation of appointment of sole selling agents in other cases.
11. To allow a director, partner or his relative to hold office or place of profit.
12. Payment of commission of more than statutory requirement to a managing or a whole-time director or a manager.
13. To make loans, to extend guarantee or provide security to other companies or make investment beyond the limit specified.
14. To borrow money and to charge out the assets of the company to secure the borrowed money where the sums to be borrowed along with money already borrowed exceeds the paid-up capital of the company and its free reserves i.e. reserves not set apart for any specific purpose.
15. To appoint directors.
16. To increase or reduce the number of directors within the limits laid down in Articles of Association.
17. To cancel, redeem debentures etc.
18. To make contribution to funds not related to the business of the company.

In view of the rights conferred on shareholders to be exercised at General Meetings, the Act casts an obligation on the directors to send notices for convening general meetings or else the meetings shall be declared to be void as also all proceedings transacted thereat.

Apart from the rights which are vested in the shareholders to be exercised in relation to the conduct of the business of the company, the directors of the company have certain obligations towards the shareholders.

The courts have determined two broad duties to be performed by a director:

1. Duties of utmost care and skill in managing the affairs of the company or else be liable for damages.
2. Fiduciary duties to act *bona fide* in the interest of the company, not to exercise powers for collateral benefit and not to earn profit from the position as a director.

Despite the powerful weapons handed over to the shareholders by the Companies Act, the shareholders have not been able to use them and most of the provisions remain dead provisions and have not been used by the shareholders as potential weapons to correct any wrongful act on the part of the directors or to give them any directions. Consequently, the Board of directors of a large number of companies are elected only by a few shareholders who attend the Annual General Meetings and those who can muster sufficient number of proxies and can demonstrate their voting power. Government Companies are an exception. In Government Companies all the directors are appointed on the advice of the Government by the President of India or the Governor of a State. Hence, theoretically it can perhaps be said that the shareholders democracy is absolute in such companies.

In other companies however, the shareholders democracy is dependent upon the

voting strength of shareholders and also to a great extent on the availability of members attending their General Meetings either by themselves or through their proxy. This again depends on the proximity of Registered Office of the company to the place of residence of the shareholders. Apart from this most of the shareholders do not have enough time to spare from their busy schedules to concern themselves with the affairs of the company in which they have invested. Besides, they are not always educated enough and experienced enough to be conversant with the working of the joint stock companies. Although the concept of shareholders' democracy has been enshrined in the Companies Act, 1956, yet, because of the aforementioned deficiencies and flaws in the general body of shareholders as a whole, it is not reflected in the constitution of the Boards of directors of many companies in India.

The Companies (Amendment) Act, 2000 had however provided an opportunity to shareholders to participate in the decision making process by introducing provisions relating to passing of resolutions in respect of certain matters through postal ballot.

For achieving the shareholders' democracy, the shareholders have to unite and organise themselves on national, state and district levels and get their associations registered under the Societies Registration Act or any other applicable statute so that their voice is heard and they can assert themselves and safeguard the interests of their members. Constitution of such associations should be suitably amended so as to insist upon all the non-Government companies to allot a minimum number of shares to such associations of shareholders so that these associations can attend the Annual General Meetings of all the companies and make sure that the directors elected to company Boards reflect a fair representation.

2. MAJORITY POWERS AND MINORITY RIGHTS

Powers of Majority

As a company is an artificial person with no physical existence, it functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that *prima facie* a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs. According to Section 87 of the Companies Act, 1956, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. This rule is modified by the Act in certain cases. A special resolution, for instance, requires a majority of 3/4ths of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough [*Edwards v. Halliwell*, (1950) 2 All. E.R. 1064]. The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company [*North-West Transportation Co. v. Beatty* (1887) L.R. 12 A.C. 589].

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the majority of members is subject to

the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which being outside the ambit of the memorandum, is *ultra vires* of the company [*Ashbury Rly. Carriage and Iron Co. v. Riche*, (1875) L.R. 7 H.L. 653]. Also, where the articles authorise the directors to deal with any matters except those which are outside the scope of the authority of the directors; or with which the directors, having power, are unable or unwilling to deal. Secondly, the resolution of a majority must not be in consistent with the provision of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

The Principle of Non-interference (Rule in *Foss v. Harbottle*)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provide for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the Board of directors for carrying out their object at the cost of minority of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

In *Foss v. Harbottle*, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action. The wrong done to the company was not which could be ratified by the majority of members. The company (i.e. the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide whether to commence proceedings against the directors. The reasons for rule were nicely stated by Melish L.J. in *MacDougall v. Gardiner*, (1875) 1 Ch. D. 13 (C.A.) at p. 25 in the following words:

“If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally

which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.”

In *Rajahmundry Electric Supply Co. v. Nageshwara Rao* AIR 1956 SC 213, the Supreme Court observed that:

“The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it.”

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

In *Pavrides v. Jensen* (1956) Ch. 565, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, “It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company’s mine at an undervalue, proceedings should not be taken against the directors”.

In *Edwards v. Halliwell* (1950) 2 All. E.R. 1064, Jenkins, L.J. restated the rule in the following terms: “The rule in *Foss v. Harbottle* comes to no more than this. First, the proper plaintiff in respect of wrong alleged to be done to company is *prima facie* the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then *cadit quaestio...* (cannot be questioned). If on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company itself should not sue”.

Justification and Advantages of the Rule in *Foss v. Harbottle*

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company’s affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be

brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray v. Lewis*, (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in *Foss v. Harbottle* are of a purely practical nature and are as follows:

1. **Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.
2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. **Litigation at suit of a minority futile if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall v. Gardiner*, (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of Foss v. Harbottle Rule in Indian context — The Delhi High Court in *ICICI v. Parasrampuriah Synthetic Ltd.* SSL, July 5, 1998 has held that an automatic application of *Foss v. Harbottle Rule* to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding at least 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss v. Harbottle Rule* would be unjust and unfair.

Exceptions to the Rule in *Foss v. Harbottle* — Protection of Minority Rights and shareholders remedies

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions

and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 1956.

Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases;

(1) Ultra Vires Acts

Where the directors representing the majority of shareholders perform an illegal or *ultra vires* act for the company, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or *ultra vires* transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an *ultra vires* act.

In *Bharat Insurance Ltd. v. Kanhya Lal*, A.I.R. 1935 Lah. 792, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was : "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments". The Court observed:

"In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting *ultra vires* in the application of the funds of the company, a single member can maintain a suit".

It means that the rule in *Foss v. Harbottle* will operate in full force only when the majority of shareholders through their chosen directors act within the extent of the powers of the company.

(2) Fraud on Minority

Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in *Foss v. Harbottle* in a number of cases. In *Menier v. Hooper's Telegraph Works*, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

Though there is no clear definition of the expression “fraud on the minority”, but the court decides a particular case according to the surrounding facts. The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is “*bona fide* for benefit of the company as a whole” [*Allen v. Gold Reefs of West Africa*, (1900) 1 Ch. 656]. As regards the meaning of the expression “*bona fide* for the benefit of the company as a whole” Evershed M.R. in *Greenhalgh Ardeme Cinemas Ltd.* (1950) 2 All E.R. 1120 has observed thus : “It mean that the shareholder must proceed on what, in his honest opinion, is for the benefit, of the company as a whole. Secondly, the phrase ‘the company as a whole’ does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body.” In other words, it can be said that the court ought not to interfere with decision of the majority in a general meeting if that decision is arrived at fairly and honestly [*In Re. Transval Gold Exploration and Land Co. Ltd.* (1885) 1 T.L.R. 604]. and is not an act of fraud on the minority.

(3) Wrongdoers in Control

If the wrongdoers are in control of the company, the minority shareholders’ representative action for fraud on the minority will be entertained by the court [*Cf. Birch v. Sullivan*, (1957) 1 W.L.R. 1274]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par Jenkins L.J. in *Edwards v. Halliwell*, (1950) 2 All E.R. 1064, 1067].

In *Glass v. Atkin* (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: “While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action.”

(4) Resolution requiring Special Majority but is passed by a simple majority

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid, formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [*Baillie v. Oriental Telephone and Electric Co. Ltd.*, (1915) 1 Ch. 503 (C.A.); refer also *Nagappa Chettiar v. Madras Race Club*, 1 M.L.J. 662].

(5) Personal Actions

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [*Salmon v. Quin*

and *Aztens*, (1909) A.C. 442]. In *Nagappa Chettiar v. Madras Race Club*, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [*Joseph v. Jos*, (1964) 1 Comp. L.J. 105].

(6) Breach of Duty

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In *Daniels v. Daniels*, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court.

Held, by the Chancery Division, Templeman, J, the application of director should be dismissed. The exception to the rule in *Foss v. Harbottle* enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit to the directors; accordingly, on the facts alleged, the minority shareholders had a cause of action.

(7) Prevention of Oppression and Mismanagement

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

In *Bennet Coleman & Co. and Ors. v. Union of India & Ors.*, (1977) 47 Comp. Cas. 92 (Bom), the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non-corporate management which may take the form of appointing an administrator or a

special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

The exceptions to the rule in *Foss v. Harbottle* are not limited to those covered above. Further exceptions may be admitted where the rules of justice require that an exception to the rule should be made.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [*Panipat Woollen & General Mills Co.Ltd. v. R.L. Kaushik*, (1969) 39 Comp. Cas. 249 (Punj & Har)].

Statutory Remedies (under the Companies Act)

Though the shareholders' democracy is supreme the Companies Act and the decided cases suggest that the majority shall not be allowed to act in an unfair, fraudulent, or oppressive way against the interests of the minority shareholders. Under Section 38, 167, 388-B, 397, 398, and 399 various powers are given to the shareholders. Further, under Section 265 a company may adopt principle of proportional representation. Under Section 408 the Central Government may direct the company to amend its articles providing for appointment of directors according to the principle of proportional representation under Section 265 and make fresh appointment in pursuance of the articles so amended within such time as may be specified. The Companies Act, 1956, extends protection to minority by granting various rights to minority shareholders which are discussed as below :

- (a) **The variation of class rights:** The rights attached to the shares of any class can be varied under Section 106 of the Act with the consent in writing of the holder of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. But the holders of not less than 10% of the shares of that class who had not assented to the variation may apply to the Court for the cancellation of the variation under Section 107 of the Act.
- (b) **Schemes of reconstruction and amalgamation:** The minority is accorded protection in cases where they dissent to the scheme of reconstruction or amalgamation.
- (c) **Oppression and mismanagement:** The principle of majority rule does not apply to cases where Sections 397 and 398 are applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the Company Law Board by petition under Section 397 of the Act. In *O.P. Gupta v. Shiv General Finance (P) Ltd. and others* [1977] 47 Comp. Cas. 297, the Delhi High Court held that a member's right to move the Court under Section 397 was a statutory right and cannot be affected by an arbitration clause in the articles of association of a company.
- (d) **Alternative remedy to winding up:** Any member or members, who

complain that the affairs of the company are being conducted in a manner oppressive to some of the members including themselves, may apply to the Company Law Board for redressal (Section 397).

- (e) **Investigation by the Government:** Under Section 235 of the Act the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of any company and to report thereon in such manner as the Central Government may direct:
- (a) Where in case of a company, on a report by the Registrar, under Sub-section (6) or (7) of Section 234 read with Sub-section (6) of Section 234.
 - (b) Where —
 - (i) in the case of a company having a share capital on the application either of not less than 200 members or of member holding not less than one-tenth of the voting power thereof; and
 - (ii) in the case of a company not having a share capital, on the application of not less than one fifth in number of persons on the company's register of members.

The Company Law Board, after giving the parties an opportunity of being heard, declare that the affairs of the company ought to be investigated by an inspector or inspectors.

3. PREVENTION OF OPPRESSION AND MISMANAGEMENT

As observed in the preceding topic that one of the exceptions to the majority rule laid down in *Foss v. Harbottle* is the right of the oppressed minority to get relief against the wrongful conduct of the majority. This protection to the oppressed minority is also statutorily prescribed under section 397 of the Companies Act, 1956. This statutory protection for prevention of oppression and mismanagement is an alternative remedy for winding up of the affairs of the company. The reason is that the oppressed minority may file petition with the Company Law Board to wind up the company. However, the company may be a sound and profitable concern. In that case, the petitioners will not only be deprived of whatever dividends they might have been getting but also the value of the assets of the company might be substantially reduced. As Alfred Palmer rightly said:

“The liquidation of the company may result in the sale of its assets at break up value without regard to the value of the goodwill or ‘know how’ of the company and the minority shareholder who urged by the shareholder's oppression petitions for a winding up order may in effect play up his opponents game.”

The oppressed minority, therefore, are willing in such cases not to end the company but to mend it. Section 397 of the Companies Act, 1956, is intended to give a remedy alternative to compulsory winding up in such cases.

Prevention of Oppression (Section 397)

The first remedy in the hands of an oppressed minority is to move the Company Law Board. Section 397 provides that any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public

interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief. Following requirements must be satisfied for seeking a relief under Section 397:

- (i) That the affairs of the company are being conducted: (a) in a manner prejudicial to public interest; or (b) oppressive to any members.
- (ii) That the fact justified the compulsory winding up order on the ground that it is just and equitable that the company should be wound up.
- (iii) That to wind up the company would unfairly prejudice the petitioners [*Ramji Lal Baiswala v. Britain Cable Ltd.*, (1964) 14 Raj. 135].

On being satisfied about the above requirements, the Company Law Board may make the necessary orders for ending the matters complained of. The first requirement relates to public interest or oppression. First we analyse and discover the precise connotation of the word “oppression” with the help of judicial decisions.

Meaning of Oppression

The words “oppression” and “mismanagement” are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term “oppression” as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Western Ltd.*, (1952) Scottish Cases 49, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in *Shanti Prasad v. Kalinga Tubes*, (1965) 1 Comp. L.J. 193 at 204 is as under :

“The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely.”

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in *Re. Hindustan Co-operative Insurance Society Ltd.*, AIR. 1961 Cal. 443 wherein the life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilise the compensation money for the new objects. This was held to be an “Oppression”. The court observed: “The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards”.

A similar relief was allowed by the House of Lord in *Scottish Co-operative Wholesale Society v. Mayer* (1959) AC 324. In this case, the society created a subsidiary company to enable it to enter in the rayon industry. Subsequently when the need for the subsidiary ceased to exist, the society adopted a policy of running down its business which depressed the value of its shares. The two petitioners who

were managing directors and minority shareholders in the company successfully pleaded “oppression”. The court ordered the society to purchase the minority shares at the value at which they stood before the oppressive policy started [This decision has also been followed in *Re. H.R. Harmer Ltd.*, (1959) 1 WLR 62].

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi v. Indian Motor Co.* A.I.R. 1962 Cal 127, the petitioner alleged that the Board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers travelling without ticket on the company’s buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company had been disposed of at low price, that dividends were being declared at too low a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor [In *Re. Bellador Silk Ltd.*, (1965) 1 All ER 667].

The legal representatives of a deceased member whose name is still on the register of members are entitled to file a petition under Sections 397 and 398 of the Companies Act, 1956, for relief against oppression or mismanagement, *Worldwide Agencies Pvt. Ltd. and Another v. Mrs. Margaret T. Desor and Others*, Comp. Cas. Vol. 67 (1990), 807 (S.C.).

The Legal heirs to be registered on probate or will are also entitled to apply. [*K.S. Mothilal v. K.S. Kasimaris Ceranique (P) Ltd.*, (2007) 135 Comp Cas 609 CLB].

A shareholder dies and his heirs apply for transmission of shares while their application for succession certificate was pending before the Civil Court. The legal heirs alleged illegal allotment of shares by respondent to themselves, reducing the legal heirs to minority. It has held that the legal heirs are entitled to file a petition alleging oppression and mismanagement. [*Rajkumar Devraj & Aur. v. Jai Mahal Hotels Pvt. Ltd. & Others* (CLB) CA. No. 133 of 2006 in C.P. No. 30 of 2006.

In *Re Five Minute Car Wash Service Ltd.* (1966) 1 All ER 242, a petition founded on the ground that the managing director has been unwise, inefficient and careless in the performance of his duties could not succeed.

It should not, however, be supposed that these special remedies against oppression or mismanagement are available only to minorities. “In an appropriate case, if the court is satisfied about the act of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. “Accordingly, a relief under the section was allowed to a majority group by Mitra, J., of the Calcutta High Court in *In Re. Sindhri Iron Foundry (P) Ltd.* (1963) 68 CWN 118. His Lordship observed that “if the court finds that the company’s interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that

two rival Boards are holding meetings, that the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors there is no reason why the court should not make appropriate order to put an end to such matters.

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, his Lordship said:

"The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a Board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty-five ... There would be complete chaos and confusion ... " (Ibid., p. 335).

"This ingenious remedy has not only permitted redressal of many abuses, but its mere availability has had a deterrent effect upon management." [George H. Hornstein: *The Future of Corporate Control*, (1950) 63 HLR 476].

It was held in the case of *Ajit Singh Ahuja v. Sapphire (India) (P) Ltd.* [(2009) 1 Comp LJ 313 (CLB)] that in a case of oppression, a member has to specifically plead on five facts – (a) what is the alleged act of oppression; (b) who committed the act of oppression; (c) how it is oppressive; (d) whether it is in the affairs of the company; and (e) whether the company is party to the commission of the act of oppression.

Oppression must be of a Continuous Nature

"Oppression must be a continuous process. This is suggested by the words, 'are being conducted in a manner...' used in Section 397. Hence isolated acts of oppression or mismanagement will not give rise to an action under Section 397 of the Act. In *Shanti Pd. Jain's Case*, the court said:... "events have to be considered not in isolation but as a part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing up-to-date of petition."

However in *Tea Brokers P. Ltd. v. Hemendra Prosad Barooah* (1998) 5 Comp LJ 963 (Cal.) the Division Bench of Calcutta High Court observed that:

'This is undoubtedly, a right and privilege which a member enjoys in his capacity as a member of the company.. such an act may be even a single act done on one particular occasion if the effect of such an act will be of a continuing nature and the member concerned is deprived of his rights and privilege for all time to come in future'.

In *Ramshankar Prasad v. Sindu Iron Foundry (P) Ltd.*, AIR 1966 Cal 512, it was held that a petition under Section 397, would be maintainable even if the oppression was of a short duration and of a singular conduct if its effects persisted indefinitely [followed in *Maharashtra Power Development Corporation. Ltd. v. Dabhol Power Co. Ltd.* (2003) 56 CLA 263 (Bom.)].

In *Bhagirath Agarwala v. Tara Properties P. Ltd.* (2003) 51 CLA 57 (Cal.), also the removal of a director and allotment of shares were set aside as they were done at a meeting which was covered without complying with the requirements of Section

286 and also reflected an oppressive policy. The allotment was made only to one member without simultaneous offer to others on pro rata basis. A single act of issue of additional shares can have a continuous effect. It can constitute oppression. A relief can be had against it. There is no bar of limitation in such a case. [*Ashok Kumar Oswal v. Panchsher Textile Mfg. & Trading Co. Ltd.* (2002) 110 Com Cases 800 (CLB-PB)].

Past acts of oppression will not entitle a plaintiff to seek the remedy under Section 397. The purpose of this section is not so much to take up the past as to redeem the future. A catalogue of charges of the past alleged misdeeds will not attract the section [*Thakur Prem Singh v. Thakur Hotel (Simla) Co. (P) Ltd.*, AIR 1963 Punj. 63; *Raghunath Swarup Mathur v. Har Swarup Mathur*, (1970) 40 Comp Cas 282 (All)].

Choose the correct answer:

Which section provides that any member of a company can complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member?

- (a) Section 398
- (b) Section 388
- (c) Section 397
- (d) Section 399

Correct answer: c

Prejudicial to Public Interest

Relief under Section 397 will also be available if the affairs of the company are being conducted in a way prejudicial to public interest. 'Public interest' is a very broad term involving the welfare not only of the individual shareholders but also of the country according to the economic and social policies of the State. The concept of 'Social profitability' is very much akin to public interest.

Winding up Order under Just and Equitable Clause

The other requirement is that the facts justify the making of a winding up order under just and equitable clause. The principle is that if there is persistent violation of the regulations and statutes and an appeal to general body is not likely to put an end to the matters complained of by reason of the fact that those responsible for the violations control the affair of the company, then it will be just and equitable to wind up the company, [*Ramjilal Baisiwala v. Baiton Cables Ltd.*, (*supra.*)].

In *Re. Bellador Silk Ltd.*, (*supra.*) however this requirement proved too harsh. One of the grounds on which the relief was denied to the petitioner was that the company being solvent, it was not just and equitable to wind it up. This decision has been criticised by some authors. According to them it is not necessary that the company should be insolvent. Reference in Section 210 of the English Companies Act, 1948 to the requirement to winding up order is purely hypothetical, [*Palmer's Company Law*, (1976) 618: 68 Cal W.N. 163].

Winding Up would Unfairly Prejudice the Petitioners

Though it is necessary that facts should justify winding up, instead of winding up an alternative relief is provided if the facts are such that the winding up would unfairly prejudice the interest of the complaining members.

The basic principles given in section 443(2) and section 397 are the same, viz., to stave off the winding up of a company as far as possible. If the shareholders approach the CLB under this section, it has to form its own opinion that a case has been made out on which the company could be wound up on just and equitable ground, but is not desirable to wind up the company. So, also when the Company Judge in the winding up petition comes to the conclusion that an alternative remedy is available, and the petitioner are not acting in a reasonable manner, the winding up petition should be dismissed. [Takshila Hospital Ltd. v Dr. Jagmohan Mathur, (2002) 50 CLA 51 : (2002) 39 SCL 423 (Raj)].

Prevention of Mismanagement (Section 398)

Section 398 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest, [(Section 398 (1) (A)] or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner [(Section 398 (1) (b)]. If the court is so convinced, it may, with a view to bringing to an end or preventing the matter complained of or apprehended, make such order as it thinks fit [Section 398 (2)].

A very clear illustration of mismanagement contemplated by the section is *Rajahmundry Electric Supply Corporation v. A. Nageswara Rao*, AIR 1956 SC 213., In this case, a petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purpose, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and “a powerful *local junta* was ruling the roost”, and that the shareholders outside the group of the chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The Court accordingly appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

A similar verdict was provided to a company by the Calcutta High Court in *Richardson and Cruddas Ltd. v. Haridas Mundra*, (1959) 29 Comp. Cas. 547.

There should be present and continuing mismanagement. The charges of mismanagement in the past, even if proved, are not enough to establish an existing injury to the interest of the company or public interest [*R.S. Mathur v. H.S. Mathur*, (1970) 1 Comp. LJ 35].

“Relief against mismanagement runs in favour of the company and not to any particular member or members’. (See Mathew J. Kust : *Foreign Enterprise in India*,

293 (1964). Secondly. "It is not necessary for the court to find a case for winding up in cases of mismanagement in order to grant relief. (*Ibid.*, p. 294). "Proof of prejudice to the public interest or to the company is enough. Thirdly, the section enables the court to take into consideration outside interest affected by corporate operation." Thus, the Calcutta High Court refused to order the winding up of a grossly mismanaged company and appointed a special officer to manage it because the company was engaged in special industries necessary for the implementation of the country's plans. [*Richardson & Cruddas Ltd. v. Haridas Mundra*, (*ibid.*)].

It was held in the case of *Indowind Energy Ltd. V. ICICI Bank Ltd* [2010] 153 *Comp Cas* 394 (CLB) that non-declaration of dividend would not amount to oppression and mismanagement.

Persons Entitled to Apply

The number of members required to make application under Sections 397 and 398 (i.e., who must sign the application) is given in Section 399. It provides that where the company has a share capital, the application must be signed by at least 100 members of the company or by one-tenth of the total number of the members, whichever is less; or by any member or members holding not less than one-tenth of the issued share capital of the company. If the company has no share capital, the application has to be signed by at least one-fifth of the total number of its members. The Central Government may, however, allow any member or members to apply, if in its opinion, circumstances exist which make it just and equitable to do so. The contents of such an application should fulfil the requirements laid down in Rule 13 of the Companies (Central Government's) General Rules and Forms, 1956. The Central Government may demand security for costs as a safeguard against vexatious litigation.

Joint holders of any share or shares are counted as one member. To be entitled to make the application, the members must have paid all the calls and other sums due on their shares.

It was held in *Northern Projects Ltd. v. Blue Coast Hotels and Resorts Ltd.* [(2008) 88 SCL 74 (Bom.)], that in Section 399, the term 'issued share capital' includes both equity and preference share capital.

Once the consent has been given by the requisite number of members by signing the application, the application may be made by one or more of them on behalf and for the benefit of all of them. It has been held by the Supreme Court in *Rajahmundry Electric Supply Co. v. Nageshwara Rao*, AIR 1956 SC 213, that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application.

Obtaining of consent is a condition precedent to the making of the application and hence a consent obtained subsequent to the application is ineffective. *Makhan Lal Jain v. The Amrit Banaspati Co. Ltd.*, I.L.R. (1954) I All. 131.

In *L. Chandramurthy v. K.L. Kapsi* (2005) 48 SCL 294 CLB, a person who had disposed off his shares was not allowed to apply.

The Central Government or any person authorised by it in this behalf has also the power as per Section 401 to apply for relief under the section.

On the presentation of the petition for oppression and mismanagement, the Company Law Board may make such orders as it thinks fit under this section, If it is of the opinion that —

- (a) the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members.
- (b) to wind up the company would unfairly prejudice the members who have lodged a complaint.
- (c) but the Company Law Board would be prepared to make a winding up order on the ground that it is just and equitable that the company should be wound up.

Both the conditions mentioned at (a) and (b) above must be fulfilled before the Company Law Board can entertain any petition under Section 397 of the Act. The petitioner must not only allege that the winding up order is justified but also allege that an order for winding up should not be made as it will unfairly prejudice the petitioners and other members [*In Re. Bengal Lakshmi Cotton*, (1965) 35 Comp. Cas. 187].

The scope of this section was very succinctly enunciated by the Supreme Court in *Shanti Prasad Jain v. Kalinga Tubes Ltd. (supra)* where it observed that "It is not enough to show that there is just and equitable cause for winding up of the company though that must be shown as a preliminary to the application under Section 397. It must further be shown that the conduct of majority shareholders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as a part of consecutive story. There must be continuous acts on the part of the majority shareholders continuing to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some members. The conduct must be burdensome, harsh and wrongful. Mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless lack of confidence springs from oppression of minority by the majority in the management of the company's affairs and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary right as a shareholder."

"Mere unwise, inefficient or careless conduct of a director in the performance of his duties may not be ground for relief under this section". [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Comp. Cas. 743 (S.C.)].

In *Rameshwar Prasad v. Sindri and Foundary Pvt. Ltd.*, AIR 1966 Cal. 512 the Calcutta High Court held that the majority shareholders who qualify under Section 399 can apply for relief under Section 397 and rejected the argument that the relief under Section 397 is available only to minority shareholders. However, the Delhi High Court in *Suresh Kumar Sanghi v. Supreme Motors Ltd. and Others* (1983), 54 Comp. Cas. 235 held that the provisions of Section 397 would be applicable only in cases of an oppression by majority shareholders on the minority shareholders. According to the court, unless a shareholder or shareholders filing the petition were in the minority Section 397 cannot be invoked at all.

Choose the correct answer:

What is the number of persons required to make an application under sections 397 and 398 of the Companies Act, 1956?

- (a) where the company has a share capital, 100 members
- (b) where the company has a share capital, one/tenth of the total number of members.
- (c) where the company has a share capital, 100 members or one/tenth of the total number of members, whichever is less.
- (d) none of the above.

Correct answer c

In the case of *Provakar Das Gupta V. Veteran Co. P. Ltd* [2010] 156 Comp Cas 241(CLB), it was held that when the main purpose for establishing the company was for the welfare of ex-service men, the petitioners could not have sold their shares to an outsider—a non ex-service men. Till the transfer of shares was declared null and void, the petitioners could not participate in the affairs of the company even though their names continued to be in the register of members. Articles of association stipulate transfer of shares only to ex-military/ retired military personnel. Amendment of articles to induct heirs of existing directors as members and directors will constitute oppression and mismanagement.

4. POWERS OF THE COMPANY LAW BOARD (SECTION 402)

Powers of the Company Law Board under Section 397 and 398 are fairly wide, “In fact, the court may make any order for the regulation of the conduct of the company’s affairs upon such terms and condition as may, in the opinion of the Court, be just and equitable in all the circumstance of the case” (AIR 1956 S.C. 213). Apparently the only limitation seems to be the over all objective of the sections and, therefore, the order must be directed to bring to an end to the matter complained of. However, an attempt is made under Section 402 to define the powers of the CLB. This section provides that without prejudice to the generality of the powers of the CLB, any order under Section 397 or 398 may provide for:

1. The regulation of the conduct of the company’s affairs in future. Thus, for example, in *Richardson & Cruddas Ltd. v. Hardas Mundra*, (63 CWN 439; AIR 1959 Cal 695), the court appointed a special officer with an advisory board to the total exclusion of the shareholders of a company to function subject to the terms and condition laid down in the order.
2. The purchase of the shares or interests of any member of the company by other members or by the company. This relief was provided in *Mohan Lal v. The Punjab Co. Ltd.*, AIR 1961 Punj. 485.
3. In the case of purchase of its shares by the company, the consequent reduction of its share capital.
4. The termination, setting aside or modification of and agreement between the company and managing director, or any other director, and the manager.
5. The termination, setting aside or modification of any agreement with any person, provided due notice has been given to him and his consent obtained.

6. Setting aside of any fraudulent preferences made within three months before the date of the application.
7. Any other matter for which, in the opinion of the court, it is just and equitable that provision should be made. [See as an illustration, *Mrs. Gajarbai v. Patny Transport (P) Ltd.*, (1966) 2 Comp LJ 234, a decision of Andhra Pradesh High Court]. The facts were that one of the directors died leaving behind a will bequeathing the shares in the company to his second wife and sons who were already the shareholders of the company and the petitioner. The directors on account to their private dispute with the petitioners, acting, in a high-handed manner and unreasonably refused to transfer a part of the shares bequeathed under the Will while transferring some shares in favour of themselves as provided under the Will. They made certain improper transfers also. The petitioners applied under Sections 397 and 398 of the Companies Act for removal of one of the director from the Board, and for the appointment of committee of shareholders to manage the affairs of the company. But the court held that “the proper order to make, in the circumstances, is to direct the directors to transfer the shares to the petitioners in accordance with the terms of the Will”.

If the Company Law Board orders any alteration of the memorandum or articles of the company, the company shall not be at liberty to introduce any provision inconsistent with the order [Section 404(1) and see also Sub-sections (2), (3) and (4)]. If the order sets aside or modifies any agreement with any management personnel, it will not give rise to any claim for damages or compensation for loss of office [Section 407 (1) (a)]. Further any managerial personnel whose appointment is so set aside shall not be capable of serving the company in any managerial capacity for the period of five years except with the leave of the Company Law Board [Section 407 (1) (b)]. The prohibition applies to any person who becomes his associate [Sub-section (1); See also Sub-section (3)]. Where the CLB, for the purposes of fulfilling the objects of Section 397, orders the company to purchase the shares of the outgoing shareholders, the other provisions of the Act, like those of Section 77A, would not be attracted. The application of other sections may defeat the very purpose of the provisions of the Act relating to prevention of oppression and mismanagement. [*Gurmit Singh v. Polymer Papers Ltd.* (2003) 45 SCL 251 (CLB-ND)].

5. CONSEQUENCES OF TERMINATION OR MODIFICATION OF AGREEMENTS

Section 407(1)(b) of the Act states the consequences which follow upon the termination setting aside or modification of agreements between the company and its manager, managing director under Section 397 & 398. It provides that where an agreement has been terminated, set aside or modified by the order in respect of manager, managing or other directors, such person or persons cannot claim any compensation or damages against the company for the loss of office or in any other respect. Further, no manager, managing or other director whose agreement has been terminated, set aside or modified, shall for a period of 5 year from the date of the order of the CLB, without the leave of the CLB, be appointed or act as manager, managing or other director of the company. Before granting the leave Company Law Board must give an opportunity to the Central Government of being heard in the matter. If any person acts as manager, managing director or other director in contravention of this provision, he shall be punishable with imprisonment up to one year or fine up to ₹ 50,000 or with both.

An application seeking the leave of the Company Law Board under Section 407 shall be made to the Principal Bench of the CLB, with a fee of ₹ 2500, and accompanied by a copy of the notice of the intention to apply for leave given to the Central Government together the following documents:

1. Documentary and/or other evidence in support of the statement made in the petition, as are reasonably open to the petitioner(s);
2. Documentary evidence in proof of the eligibility and status of the petitioner(s) with the voting power held by each of them;
3. Where the petition is presented on behalf of members, the consent letters given by them.
4. Statement of particulars showing names, addresses, number of shares held and others moneys due on shares have been paid in respect of members who have given consent to the petition being presented on their behalf;
5. Where the petition is presented by any member or members authorised by the Central Government under Section 399(4), the order of the Central Government authorising such member or members to present the petition shall be similarly annexed to the petition.
6. Affidavit verifying the petition.
7. Bank draft evidencing payment of application fee.
8. Memorandum of appearance with copy of the Board resolution or the executed vakalatnama, as the case may be.

The petition herein shall also state that notice of the intention to apply for such leave has been given to Central Government and shall be accompanied by a copy of such notice.

The petitioner shall be required to serve a copy of the petition upon the concerned Registrar of Companies [Reg. 14(3)].

6. POWERS OF THE CENTRAL GOVERNMENT TO PREVENT OPPRESSION OR MISMANAGEMENT

1. The Act not only confers special powers upon the Company Law Board to prevent oppression or mismanagement, but also confers extraordinary powers upon the Central Government to attain the same end.

The Central Government may appoint such number of persons specified in writing to hold office as directors thereof as is necessary to effectively safeguard the interests of the company, its shareholders or the public interest, for such period, not exceeding 3 years on any one occasion as it may think fit, if the Company Law Board considers it necessary to make the appointment in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interest of the company or to public interest [Section 408(10)], where—

- (i) not less than 100 members of the company or of the members holding not less than 1/10th of the total voting power therein apply to the Company Law Board in the matter [Section 408(1)]; and

- (ii) on receipt of such application or on a reference made to it by the Central Government make such inquiry as it deems fit to make [Section 408(1)] and found necessary to such appointment.
2. But instead of passing such an order, the Company Law Board may direct the company to amend its articles to provide for a proportional representation (according to Section 265) for appointment of directors so that minority interests may be properly represented and make fresh appointments of directors in pursuance of the articles so amended, within such time as may be specified [Section 408(1)].
 3. In case the CLB passes on order for amendment of a company's articles and to make fresh appointment of directors in accordance with it, it may direct that until new directors are appointed in pursuance of the Government's order such number of persons of the company specified by the Company Law Board shall hold office as additional directors of the company as are necessary to effectively safeguard the interests of the company, its shareholders or the public interest and on such directions, the Central Government shall appoint such additional directors [Section 408(2)].
 4. Any directors appointed by the Central Government shall not be liable to retirement by rotation. For the purpose of reckoning two-thirds or any other proportion of the total number of directors of the company, any director(s) so appointed by the Central Government shall not be taken into account. The term of office of such directors will depend upon the order of the Central Government by which they are appointed [Section 408(3)].
 5. A person appointed under Sub-section (1) to hold office as a director or a person directed under Sub-section (2) to hold office as an additional director, shall not be required to hold any qualification shares nor his period of office shall be liable to determination by retirement of directors by rotation; but any such director or additional director may be removed by the Central Government from his office at any time and another person may be appointed by the Government in his place to hold office as director or as, the case may be, an additional director [Section 408(4)].
 6. No change in the Board of directors made after a person is appointed or directed to hold office as a director or additional director under Section 408 shall, so long as such director or additional director holds office, have effect unless confirmed by the Company Law Board [Section 408(5)].
 7. Notwithstanding anything contained in this Act or in any other law, where any person is appointed by Central Government to hold office as director or additional director of a company in pursuance of Sub-section (1) or Sub-section (2) of Section 408, the Central Government may issue such directions to the company as it may consider necessary or appropriate in regard to its affairs. Such directions may include directions to remove an auditor already appointed and to appoint another auditor in his place or to alter the articles of the company and upon such directions being given, the appointment, removal or alteration as the case may be, shall be deemed to have come into effect as

if the provisions of this Act in this behalf have been complied with without requiring any further act or thing to be done [Section 408(6)].

8. The Central Government may require the persons appointed as directors or additional directors in pursuance of Sub-section (1) or Sub-section (2) to report to the Government from time to time with regard to the affairs of the company [Section 408(7)].

Sub-sections (6) and (7) were added to Section 408 by the Amendment Act, 1974. The weakness of the section before this amendment was that the appointment of one or two directors was not effective enough to check mismanagement. The merit of the new provisions added is that it gives a power of direct action to interfere and control the management of the company by controlling the Board of directors itself, by appointing such number of directors as may be required for the purpose. The power to call the reports [Sub-section (7)], and the power to give directions [Sub-section (6)], will play a vital role in disciplining the company's management.

9. *Union of India v. Satyam Computers Services Ltd. & Ors.* [(2009) 1Comp LJ 308(CLB)] The Respondent Company indulged in grave financial mismanagement practices due to which its Chairman resigned. The Central Government applied to the CLB for the removal of the Board of directors and to appoint its directors to manage the respondent company.

It was held that the petitioner has sufficient grounds to invoke the provisions of section 388B/397/398 and 408 of the Companies Act, 1956. The written admission of the second respondent, who is the chairman of the company, establishes beyond any shadow of doubt that there have been financial impropriety and jugglery of financial statements, with the view to mislead the stakeholders, employees and the public in general. It appears that a serious fraud has been perpetrated on the society as a whole. The manner in which the affairs of the company have been conducted has shaken the confidence of the public in the company as is evident from the fall in the share price of the company on 7.1.2009 from ₹188 to 38.40. As indicated above, the company is the fourth largest IT Company in India. It has clients in over 60 countries and also has over 53,000 employees and has nearly 3 lakh shareholders. Their interests along with the interests of the company have to be protected. The public interest at large is also at stake.

The need of the hour is to be to create confidence in the minds of all those connected with the company in any capacity and also to assure that regulatory/judicial mechanism in India is alive and active to take immediate and positive steps in case of needs. The present state of affairs of the company is such, that there could not be a better case, wherein, this Board, in exercise of its powers under sections 388C/403 of the Act, is obligated under the law to regulate the affairs of the company on an urgent basis.

Therefore, in the interests of the members, employees, customers of the company and also in the larger public interest, the interim reliefs sought should be granted *ex parte*. Accordingly, it is directed/ordered, *inter alia*, as follows (i) the present board of directors stands suspended with immediate effect. None of the present directors shall represent himself to be a director of the company and shall also not exercise any powers as a director (ii) On the authority of this order, in the name and on behalf of the

Board, the Central Government shall immediately constitute a fresh board of the company with not more than 10 persons of eminence as directors. The Central Government may also designate one of them as the chairman of the board. This board shall be entitled to exercise and discharge all powers vested in the board by the articles and the Act. The said constitution shall be notwithstanding anything contrary contained in the articles, the Act, listing agreement or any other law/regulations relating to the constitution of the board of a listed company. The said board will continue till further orders. (iii) The newly constituted board shall meet within seven days of its constitution and take necessary immediate action to put the company back on the road. (iv) It shall submit periodical reports to the Central Government, with a copy to this Board on the state of affairs of the company. (v) The petitioner is permitted to file additional affidavits that may become necessary after further investigations/enquiries into the affairs of the company. (vi) The petitioner will serve a copy of the petition along with a copy of this order on all the respondents immediately, who shall file their replies to the petition by 20.2.2009.

7. POWER TO PREVENT CHANGES IN THE BOARD

Section 409 of the Companies Act, 1956 provides as under :

1. Manager, managing director or any other director of a Company is empowered to complain to the Company Law Board that as a result of change which has taken place or is likely to take place in the ownership of any shares held in the company, a change in the Board of directors is likely to take place which (if allowed) would affect prejudicially the affairs of the company [Section 409(1)]. A change in the Board of directors would mean appointment or removal of a director, replacement of the Board either partly or in full. No change in the designation or powers of the Board can be considered to be a change within the meaning of Section 409.
2. The Company Law Board may make such enquiry as it deems fit on the complaint made to it [Section 409(1)].
3. The Company Law Board after such enquiry if satisfied that it is just and proper so to do, by order, direct that no resolution passed or that may be passed or no action taken or that may be taken to effect a change in the Board of directors after the date of the complaint shall have effect unless confirmed by the Company Law Board. Any such order shall have effect notwithstanding anything contained contrary in the memorandum or articles of the company or any agreement made or resolution passed in general meeting or/by the Board of directors [Section 409(1)].
4. The Company Law Board has the power when any such complaint is received by it to make interim order before making or completing the necessary inquiry [Section 409(2)].
5. The powers conferred by Section 409 cannot be exercised in the case of a private company unless it is a subsidiary of public company [Section 409(3)].

LESSON ROUND-UP



- The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.
- Under the Companies Act the powers have been divided between two segments; one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their power through Annual General Meetings/Extra-ordinary General Meetings.
- The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority.
- Since the majority of the members are in an advantageous position to run the company according to their command, the minority shareholders are often oppressed. The company law provide for adequate protection for the minority shareholders when their rights are trampled by the majority.
- The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company.
- The supremacy of the majority, however, does not prevail in all situations. There are certain acts which the majority of shareholders cannot approve or affirm. In such cases, any shareholder may sue to enforce obligations owed to the company. He brings the action as representative of the corporate interest.
- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief.
- Relief under the Act will also be available if the affairs of the company are being conducted in a manner prejudicial to public interest. 'Public interest' is a very broad term involving the welfare not only of the individual shareholders but also of the country according to the economic and social policies of the State.
- If there is persistent violation of the regulations and statutes and an appeal to general body is not likely to put an end to the matters complained of by reason of the fact that those responsible for the violations control the affairs of the company, then it will be just and equitable to wind up the company.
- If the court is so convinced that the affairs of a company are being conducted in a manner prejudicial to the interest of the company or public interest, or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner, it may with a view to bring an end or preventing the matter complained of or apprehended, make such order as it thinks fit.

- Section 399 provides that where the company has a share capital, the application must be signed by at least 100 members of the company or by one-tenth of the total number of the members, whichever is less; or by any member or members holding not less than one-tenth of the issued share capital of the company. If the company has no share capital, the application has to be signed by at least one-fifth of the total number of its members.
- Company Law Board and Central Government have been empowered under the Act to prevent oppression and mismanagement.

SELF-TEST QUESTIONS



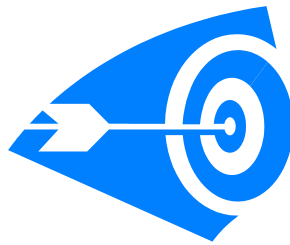
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. "A company is a democratic institution in which the majority have a right to control the company." Do you support this statement? Give your comments in the rule laid down in *Foss v. Harbottle*.
2. Explain clearly the meaning of 'majority rule' as applied in managing a company registered under the Companies Act 1956. Are there any exceptions to this rule? If so, explain in the light of the statutory law and case law.
3. "The rule in *Foss v. Harbottle* presently has lost its importance because of adequate statutory provisions made in the Companies Act, 1956". Discuss the adequacy of these provisions.
4. The articles of a company provided for the taking of a poll at a general meeting of the company if so demanded by five shareholders. At a general meeting the Chairman, in breach of the articles, declined to take a poll. One of the shareholders brought an action on behalf of himself and other shareholders against the directors and company, seeking a declaration that decisions taken at the meeting were invalid and seeking an injunction to restrain their implementation. Are the shareholders competent to file the suit?
5. "Majority will have its way but minority must be allowed to have its say." Discuss the above proposition with reference to prevention of oppression and mismanagement?
6. Enumerate the powers of the Company Law Board to prevent oppression and mismanagement. What are the powers of the Central Government to prevent oppression and mismanagement?
7. "Section 397 and 398 are intended to avoid winding up, if possible, and keep the company going, while at the same time saving the minority shareholders from oppression and mismanagement". Explain.

STUDY XXVIII

COMPROMISES AND ARRANGEMENTS — AN OVERVIEW

LEARNING OBJECTIVES



This lesson explains the concept of compromise and arrangement along with the respective provisions under the Companies Act. The lesson also discusses the powers of the court in respect of compromises and arrangements.

At the end of the lesson, you should be able to understand:

- Meaning of compromise and arrangement.
- Sanctioning of schemes.
- Sanctioned arrangement binding on all concerned parties.
- When courts do not sanction a scheme.
- Explanatory statement.
- Powers of the court to supervise the implementation of the scheme.
- Powers of the court to sanction modification of the terms of a scheme.
- Powers of the court to order a winding up while considering a scheme.
- Powers of the court to make consequential orders.
- Need for reports from Registrar of Companies.

2. SECTION 390 PROVIDES THE INTERPRETATION OF SECTIONS 391 AND 393

In sections 391 and 393, -

- (a) the expression "company" means any company liable to be wound up under this Act ;
- (b) the expression "arrangement" includes a reorganisation of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both those methods ; and
- (c) unsecured creditors who may have filed suits or obtained decrees shall be deemed to be of the same class as other unsecured creditors.

'Compromise' is a term which implies the existence of a dispute such as relating to rights. It means settlement or adjustment of claims in dispute by mutual concessions. If the members have to give up their rights entirely, it will not be a compromise [*NFU Development Trust Ltd., Re* (1973) 1 All E.R. 135].

The provisions of the Act regarding a scheme of 'Compromise' or 'Arrangement' are mainly applicable to those companies which are liable to be wound up under the Act [Section 390 (a)].

The term '**arrangement**' is of very wide import. It includes a reorganization of the share capital of a company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or by both these methods [Section 390(b)]. All modes of reorganizing the share capital, including interference with preferential and other special rights attached to shares, can properly form part of an arrangement with members [*Investment Corp. of India Ltd., Re* (1987) 61 Comp. Cas. 92 (Bom.)].

There can be no 'compromise' unless there is first a dispute [*Guardian Assurance Co., Re* (1917) 1 Ch. 431].

According to Black' Law Dictionary, Seventh Edition, page 375 **Creditor** means One to whom a debt is owed; One who gives credit for money or goods.

In v Films Ltd. Re (Mad) CLA 95, 231 In terms of clause (c) of Section 390, the bond holders are unsecured creditors and they are entitled to raise objections if the scheme of arrangement to defeat the claims of the unsecured creditors. Therefore, there is no justification in the contention that the bondholders, who are unsecured creditors in terms of clause (c) of Section 390, have no right to complain of the breach of the terms of trust deed in the proceedings for sanction of the scheme of arrangement before the Court.

2. SCOPE OF SECTION 391

Section 391(1) of the Companies Act, 1956 provides that where a compromise or arrangement is proposed between company and its creditors or any class of them or between company and its members or any class of them, the Court may on the application of the company or any creditor or member of the company or liquidator (where company is being wound up), order a meeting of creditors or class of creditors or members or class of members, as the case may be, to be called, held and conducted in such manner as it directs. From the above provision of law, it is clear that there could be a compromise or arrangement between a company on the one side and its creditors or any class of them on the other side. There could be an arrangement between a company and its members or any class of them. In such a scheme of compromise or arrangement, the creditors or members could be the interested parties. In the case of a company in winding up, the liquidator becomes the party entitled to present the scheme to the court. All or any one of the interested parties have to make an application to the court praying for sanctioning the scheme of compromise or arrangement.

Pertinently, it has been held in several cases that Section 391 is a 'complete code' or 'single window clearance system', and that the Court has been given wide powers under this section, to frame a scheme for the revival of a company. Being a complete code, the Court can, under this 'section', sanction a scheme containing all the alterations required in the structure of the company for the purpose of carrying out of the scheme.

Section 391 contemplates a compromise or arrangement between a company and its creditors or any class of them, or its members or any class of them, and

provides machinery whereby such a compromise or arrangement may be binding on dissentient persons by an order of the Court. [*Oceanic Steam Navigation Co. In re.* (1939) 9 Comp. Cas. 229 (Ch.D)].

When an application is made, the Court will naturally consider the merits of the scheme. The Court will also see whether all interested parties or whether all parties whose rights are likely to be affected have been given the notice about the scheme. In other words, Court gives an opportunity to all persons who are concerned or interested in the scheme. The Court may order a meeting of the creditors and / or the members. While ordering the convening of a meeting, the Court has the power to direct the manner in which the meeting should be conducted and how the proceedings and the result of the meeting should be reported. The Court has the discretion to sanction the scheme. You may note the use of the word 'may' in Sub-section (1) of Section 391 of the Act. It clearly implies that the Court has the discretion to make or not to make the order. As already stated, even before convening a meeting, the Court should pay attention to the fairness of the proposed scheme because it would be no use putting before the meeting a scheme, which is not fair. The Court may also refuse a meeting to be called where the proposals contained therein are illegal, or in violation of provisions of the Act or incapable of modification. [*Travancore National & Quilon Bank, In Re.* (1939) 9 Comp. Cas. 14 (Mad.)]. Thus, the Court does not have to compulsorily call for a meeting, but in its discretion, dismiss the application at that stage itself [*Sakamari Metals & Alloys Limited, In Re.* (1981) 51 Com. Cas. 266 (Bom.)].

The Court is duty bound to ascertain the *bona fides* of the scheme and whether the scheme is *prima facie* feasible. The Court will not act merely as a rubber stamp while sanctioning a scheme. The Court must consider the application on merits. [*N.A.P. Alagiri Raja & Company v. N. Guruswamy* (1989) 65 Comp. Cas. 758 (Mad.)]. The Court should examine the nuts and bolts of the scheme and should not hesitate to reject the scheme or ask for additional material or even point to creditors, members, etc. of pitfalls in the scheme and the Court's role under Section 391(1) is equally useful, vital and pragmatic as under Section 391(2) [*Sakamari Metals & Alloy Limited In Re.* (1981) 51 Comp. Cas. 266 (Bom.)]. Where a large number of creditors opposed the scheme, it was obvious that there was no possibility of its being implemented [*Krishnakumar Mills Co. Ltd. In Re.* (1975) 45 Comp. Cas. 248 (Guj.)].

It was held in the case of *Mekaster Valves and Engineering Services P. Ltd., In re.* [(2009) 149 Comp Cas 593 (Guj)] that when the court sanctions a scheme of arrangement or compromise, the scheme is sanctioned as a whole with all its clauses and proposals. The certified copy of the order sanctioning the scheme filed with the Registrar of Companies shall be treated as intimation to the Registrar of Companies and he shall take note of all the changes proposed and sanctioned by the court. Since all the changes were proposed to be effected as an integral part of the scheme, the approval granted by the shareholders at the meeting to the scheme as a whole amounted to approval granted to all such incidental proposals and no separate procedure was required to be followed as envisaged by sections 17, 31, 94, 97, 81(1A), 100 and 149(2A), respectively. Therefore, there was no need to comply with the provisions of the Act. The scheme of amalgamation being in the interest of the companies and their members and creditors, the scheme was to be sanctioned.

3. SANCTIONED ARRANGEMENT BINDING ON ALL CONCERNED PARTIES

According to sub-section (2) of Section 391, if a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the court, be binding on all the creditors, or all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of company which is being wound up, on the liquidator and contributories of the company.

4. NEED FOR REPORTS FROM REGISTRAR OF COMPANIES

In a scheme of compromise or arrangement, the Court is bound to seek a report of the Registrar of Companies representing the Ministry of Corporate Affairs in order to ensure that the affairs of the company have not been conducted in a prejudicial manner. The Registrar of Companies makes a report to the Regional Director in the Ministry of Corporate Affairs. On receipt of the report of the Registrar of Companies, the Regional Director submits his report to the Court through the standing counsel of the Central Government in the form of an affidavit. Thus the Court receives the report of the government and only after considering the same, passes necessary orders sanctioning or rejecting the scheme.

5. WHEN COURTS DO NOT SANCTION A SCHEME?

If a compromise or arrangement is not bona fide but intended to cover misdeeds of delinquent directors, the Court shall not sanction the scheme [*Pioneer Dyeing House Limited v. Dr. Shanker Vishnu Marathe* (1967) 2 Comp. LJ 16].

If the object of the scheme is to prevent investigation or there is failure in the management of affairs of the company or disregard of law or withholding of material information from the meeting or the scheme is against public policy, the Court will not sanction the scheme [*J.S. Davar v. Dr. S.V. Marathe*, AIR 1967 Bom. 456 (DB)].

If it can be shown that the petition is made *mala fide* and motivated primarily to defeat the claims of certain creditors who had obtained decrees against the company, there was inordinate delay in making the application for sanctioning the scheme and certain information was withheld from the Company Court, the petition for sanctioning the scheme though approved by the creditors and shareholders was rejected [*Richa Jain v. Registrar of Companies* (1990) 69 Comp. Cas. 248 (Raj.)].

Salient aspects emerge in every proposal containing a scheme of compromise or arrangement:

- Any scheme of compromise or arrangement that falls within the provisions of Sections 391 to 393 of the Act should receive sanction from the Court in order to become effective and binding.
- The scheme of compromise or arrangement should be prepared as a written document.
- It should be presented to the Court.
- Court will direct the convening of meetings of creditors or a class of them and/or Court will direct the convening of meetings of members or a class of them.

- Court gives opportunity to all concerned.
- Under Section 391(1) of the Act, the Court gives directions with regard to conducting of meetings.
- The Court also fixes the time and place of such meeting, and appoint a chairman of the meeting.
- The Court fixes the quorum and lays down the procedure to be followed at the meeting, including voting by proxy; determines the value of creditors or members and the persons to whom notice is to be given.
- The Court also gives directions to the chairman to report to the Court the result of the meeting within a given period.

In *Webneuron Services Ltd., In re.* [(2009) 149 Comp Cas 61(Del)], the transferor company sought approval to a scheme of amalgamation with the transferee company. Employee of Transferor Company opposed the petition on the ground of non payment of dues of ₹ 4,48,040. Objection of the employee was overruled and the scheme was sanctioned. The reason given was that the transferor company had, in accordance, with the direction of the court, deposited an amount of ₹4,48,040 with the Registrar General of the court and in case the ex employee was found entitled to the amount, he could get it with interest. The terms and conditions of service of the employees of the transferor company were not affected and there was no legal impediment in sanctioning the proposed scheme of amalgamation. The scheme was to be sanctioned and the transferor company was to be wound up without formal winding up.

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

If a compromise or arrangement is not *bona fide* but intended to cover misdeeds of delinquent directors, the Court can sanction the scheme.

- True
- False

Correct Answer: False

If a compromise or arrangement is not *bona fide* but intended to cover misdeeds of delinquent directors, the Court shall not sanction the scheme.

6. EXPLANATORY STATEMENT TO THE NOTICE OF MEETING

Apart from the directions of the Court, the provisions of Section 393 of the Act, regarding furnishing of adequate information about the scheme to creditors and members, should also be complied with. Accordingly, with every notice calling the meeting, sent to the creditor or member, a statement setting forth, the terms of compromise or arrangement specifically stating any material interests of director(s) or, managing director(s) or manager of the company in whatsoever capacity, in the scheme and the effect of their interest as in contradiction to the interests of other persons, should be included.

Also, where a notice calling the meeting is given by advertisement, there shall be included either the statement as aforesaid or notification of the place where and the manner in which, the creditors or members entitled to attend the meeting may obtain the copies of such statement. In case, the compromise or arrangement affects the

rights of debenture holders, the statement shall accordingly give like information in such respect. Every such copy should be made available to the members or creditors entitled to attend the meeting, in the manner specified and free of charge.

If default is made in complying with the above provisions regarding the notice and the statement, every officer (including liquidator of the company, if any, and every trustee of debenture-holders) in default and the company shall be punishable with fine, which may extend to ₹ 50,000. But if it can be shown that the default in sending the aforesaid notice and the statement was due to refusal of any such person, who is required under law to supply the necessary particulars as to his material interest, the company and its officers shall not be so punishable.

Every officer (director, managing director or manager and every trustee of debenture-holders) of the company, is required to give notice to the company for such matters relating to himself as may be necessary for the purpose of the compromise or arrangement, and if he fails to do so, he shall be punishable with fine which may extend to ₹ 5,000.

At the meeting the scheme is to be passed with the support of majority in number and three-fourths in value of those present and voting. The creditors or members who are present at the meeting but remain neutral or abstain from voting, will not be counted in ascertaining the majority in number or value [*Hindustan General Electric Corporation, In Re.*, AIR 1959, (Cal.) 679].

The Chairman appointed by Court to preside over the meeting has to file his report within 7 days of the conclusion of the meeting where the scheme was considered and voted upon by the creditors or members. Subsequently, the petitioner makes the application for confirmation of the scheme within 7 days of filing of the report of the chairman.

The Court, while sanctioning the scheme, must be satisfied that there is full and fair disclosure of information by the petitioner about the state of affairs of the company and its latest financial position. The Court should also be satisfied that statutory majority are acting bona fide and the compromise or arrangement is such that as it may be reasonably approved. [*Dorman Long & Co. Limited* (1933) All ER Rep. 460]. Therefore the Court would like to be satisfied basically on three points: Firstly that the provisions of the statute have been complied with. Secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class, they purport to represent and; thirdly that the arrangement is such, as a man of business, would reasonably approve [*Anglo Continental Supply Co., Re.* (1922) 2 Ch. 723]. The scheme, if sanctioned by the Court, with or without modifications, if any, to make it operational, is binding on all the creditors including government, creditors and liquidator, contributories, all the members or classes thereof, as the case may be, and also on the company. It takes effect not from the date of sanction of the Court, but from the date it was arrived at.

Sub-section (3) of Section 391 provides that the order of the Court becomes effective only after a certified copy thereof is filed with the Registrar of Companies.

Sub-section (4) of Section 391 provides that a copy of every such order of the

Court has to be attached to every copy of the Memorandum of Association of the Company.

According to Sub-section (5) of Section 391 if default is made in complying with Sub-section (4), the company, and every officer of the company who is in default, shall be punishable with fine.

As per Sub-Section (6) of Section 391 the Court may, at any time after an application has been made, stay the commencement or continuation of any suit or proceedings against the company on such terms as it may think fit, until the application is finally disposed of.

Sub-section (7) of Section 391 provides that an appeal from the order of the Court can be made to the higher Court so empowered.

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

The Chairman appointed by the Court to preside over the meeting has to file his/her report within seven days of the conclusion of the meeting where the scheme was considered and voted upon by the creditors or members.

- True
- False

Correct Answer: True

7. POWERS OF THE COURT TO SUPERVISE THE IMPLEMENTATION OF THE SCHEME

Section 392 of the Companies Act, 1956 confers the powers on the High Court sanctioning a compromise or arrangement in respect of a company, to supervise the carrying out of a compromise or arrangement and give any directions or making modifications in the scheme, as it considers necessary, either at the time of sanctioning it or any time thereafter. Under this Section, the Court cannot issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct. [*Mysore Electro Chemical Works Ltd. v. ITO*, (1982) 52 Comp. Cases 32 (Ker.)]. The Court has powers to give directions even to third parties to the compromise or arrangement provided such direction is necessary for the proper working of compromise or arrangement.

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

The Court can also issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct.

- True
- False

Correct Answer: False

Under Section 392 of the Companies Act, 1956, the Court cannot issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct.

8. POWERS OF THE COURT TO SANCTION MODIFICATION OF THE TERMS OF A SCHEME

As regards the modification of a scheme, application thereof can be made by any person interested. 'Any person interested' should not be confined to creditor or liquidator of the company whereby any person who has obtained a transfer of shares in the company but has not yet been registered as a member is also to be included therein [*K.K. Gupta v. K.P. Jain* (1979) 49 Comp. Cases 342: AIR 1979 SC 734]. In *Saroj G. Poddar (Smt.), in Re.*, (1996) 22 Corpt LA 200 at 216 (Bom.); *T. Mathew v. Saroj Poddar* (1996) 22 Corpt LA 200 at 216 (Bom.) the following main points emerged:

- (a) The scheme can be modified by the Court either at the time of or after its sanction.
- (b) Such modification can include the substitution of sponsorer of the scheme.
- (c) Modification of scheme or substitution of sponsor should be necessary for proper, efficient and smooth working of the scheme.
- (d) Modification can be made at the instance of any person who is interested in the affairs of the company and the court can also introduce modification *suo motu*.
- (e) The Court should examine the bona fides of the person applying to be substituted as a sponsor, his capability and his interest in the company.

9. POWERS OF THE COURT TO ORDER A WINDING UP WHILE CONSIDERING A SCHEME

If the Court is satisfied that a compromise or arrangement sanctioned under Section 391 cannot be carried out satisfactorily with or without modifications, it may vide Section 392(2) of the Act, either on its own motion or on the application of any person interested in the affairs of the company, make an order for winding up which shall be deemed to be the same as under Section 433 of the Act.

10. POWERS OF THE COURT TO MAKE CONSEQUENTIAL ORDERS

Where an application is made to the Court under Section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as mentioned therein, and the Court is satisfied that the scheme relates to the reconstruction or amalgamation of any two or more companies, it will make consequential orders as provided in Section 394 of the Act.

According to section 394, where an application is made to the court under section 391 and it is shown to the court that the compromise or arrangement has been proposed for the purpose of a scheme of reconstruction of any company or amalgamation of two or more companies and that under the scheme the whole or any part of the undertaking, property or liabilities of any company is to be transferred to another company, the court may make provisions for all or any of the following matters:

- (i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- (ii) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the

compromise or arrangement, are to be allotted or appropriated by that company to or for any person;

- (iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- (iv) the dissolution, without winding up, of any transferor company;
- (v) the provision to be made for any person who, within such time and in such manner as the directs, dissent from the compromise or arrangement; and
- (vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out:

However, the Court shall not sanction any compromise or arrangement for the amalgamation of a company, which is being wound up, with any other company unless the Court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in manner prejudicial to the interests of its members or to public interests. Similarly, the court will not make an order for dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not be conducted in a manner prejudicial to the interests of its members or to public interest.

Notice to be given to Central Government for applications under sections 391 and 394.—

As per section 394A of the Companies Act, 1956, the Court shall give notice of every application made to it under section 391 or 394 to the Central Government, and shall take into consideration the representations, if any, made to it by that Government before passing any order under any of these sections.

Power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority (Section 395)

Section 395 lays down as follows:

1. Where the transferee company has offered to acquire the shares or any class of shares of the transferor company, the scheme or contract embodying such offer has to be approved by the shareholders concerned within four months. The approval must be given by the holders of not less than 9/10th value of shares, the shares already held by the transferee company or its nominee or subsidiary are excluded.

2. If the offer is approved, the transferee company may, at any time within two months of the expiry of the said four months, give a notice to the dissenting shareholders that it desires to acquire their shares. The transferee company is entitled and bound to acquire the shares of dissenting shareholders on the same terms on which the shares of approving shareholders were approved unless on the application of the dissenting shareholders within one month of such notice, the court orders otherwise.

3. If the transferee company already holds in the transferor company shares of the class whose transfer is involved, to a value more than 1/10th of the total value of

all shares of that class in that company, then the above provision will not apply and the transferee company cannot acquire the shares of the dissenting members. However, it is entitled to still acquire the share if:

- (a) it offers the same terms to all the shareholders of the same class, and
- (b) the shareholders who approve of the scheme, besides holding not less than 9/10ths in value of the shares other than those already held by the transferee company itself or through nominees, are also not less than 3/4ths in number of the holders of those shares.

Special Power of Central Government to Order Amalgamation

Section 396 of Companies Act, 1956 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate.

Ministry of Corporate Affairs vide its General Circular No. 16/2011 F.No. 51/16/2011/CL-III dated the 20th April, 2011, simplified procedure for amalgamation of Government Companies U/s 396 of the Companies Act, 1956.

The Ministry of Corporate Affairs have been dealing with the amalgamation of Government Companies in the Public Interest under section 396 of the Companies Act, 1956 by following the procedures prescribed under Companies (Court) Rules, 1959 which are applicable to amalgamation under Sections 391-394 of the Companies Act, 1956. Without prejudice to the generality of Section 396, it has now been decided that, in appropriate cases, simpler procedures shall be adopted for the amalgamation of Government Companies under section 396 of the Companies Act, 1956 as given below:-

(1)(a) Every Central Government Company which is applying to the Central Government for amalgamation with any other Government Company or Companies required to obtained approval of the Cabinet i.e. Union Council of Ministers to the effect that the proposed amalgamation is in the 'public interest'.

(b) In the case of State government companies, the approval of the State Council of Ministers would be required.

(c) Where both central and state government companies are involved, approval of both State Cabinet(s) and Central Cabinet shall be necessary.

(2) (i) A Government Company may, by a resolution passed at its general meeting decide to amalgamate with any other Government Company, which agrees to such transfer by a resolution passed at its general meeting;

(ii) Any two or more Government Companies may, by a resolution passed at any general meetings of its Members, decide to amalgamate and with a new Government Company.

(3) Every resolution of a Government Company under this section shall be passed at its general meeting by members holding 100% of the voting power and such resolution shall contain all particulars of the assets and liabilities of amalgamating government companies.

(4) Before passing a resolution under this section, the Government Company shall give notice thereof of not less than 30 days in writing together with a copy of the proposed resolution to all the Members and creditors.

(5) A resolution passed by a Government Company under this section shall not take effect until (i) the assent of all creditors has been obtained, or (ii) the assent of 90% of the creditors by value has been received and the company certifies that there is no objection from any other creditor.

(6) The resolutions passed by the transferor and transferee companies along with written confirmation of the Cabinet decision then be submitted to the Central Government which shall, if it is satisfied that all the requirements of Section 396 have been fulfilled, order by notification in the Gazette that the said amalgamation shall take effect.

(7) The order of the Central Government shall provide:-

- (a) for the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company
- (b) that the amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.
- (c) for such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out

(8) The Cabinet decision referred to in para (1) above may precede or follow the passing of the resolution referred to in para (2).

(9) When an order has been passed by the Central Government under this section, it shall be a sufficient conveyance to vest the assets and liabilities in the transferee.

(10) Where one government company is amalgamated with another government company, under these provisions, the registration of the first-mentioned Company i.e. transferor company, shall stand cancelled and that Company shall be deemed to have been dissolved and shall cease to exist forthwith as a corporate body.

(11) Where two or more Government Companies are amalgamated into a new Government Company in accordance with these provisions and the Government Company so formed is duly registered by the Registrar, the registration of each of the amalgamating companies shall stand cancelled forthwith on such registration and each of the Companies shall thereupon cease to exist as a corporate body.

(12) The amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations, and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by,

or against, the concerned resulting company, or transferee company, as the case may be.

(13) The Registrar shall strike off the names of every Government Company deemed to have been dissolved under sub-sections (10) to (11).

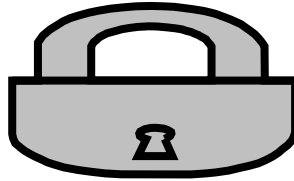
(14) Nothing in this Circular shall prevent government companies from applying for amalgamation before the Central Government under Sections 391-394 of the Companies Act.

Section 396 of Companies Act, 1956 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate

LESSON ROUND-UP



- A compromise means settlement or adjustment of claims in dispute by mutual concessions.
- Arrangement includes a reorganization of share capital of company by consolidation of shares of different classes or division of shares into shares of different classes or by both these methods.
- The Act provides that where a compromise or arrangement is proposed between company and its creditors or any class of them or between company and its members or any class of them, the court may, on the application of the company or of any creditor or member of the company, or in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the court directs.
- The sanctioned scheme would be binding on all the concerned parties. However, in certain circumstances, the court shall not sanction a scheme of compromise or arrangement.
- In a scheme of compromise or arrangement, the court is bound to seek a report of the Registrar of Companies in order to ensure that the affairs of the company have not been conducted in a prejudicial manner.
- An explanatory statement, as provided for in the Act, would be attached to every notice calling the meeting.
- The court has the powers to supervise the implementation of the scheme and to sanction modification of the terms of the scheme. While sanctioning the scheme, the court also has the power to order winding up.
- Section 396 of Companies Act, 1956 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate.

SELF-TEST QUESTIONS

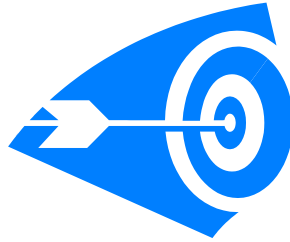
(These are meant for recapitulation only. Answers to these are not to be submitted for evaluation).

1. What is an arrangement in respect of a company? How may it be effected and by whom?
 2. Explain clearly the meaning of compromise. What procedure must a company adopt to give effect to a compromise, when such a company is a going concern?
 3. What are the powers of the High Court with regard to enforcement of its order sanctioning a compromise or arrangement?
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STUDY XXIX

LAW RELATING TO CO-OPERATIVES, SOCIETIES AND TRUSTS

LEARNING OBJECTIVES



- This lesson discusses various issues relating to Co-operative Societies and Trusts. The lesson is divided into two parts. At the inception of the lesson students will get acquainted with the conceptual knowledge about Co-operative Societies. Apart from statutory provisions, the students will get to know various kinds of societies operating in our country and their respective objectives. Also it discusses about the management aspect of such societies and powers/functions of the Board. In the next half matters relating to trust have been discussed elaborately.
- All issues relating to formation, types and other matters relating to trusts are discussed. Also discussed are doctrines, note of beneficiaries, trustees, etc.

1. LAW RELATING TO CO-OPERATIVE SOCIETIES

Introduction

The word "Co-operative" is derived from the Latin word "Co-operari". This word has two parts — 'Co' and 'Operari' which means 'with' and 'to work' respectively. Hence, the word "Co-operative" indicates an organisation which is set up for working together with others i.e. in Co-operation with others. The concept of co-operation came up in 1844 when Rochdale Pioneers established a Co-operative Society of Weavers. Its ideals were widely accepted around the world and are known as principles of co-operatives. The 23rd congress of the International Co-operative Association accepted and reformulated the "Principles of Co-operative". They are

- (1) Voluntary and open membership;
- (2) Democratic control;
- (3) Limited interest of share capital;
- (4) Distribution of surplus to members;
- (5) Promotion of Co-operative education and training;
- (6) Co-operation among Co-operatives.

The main object of setting up of a co-operative is to ensure upliftment of weaker individuals, financially through employing their resources in useful manner to enable

them to collectively compete with financially strong ones. The first legislation was Co-operative Credit Society Act 1904 for forming Credit Societies for economic and social betterment of people. Further improvements were made in the Co-operative Societies Act 1912 and the concept of limited and unlimited liability was introduced. In 1919, the co-operative was made provincial subject and Bombay Province enacted its Co-operative Societies Act 1925 which replaced the Act of 1912. Subsequently, other states enacted their co-operative laws which are based on the above principles but they are different in their operations and procedure widely. A Co-operative society which limits its operation in one State only, is governed by the co-operative law of that State only.

Delhi Co-operative Societies Act 1972 and Rules 1973 were enacted for the Union Territory of Delhi for Co-operative societies operating in Delhi. For societies functioning in more than one State, the Multi-unit Co-operative Society Act 1942 was replaced by the Multi State Co-operative Societies Act 1984. It is a comprehensive legislation. At present, there are number of Multi-State Co-operative Societies and National Co-operative Societies such as National Co-operative Union of India Ltd., New Delhi, Indian Farmers' Fertilizer Co-operative Ltd. New Delhi, Krishak Bharti Co-operative Ltd., New Delhi, All India Federation of Co-operative Spinning Mills Ltd., Bombay, All India Industrial Co-operative Banks' Federation Ltd., Bangalore and others.

Types of Societies

Many types of societies can be registered. They differ according to their objectives such as, Credit, Non-credit, Marketing, Joint farming, Tenants, Transporters etc. A Co-operative society has several privileges. They are —

- (1) A Co-operative society is a legal entity. It has a perpetual succession and a common seal. It can own property, enter into contract, institute and defend suits and do all acts to achieve its objects.
- (2) It has first charge upon the assets, goods and produces belonging to it.
- (3) It can create charge on its assets to secure loans to be borrowed.
- (4) It can set-off any sum credited or payable to a member or past member or the estate of its members in or towards payment of any debt.
- (5) The share or contribution or interest of a member in the capital of a Co-operative society is not liable to attachment or sale under any decree or order of any Court.
- (6) It provides exemption from compulsory registration of instruments relating to shares, debentures and others under Indian Registration Act, 1908.
- (7) It has certain exemptions from taxes, fees and duties under respective Acts.
- (8) It can make deduction from salary of its employees in satisfaction of any debt or demand payable to it.
- (9) It may obtain financial assistance in various ways from the Central and State Government.
- (10) No one can file a suit against a Co-operative society unless notice of three months is given to the Registrar of Co-operative Societies.

- (11) The provisions of the Companies Act, 1956 not applicable to the working and functioning of Co-operative societies.

The Multi-State Co-operative Societies Act, 2002

Definition

A Multi-State Co-operative Society has been defined under Section 3(p) of the Act, so as to mean a society registered or deemed to be registered under this Act and includes a National Co-operative Society and a Federal Co-operative. "Societies deemed to be registered under this Act" means those societies which were incorporated before commencement of this Act or under any Co-operative Societies Act and registration of which has not been cancelled before the commencement of this Act. "National Co-operative Societies" mean Multi-State Co-operative Societies which have been listed in the Second Schedule of the Act.

Multi-State Co-operative Societies with Limited Liability means a society having liability of members, as per the bye-laws of the society, is limited to the amount, if any, unpaid on the shares respectively held by them or to such amount as they may undertake to contribute to the assets of the society in the event of its being wound up.[Section 3(q)]

Cooperative Principles

In terms of Schedule I to the Act, the Cooperative Principles of a multi-state cooperative society are as under:

1. **Voluntary and Open Membership:** Co-operatives are voluntary organisations, open to all persons capable of using their services and willing to accept the responsibilities of membership, without discrimination on bases of gender, social inequality, racial, political ideologies or religious consideration.
2. **Democratic Member Control:** Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and decision-making. Elected representatives of these co-operatives are responsible and accountable to their members.
3. **Members' Economic Participation:** Members contribute equitably and control the capital of their co-operative democratically. At least a part of the surplus arising out of the economic results would be the common property of the co-operatives. The remaining surplus could be utilised for benefitting the members in proportion to their share in the Co-operative.
4. **Autonomous and Independent Co-operatives:** Co-operatives are autonomous, self-help organisations controlled by their members. If co-operatives enter into agreement with other organisations including Government or raise capital from external sources, they do so on terms that ensure their democratic control by members and maintenance of co-operative autonomy.
5. **Education, Training and Information:** Co-operatives provide education and training to their members, elected representatives and employees so that they can contribute effectively to the development of their co-operatives. They also make the general public, particularly young people and leaders, aware of the nature and benefit of co-operation.

6. **Co-operation among Co-operatives:** Co-operatives serve their members most effectively and strengthen the co-operative movement, by working together through available local, regional, national and international structures.
7. **Concern for Community:** While focusing on the needs of their members, co-operatives work for the sustainable development of communities through policies accepted by their members.

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

Principles of co-operatives allow voluntary and open membership.

- True
- False

Correct Answer: True

Objects of Multi-State Co-operative Societies

A Multi-State Co-operative Society is registered under this Act to serve the interest of the members in more than one State with the object to promote the economic and social betterment of its members through mutual aid and in accordance with the Co-operative principles, such as —

- (1) Membership is voluntary and open without any social, political or religion discrimination to all persons, utilising its services.
- (2) All members, institutional or individual, enjoy equal right of voting i.e. one member one vote.
- (3) Surplus of savings, if any, arising from the operations of the society belongs to the society as a whole and no individual member has a claim to the surplus.
- (4) Surplus should be utilised for:
 - (a) Providing for development of the business of the society;
 - (b) Providing services for the common enjoyment of members;
 - (c) Distribution among the members in proportion to their transactions with the society.
- (5) Actively co-operate with other Co-operative Societies at local, national or international levels.
- (6) Undertake education of its members, office bearers and employees and the general public regarding the principles and practice of co-operation.
- (7) The share capital of Societies shall receive strictly limited rate of interest (i.e. to say dividend).
- (8) Administration is based on democratically expressed will of the members.
- (9) The management of the society is accountable to its own members.

The Multi-State Co-operative Societies may also be formed with the object of

facilitating the operations of other such Societies or of Co-operative Societies or of both.

Choose the correct answer

Which of the following is not a principle of multi-state co-operative societies?

- (a) Voluntary and open membership
- (b) Autocratic member control
- (c) Members' economic participation
- (d) Education and training of the members

Correct Answer: b

Application for Registration

An application for registration of a Multi-State Co-operative Society is to be made to the Central Registrar in Form I prescribed in the Rules issued in 1985.

The application should be signed in the case of –

- (1) A society of which all the members are individuals by atleast 50 persons from each of the State concerned.
- (2) A Society of which the members are co-operative societies by duly authorised representatives usually the chairperson or chief executive, on behalf of atleast five such societies as are not registered in the same State.
- (3) Where any member of Multi-State Co-operative Society to be registered is a Government company, a Corporate body, or a Society registered under the Societies Registration Act, 1860, any authorised person can sign the application on its behalf.
- (4) A society of which another multi-state cooperative society and other cooperative societies are members by duly authorised representatives of each of such societies. However, not less than two of the cooperative societies shall be such as are not registered in the same state.
- (5) A society of which the members are cooperative societies or multi-state cooperative societies and individuals, then, the application may be signed by:
 - (a) fifty individual persons from each of the two states or more; and
 - (b) one cooperative society each from two states or more or one multi-state cooperative society.

Enclosures to Application

- (1) Four copies of the proposed bye-laws of the society duly signed by each of the persons who sign the application for registration.
- (2) A certificate from the banks stating the credit balance in favour of the proposed Multi-State Co-operative society.

- (3) A list of persons who have contributed to the share capital together with the amount contributed by each of them and the entry fee paid by them.
- (4) A scheme showing the details explaining how the working of the Multi-State Co-operative Society will be economically sound and the registration of such society will be beneficial for social and economic betterment of its members through self-help and mutual aid in accordance with the cooperative principles.

Certified copies of the resolution of the promoters specifying the name and address of one of the applicants to whom the Central Registrar may address correspondence under the Rules before registration and dispatch and/or hand over the registration document.

- (5) Copy of the resolution authorising the Chairman or, as the case may be, Chief Executive etc. of Multi-State Co-operative Society to sign the application and the bye-laws on behalf of the society wherever applicable.
- (6) Copy of the resolution giving authority to any person to sign the application for registration and the bye-laws on behalf of the Government company, a corporate body or Co-operative Societies or a society registered under the Societies Registration Act, 1860 wherever applicable.
- (7) A copy of resolution indicating the name of one or more applicants who are authorised to make alterations or additions to the proposed bye-laws submitted with the application.
- (8) The application in Form I shall be sent by registered Post or may be delivered by hand to the office of the Central Registrar.

Whom to Apply

The application for registration of Multi-State Co-operative Society should be addressed to the Central Registrar of Co-operative Societies, Krishi Bhawan, New Delhi.

Members of the Co-operative Society

Following persons may be admitted as members of the Multi-State Co-operative Society:

- (1) An individual competent to contract under Section 11 of the Indian Contract Act (which means the individual should be a major and of sound mind and is not disqualified for contracting according to the law to which he is subject).
- (2) Any Multi-State Co-operative Society or any Co-operative Society.
- (3) The Central Government.
- (4) The State Government.
- (5) The National Co-operative Development Corporation.
- (6) Any other Corporation owned or controlled by the Government.
- (7) Any Government company as defined in Section 617 of the Companies Act, 1956.

- (8) Such class or classes of persons or association of persons as may be permitted by the Central Registrar having regard to the nature and activities of a multi-state co-operative society.

Registration of the Society

The application so received in the office of the Registrar is given a serial number and a receipt in acknowledgement thereof is issued. The Central Registrar if he is satisfied that the provisions of the Act and the Rules have been complied with and that the objects of the society are to serve the interest of members in more than one State and that the proposed bye-laws are not contrary to the provisions of the Act and the Rules, shall register the society. The Central Registrar while disposing of the application may also be governed by the fact that there is no other Multi-State Co-operative Society having similar area of operation and identical objects, the proposed society has reasonable chances of becoming a viable unit and that its bye-laws provide for social and economic betterment of its members through self-help and mutual aid in accordance with co-operative principles. On registration a Certificate of Registration signed by the Registrar bearing his official seal and containing the registration number and date of registration is issued by the Central Registrar. A certified copy of the bye-laws as approved and registered is also sent to society. The application for registration has to be disposed off within a period of four months from the date of its receipt.

Refusal to Register

The Registrar shall communicate within a period of 4 months of the date of registration of application, to the person authorised on behalf of the proposed co-operative society, the order for refusal to register the society alongwith his reasons for doing so, but after giving a reasonable opportunities of being heard. The person aggrieved by order of refusal of the Central Registrar may file an appeal with the prescribed authority within 60 days of the date of such decision or order and the decision of the Appellate Authority will be final.

Deemed Registration

If the application for registration is not disposed off within a period of 4 months or the Central Registrar fails to communicate the order of refusal within that period, the application shall be deemed to have been accepted for registration and the Central Registrar shall issue the registration certificate in accordance with the provisions of these Act and the rules made thereunder.

Registration Certificate

After registration, the Central Registrar shall issue a certificate of registration duly signed by him, which shall be conclusive evidence that the society mentioned therein is duly registered under this Act.

After registration, it shall be a body corporate having perpetual succession and a common seal and with powers to acquire, hold and dispose of properties, to enter into contracts, to institute or defend suits etc.

Subject Matter of Bye-Laws

Every multi-state co-operative society may make its bye-laws which shall be

consistent with the provisions of this Act and shall be as under:

- (a) the name, address and area of operation of the society;
- (b) the objects of the society;
- (c) the services to be provided to its members;
- (d) the eligibility for obtaining membership;
- (e) the procedure for obtaining membership;
- (f) the conditions for continuing as member;
- (g) the procedure for withdrawal of membership;
- (h) the transfer of membership;
- (i) the procedure for expulsion from membership;
- (j) the rights and duties of the members;
- (k) the nature and amount of capital of the society;
- (l) the manner in which the maximum capital to which a single member can subscribe;
- (m) the sources from which the funds may be raised by the society;
- (n) the purpose for which the funds may be applied;
- (o) the manner of allocation or disbursement of net profits of the society;
- (p) the constitution of various reserves;
- (q) the manner of convening general meetings and quorum thereof other than those provided under this Act;
- (r) the procedure for notice and manner of voting, in general and other meetings;
- (s) the procedure for amending the bye-laws;
- (t) the number of members of the Board not exceeding twenty-one;
- (u) the tenure of directors, chairperson and other office-bearers of the society, not exceeding five years;
- (v) the procedure for removal of members of the Board and for filling up of vacancies;
- (w) the manner of convening Board meetings, its quorum, number of such meetings in a year and venue of such meetings;
- (x) the frequency of Board meetings;
- (y) the powers and functions of the Chief Executive in addition to those provided under Section 52;
- (z) the manner of imposing the penalty;
- (za) the appointment, rights and duties of auditors and procedure for conduct of audit.
- (zb) the authorisation of officers to sign documents and to institute and defend suits and other legal proceedings on behalf of the society;
- (zc) the terms on which a society may deal with persons other than members;
- (zd) the terms on which a society may associate with other co-operative societies;
- (ze) the terms on which a society may deal with organisation, other than co-operative societies;

- (zf) the rights, if any, which the society may confer on any other multi-state co-operative society or Federal Co-operative and the circumstances under which such rights may be exercised by the Federal Co-operative;
- (zg) the procedure and manner for transfer of shares and interest in the name of a nominee in case of death of a member;
- (zh) the educational and training programmes to be conducted by the society;
- (zi) the principal place and other places of business of society;
- (zj) the minimum level of services to be used by its members; and
- (zk) any other matter which may be prescribed.

Optional Inclusive Matters

- (i) Procedure and manner of redemption of shares.
- (ii) The provision of office bearers of the society, the terms and conditions, their functions and responsibilities other than those specified in the Act.
- (iii) Constitution of various funds as required under the Act and Rules.
- (iv) Rate of dividend subject to maximum of the rates specified in the bye-laws.
- (v) The procedure for the association and representation of employees of the society.
- (vi) Constitution of the committees of the Board.
- (vii) The procedure of election or selection for constitution of smaller body of delegates.
- (viii) The method of recruitment, the conditions of service and the authority competent to fix, revise or regulate the scales of pay and allowance to be paid to the officers and other employees of the society and the procedure to be followed in the disposal of disciplinary cases.
- (ix) The constitution and powers of the representative general body and the restrictions subject to which this body may exercise its powers.

Amendment in Name and Bye-Laws

Any amendment of any bye-law of a multi-state cooperative society shall not be valid, unless such amendment has been registered under this Act. Following steps are to be taken to effect a change in name, address or bye-laws of a Multi-State Co-operative Society.

- (1) Pass a resolution at the meeting of the Executive Committee, finalise the draft amendment to be made in the bye-laws and also for issuing a notice of the proposed amendment to the members in accordance with the bye-laws;
- (2) Issue a 15 days prior notice to the members of the society for a proposed annual or special meeting to consider the proposed amendment;
- (3) Pass the resolution for amendment by a two-third majority of the members present and voting;
- (4) Apply to the Central Registrar for registration of the amendment within 60 days from the date of the general meeting at which amendment was passed.

The application for registration of the amendment should be accompanied by—

- (i) Copy of the resolution.
- (ii) Particulars of the date of the general meeting, length of notice given to convene the general meeting, total number of members of the society on the date of meeting, number of members forming the quorum, number of members present at the meeting and number of members exercising the right of voting and number of members voting for the amendment.
- (iii) Copy of the existing bye-laws with amendment proposed to be made together with reasons justifying such amendments.
- (iv) Copy of the notice given to members for convening the general meeting.
- (v) Four copies of the text of bye-laws as they will stand after the amendment signed by the officers duly authorised by the Board of the society.
- (vi) Certificate signed by the presiding authority of the general meeting stating that the resolution was passed by the two-third majority and that valid notice was given for convening the meeting to consider the amendment.
- (vii) The society should send the original registration certificate to the Central Registrar for amendment who will return the same after changing the name, if any. The Central Registrar, if he is satisfied, will register the amendments and issue a certified copy of the amended bye-laws. He may also refuse the registration of amendments and this order of refusal is appealable with the prescribed authority within 60 days from the date of the order. The amended bye-laws shall come into force from the date they are registered or from any other day on which they are expressed to come into operation.

The change in name does not affect any right or obligation of the society or any of its members or past members and any legal proceedings that might have continued or commenced by or against the society by its former name. The name should not refer to any caste or religion domination and should not be inconsistent with the objects of the society.

A multi-State Co-operative Society may change the address of principal place of business with the previous approval of the Central Registrar.

Admission as a Member

Every eligible person may be admitted as a member of the Co-operative Society on his application. The application for admission is to be disposed off by the society within 4 months of the date of its receipt and the decision of the society should be communicated to the applicant within 15 days from the date of such decision. If the decision is not taken within 4 months or the decision if taken is not communicated within 15 days, it shall be deemed to have been refused by the society. The order of refusal is appealable with the Central Registrar.

The rules lay down the conditions to be complied with for admission for membership which are as follows :—

- (1) No person shall be admitted as a member of a Multi-State Co-operative Society unless,—
 - (a) he has applied in writing in the form, if any, laid down by the Multi-State

Co-operative Society or in the form specified by the Central Registrar, if any, for membership;

- (b) his application is approved by the Board of the Multi-State Co-operative Society;
 - (c) he has purchased the minimum number of shares and paid the value thereof in full or in part in such calls as may be laid down in the bye-laws of the Multi-State Co-operative Society;
 - (d) he has fulfilled all other conditions laid down in the Act, the rules and the bye-laws;
 - (e) in the case of a Multi-State Co-operative Society or a Co-operative Society or the National Co-operative Society or any other corporation owned or controlled by the Government or any Government company or body of persons whether incorporated or not, the application for membership shall be accompanied by a resolution authorising it to apply for such membership.
- (2) No person shall be eligible for admission as a member of a Multi-State Co-operative Society if he –
- (a) has been adjudged by a competent Court to be insolvent or of unsound mind;
 - (b) is concerned or participates in the profits of any contract with the society;
 - (c) has been convicted for an offence involving moral turpitude;
 - (d) holds any office or place of profit under the society; [However, this disqualification shall not apply to the chief executive or an employee of a society nominated on the Board.]
 - (e) has been a member of the society for less than twelve months immediately preceding the date of such election or appointment;
 - (f) has interest in any business of the kind carried on by the society of which he is a member;
 - (g) has taken loan or goods on credit from the society of which he is a member, or is otherwise indebted to such society and after the receipt of a notice of default issued to him by such society, has defaulted:
 - (i) in repayment of such loan or debt or in payment of the price of the goods taken on credit, as the case may be, within the date fixed for such repayment or payment or where such date is extended, which in no case shall exceed six months, within the date so extended; or
 - (ii) when such loan or debt or the price of goods taken on credit is to be paid in instalments, in payment of any instalment, and the amount in default or any part thereof has remained unpaid on the expiry of six months from the date of such default.

A member of the Board who has ceased to hold office as such under this clause shall not be eligible, for a period of one year, from the date on

which he ceased to hold office, for re-election as a member of the Board of the multi-state co-operative society of which he was a member or for the election to the Board of any other multi-state co-operative society.

- (h) is a person against whom any amount due under a decree, decision or order is pending recovery under this Act;
- (i) is retained or employed as a legal practitioner on behalf of or against the multi-state co-operative society, or on behalf of or against any other multi-state co-operative society which is a member of the former society;
- (j) has been convicted for any offence under this Act;
- (k) is disqualified for being a member under Section 29;
- (l) has been expelled as a member under Section 30;
- (m) absents himself from three consecutive Board meetings and such absence has not been condoned by the Board; and
- (n) absents himself from three consecutive general body meetings and such absence has not been condoned by the members in the general body.

Further, a person shall not be eligible for being elected as member of Board of a multi-state co-operative society for a period of five years if the Board of such multi-state co-operative society fails:

- (a) to conduct elections of the Board under Section 45; or
- (b) to call the annual general meeting under Section 39; or
- (c) to prepare the financial statement and present the same in the annual general meeting.

It may be noted that no members of a Multi-State Co-operative Society shall exercise the rights of a member unless he has made such payments to the society in respect of membership or has acquired such interest in the society.

Expulsion of Members

A member of a society can only be expelled for detrimental acts after he has been given a reasonable opportunity of making representation and the resolution for his expulsion has been passed at the general body meeting by not less than two-third of the members present and voting. A member cannot exercise his rights such as right to vote etc. unless he has made payments to the society in respect of membership or has acquired such interest in the society as may be specified in the bye-laws. An expelled member shall not be eligible for re-admission as a member of the society for a period of one year from the date of such expulsion.

To expel a member, the general body of the society, may consider any one or all the following:

1. If his business is in conflict or competition with business of the society;
2. If he has used for a period of 2 consecutive years, the services below the minimum level specified in the bye-laws; or

3. If he has not attended three consecutive general meetings of the society which were not condoned by the general meeting.
4. If he has made a default in payment of any amount to be paid to the society.

Management

General Meeting

The ultimate authority of a Co-operative Society vests in the general body of the members. However, any officer or the Board of the society may exercise such powers as may be conferred on the officer or the Board by the Act, rules or bye-laws. The general body consists of all the members of the society. Sometimes there is a provision for constitution of a smaller body consisting of the delegates of members of the society elected or selected in accordance with the bye-laws and such smaller body known as the representative general body exercises powers of the general body as may be prescribed or specified in the bye-laws of the society. The general body should meet atleast once in a year at the annual general meeting. The annual general meeting is called after the close of the co-operative year but not later than six months after the close of the corresponding years, for the consideration of—

- (i) Audited Accounts;
- (ii) Audit Compliance Report;
- (iii) Audit Report and Annual Report;
- (iv) Interest Payable on loans and deposits;
- (v) Audit fees;
- (vi) Working expenses including repairs;
- (vii) Rent;
- (viii) Taxes and depreciation;
- (ix) Bonus payable to employees and equalisation fund for such bonus;
- (x) Provision for income tax;
- (xi) Making donations approved under the Income Tax Act, 1961;
- (xii) Development Rebate;
- (xiii) Provisions for the following:
 - development fund,
 - bad debts fund,
 - dividend equalisation fund,
 - price fluctuation fund,
 - share capital reduction fund,
 - investment fluctuation fund;
- (xiv) Provision for retirement benefit of employees;
- (xv) Writing off bad debts and losses not adjusted against any fund created out of profits or provisions therefor;

- (xvi) Disposal of Net Profits;
- (xvii) Approval of Annual Budgets;
- (xviii) Approval of Amendments to Memorandum;
- (xix) Expulsion of members;
- (xx) review of operational deficit, if any;
- (xxi) review of actual utilisation of reserve & other funds;
- (xxii) approval of long-term perspective plan & the annual operational plan;
- (xxiii) review of annual report and accounts of subsidiary institution, if any;
- (xxiv) list of employees who are relatives of members of board or of the Chief Executive;
- (xxv) Amendment of bye-laws, if any;
- (xxvi) formulation of code of conduct for members of board and officers;
- (xxvii) Election of members of board, if any.

Certain powers of the society are also exercised at the special general meeting of the society. The special general meeting is called by the Chief Executive of the society within one month after the receipt of a requisition in writing from the Central Registrar or from such member or members as may be prescribed.

According to the Rules, the Annual General Meeting has to be held within six months from the close of the Co-operative year. The rules also provide that the Annual General Meeting may be called by giving not less than fourteen days notice in writing. The notice shall be accompanied by a copy of the audited balance sheet, profit and loss account together with the Auditor's report thereon relating to the preceding year and the report of the Board.

According to the Rules unless otherwise provided in the bye-laws, the quorum for a General Meeting shall be one-fifth of the total number of members. No business can be transacted unless there is quorum at the time when the business of the meeting is due to commence. If within half an hour from the appointed time for the meeting a quorum is not present, the meeting shall stand adjourned. Where a meeting has been called on requisition of the members and quorum is not present, the meeting shall be dissolved.

If at any time during the meeting sufficient member or members are not present to form the quorum, the Chairman or member presiding over the meeting on his own, or on his attention been drawn to this fact, shall adjourn the meeting and the business that remains to be transacted at the meeting, if any, shall be disposed of in the usual manner at the adjourned meeting.

Where a meeting is adjourned, the adjourned meeting shall be held either on the same day or on such date, time and place as may be decided by the Chairman or the member presiding over the meeting. Further, it may be noted that no business shall be transacted at the adjourned meeting other than the business on the agenda of the adjourned meeting. No quorum shall be necessary in respect of an adjourned General Meeting.

Section 39 empowers the Central Registrar or the person authorised by him in

this behalf to convene such annual general meeting within a period of ninety days from the date of expiry of the prescribed period if the society fails to convene the annual general meeting within such period. The expenditure incurred on such meeting shall be borne by the society.

The Chief Executive may at any time on the direction of the Board call a Special General Meeting of the Society. He is required to call such meeting within one month after the receipt of requisition in writing from the Central Registrar or from such member or members or a proportion of the total number of members as may be provided in the bye-laws. Where a Special General Meeting is not called in accordance with the requisition, the Central Registrar may order such meeting to be called which shall be deemed to be a meeting called by the Chief Executive in accordance with the provisions of the Act and that the expenditure incurred in calling such meeting shall be paid out of the funds of the society or recovered from such person or persons who in the opinion of the Central Registrar was or were responsible for the refusal or failure to convene the Special General Meeting.

Board of Directors

For day-to-day functions and supervision of the activities of the society, there is a Board of directors of every Multi-State Co-operative Society. The applicants for registration select the first Board of directors, which is interim Board. The members elect the first regular Board of directors at the first general meeting held within six months of the date of registration and subsequently at such intervals as the bye-laws may provide. However, the maximum number of directors shall not exceed twenty one. Normally the term of elected members of the Board cannot exceed five years from the date of election. The term of office bearers is, therefore, governed by the provisions made in the bye-laws. The election of the members of the Board of directors is conducted in the manner prescribed in the Multi-State Co-operative Rules, 2002.

An elected member of the Board can be removed after a resolution to this effect has been passed by the General Body at its meeting by a majority of not less than two-third of the members present and voting at the meeting.

A person cannot hold office of president or vice president, or chairman or vice-chairman in two societies simultaneously and for more than two consecutive terms in the same society. Section 99 empowers the Government to exempt a Co-operative Society from the provisions of the Act. It has been held that intention of Section 99 is to grant exemption to society and not to individuals from the provisions of the Act.

Chief Executive

Amongst themselves the members of the Board of directors appoint the Chief Executive who is a full-time employee of the society and shall be a member of the Board and of the executive committee. The chief executive, under the general superintendence, direction and control of the Board, shall exercise the powers and discharge the functions as have been specified under Section 52 of the Act.

Powers and Functions of the Board of Directors

The Board exercises all such powers as may be necessary or expedient for the

purpose of carrying out its functions under the Act. Such powers include:

- (1) To admit members.
- (2) To interpret the organisational objectives and set up specific goals to be achieved towards these objectives.
- (3) To make periodic appraisal of operations.
- (4) To appoint and remove Chief Executive and such other employees of the society.
- (5) To make provisions for regulating the appointment of employees, their pay and their conditions of service.
- (6) To approve annual and supplementary budget.
- (7) To acquire or dispose off immovable property.
- (8) To raise funds.
- (9) To sanction loans to the members.
- (10) To place before the general body the annual report, annual financial statements, annual plan and the audit report.
- (11) To recommend the distribution of profits to the general body.
- (12) To take decision on matters relating to withdrawal, transfer, retirement, refund or forfeiture of shares.
- (13) To lay down criteria for determining defaults by members.
- (14) To determine the terms and conditions of collaboration with Co-operative societies and others.
- (15) To sanction contracts of any value unless otherwise specified in the bye-laws.
- (16) To appoint trustees, attorney, agents for the business of the society.
- (17) To accept or reject resignation from the members of the Board.
- (18) To consider audit and compliance report and to place the same before the general body.
- (19) To take such other measures or to do such other acts as may be prescribed or required under this Act or the bye-laws of the society or as may be directed or delegated by the general body.

Meetings of the Board

Board has to meet once in every quarter provided that ordinarily the meetings of the Board shall not exceed the number as per its bye-laws. Venue of the meeting of the society shall be as per its bye-laws, and that the meetings of the Board shall be convened by the Chief Executive.

Investment of Funds

The co-operative principles require that funds of the society should be used ultimately to serve the interest of the members and for their economic and social

betterment. The manner of utilising the funds of the society has, therefore, been restricted/regulated by various provisions under the Act and Multi-State Co-operative Society (Privileges, Properties and Funds, Accounts, Audits, Winding up and Execution of Decrees and Orders and Decisions) Rules, 2002. It is specifically provided that only net profits of a society can be divided by way of bonus or dividend amongst the members and in no case the capital or the reserve fund shall be distributed as dividend.

A multi-state cooperative society, however, may invest its funds in any of the following ways:

1. in a cooperative bank, state cooperative bank, cooperative land development bank or central cooperative bank;
2. in any of the securities specified under Section 20 of the Indian Trust Act, 1882;
3. in the shares or other securities of any other multi-state cooperative society or any other cooperative society;
4. in the shares/securities or assets of a subsidiary institution or other institution;
5. in any other bank;
6. in such other way as may be provided in its bye-laws.

Net Profits

The society may add to its net profits for the year, interest, if any, accrued in the preceding years, but which actually has been recovered during the year in question.

If the society does not have share capital, then the surplus of income over expenditure shall not be treated as net profits and such surplus shall be dealt with, in accordance with its bye-laws.

The net profits of the society for a particular period are calculated by deducting from the gross profit the following items:

- (i) All interest accrued and accruing in relation to amount which are overdue.
- (ii) Establishment charges.
- (iii) Interest payable on loans and deposits.
- (iv) Audit fees.
- (v) Working expenses including repairs.
- (vi) Rent.
- (vii) Taxes and depreciation.
- (viii) Bonus payable to employees under the Payment of Bonus Act and Equalisation fund for such bonus.
- (ix) Provision for payment of income-tax and approved donations under Income-tax Act, 1961.
- (x) Development rebate.
- (xi) Provision for Development fund, bad debt fund, dividend equalization fund,

price fluctuation fund, share capital reduction fund, investment fluctuation fund.

- (xii) Provision for retirement benefit of employees.
- (xiii) Provision for writing off bad debts and losses not adjusted against any fund created out of profits.

The funds of the Multi-State Co-operative Society are to be utilised or invested in specific manner as provided in the Act and the Rules.

Disposal of Net Profits

A. Appropriations

Out of its net profit for each year, the Multi-State Co-operative Society shall make appropriations as under:

1. Transfer to a reserve fund, an amount which shall not be less than 25%;
2. Credit 1% to cooperative education fund;
3. Transfer to a reserve fund for meeting unforeseen losses, an amount which shall not be less than 10%.

B. Distribution

1. Dividend at a rate not exceeding the prescribed limit.
2. Constitution of or contribution to such special fund, including education fund, as may be specified in the bye laws.
3. Donating an amount exceeding 5% of its net profits for the development of corporate movement or charitable purpose.
4. Payment of *ex-gratia* to its employees to the extent and in the manner specified in its bye-laws.

Settlement of Disputes

The Central Registrar appoints the arbitrator for deciding the disputes touching the constitution, management or business of a Multi-State Co-operative Society which arise among the members, past members or between members and the society or liquidator or between the society and the past officers of the society or between the society and any other Multi-State Co-operative Society. No court shall have jurisdiction to entertain any suit or proceedings in respect of such disputes.

If any question arises as to a dispute referred to arbitration is or is not a dispute touching the constitution, management or business of a multi-state cooperative society, the decision thereon of the arbitrator shall be final and shall not be called in question in any court.

Limitation

The period of limitation in the case of any dispute, except those mentioned in the Act, which are required to be referred to arbitration shall be regulated by the provisions of the Limitation Act, 1963.

Appeals and Review

An appeal against any appealable decision or order as provided in Section 99(1)

shall be made within 60 days from the date of such decision order to the prescribed appellate authority.

The appellate authority may, if satisfied, admit the appeal within such further period as it may deem fit. The decision or order of the appellate authority on appeal shall be final.

The appellate authority may, on the application of any party with a sufficient reason, review its own order in any case and pass in reference thereto such order as it thinks fit, provided a notice and reasonable opportunity of being heard is given to all interested parties.

Amalgamation of Co-operative Societies

Any two or more Multi-State Co-operative Societies may amalgamate themselves after each society has passed a resolution by majority of not less than two-third of members present and voting. The resolution should contain all particulars of amalgamation. In the case of a Co-operative Bank the approval for amalgamation shall not be accorded by the Central Registrar without previous sanction of the Reserve Bank of India.

Transfer of Assets or Division of Assets

A Multi-State Co-operative Society may, pass a resolution by a majority of not less than two-third of the members present and voting at a general meeting held for this purpose:

- (i) transfer the assets and liabilities in whole or in part to any other Multi-State Co-operative Society or a Co-operative Society.
- (ii) divide itself into two or more Multi-State Co-operative Societies.
- (iii) divide itself into two or more Co-operative Societies.

Conversion

The Co-operative Society incorporated under any of the State Co-operative Acts by amendment in the bye-laws extend its jurisdiction and convert itself into a Multi-State Co-operative Society. However, the amended bye-laws are required to be registered with the Central Registrar. From the date the amended bye-laws are registered by the Central Registrar, the Co-operative Society shall become a Multi-State Co-operative Society and the Central Registrar shall forward to the Co-operative Society a certificate to the effect that such society has been registered as a Multi-State Co-operative Society under the Act.

Winding up of a Co-operative Society

The Central Registrar on being satisfied, may by order direct a society to be wound up in the following circumstances:

- (i) if after an audit under Section 70 or special audit under Section 77 or on enquiry under Section 78 or on inspection under Section 79, the Central Registrar is satisfied that the winding up is imminent; or
- (ii) if the society, by a resolution passed by two-third majority of members present and voting in a general meeting decides for winding up of that society.

However, reasonable opportunity should be given to the society to make any representation before the order for winding up is made.

The Central Registrar may also order winding up of the society after giving the society reasonable opportunity to represent in the following circumstances:

- (i) where the number of members of the society has been reduced to less than 50; or
- (ii) where the society has not commenced work within a period of six months from the date of its registration or such extended period as may be allowed; or
- (iii) the society has ceased to function in accordance with the co-operative principles.

However, a Multi-State Co-operative Bank cannot be wound up except with the previous sanction of the Reserve Bank of India.

The Central Registrar may appoint Liquidator for completing the process of winding up.

2. LAW RELATING TO SOCIETIES – SOCIETIES REGISTRATION ACT, 1860

Introduction

Generally a need is felt to set up an institution of non-commercial nature for promotion of numerous charitable activities like education, art, religion, culture, music, social welfare, sports etc. Associations, clubs or societies are formed to help these purposes as they work on non-profit basis. To legalise such organisations, the Societies Registration Act, 1860 was enacted. For identical purposes, a non-profit association can be registered under Section 25 of the Companies Act, 1956. However, the registration, operation and management of an association registered under the former Act is easier and simpler comparatively.

Status

After the Constitution of India came into force, the Societies Registration Act 1860, (the main Act) has continued to be in force in all the States by virtue of Article 372 of the Constitution. A registered society is a legal entity but it is not a body corporate (*Board of Trustees v. State of Delhi AIR 1962 SC 458*). It is separate from its members. It can own properties. It is capable of suing or being sued. The position of a society is comparable with an incorporated company under the Companies Act 1956. Hence, a Company Secretary has an important role to play in registration and management of a registered society.

The main Act has been continuing to be applicable in all the States with some amendments made by almost all the States in operation, administration and management of societies within the respective States.

Registration

A society can be registered by minimum seven individuals which may include foreigners, or registered society for the promotion of literature, science or fine arts or diffusion of useful knowledge and political education or charitable purposes, as

specified in Section 20 of the main Act as under:-

- (i) Grant of charitable assistance.
- (ii) Creation of military orphan funds.
- (iii) Societies established at the several Presidencies of India.
- (iv) Promotion of –
 - Science
 - Literature
 - Fine Arts
 - Instructions or diffusion of useful knowledge
 - Diffusion of political education
 - Foundation or maintenance of libraries or reading rooms
 - Public museum and galleries of paintings
 - Works of art
 - Collections of natural history
 - Mechanical and philosophical investments
 - Instruments
 - Designs

Various States have added other objects like social welfare, sports & games, environment, compassion of living creatures, recreation, athletics, cultural activities, research work, welfare of physically handicapped etc.

A "charitable purpose" is a purpose which has some element of general public benefit; it does not embrace purposes which are religious or predominantly religious (*Md. Yunus v. The Inspector General of Registration* AIR 1980 Pat. 138). A charitable purpose includes religious purpose (*Hindu Public and another v. Rajdhani Puja Samithee and others* AIR 1999 SC 964).

Procedure for Registration

The following documents are required to be filed with the Registrar of Societies for registration of a society under the main Act or corresponding Acts of various State Governments:-

1. Covering letter requesting for registration stating various documents annexed to it addressed to the registering authority and signed by all the subscribers to the Memorandum or by a person authorised by all of the them.
2. Memorandum of Association (in duplicate) containing (a) name of the society; (b) the objects of the society; (c) the names, addresses and occupation of the members of the governing body; (d) the place of registered office of the Society, and (e) the names, addresses and full signatures of the seven or more persons subscribing their names to the memorandum of Association. Their signatures should be witnessed.
3. Rules & Regulations/Bye-laws (in duplicate) duly signed by atleast three members of the governing body.

4. Affidavit on non-judicial stamp paper of requisite value by the President or secretary of the society duly attested by Oath Commissioner or Notary Public or Magistrate of first class.
5. Documentary proof such as rent receipt or property tax receipt in respect of the Registered office of the Society or no-objection of the owner of the premises.
6. Registration fee in cash or by demand draft.

The formalities and requirements may differ from State to State. Hence, it is advised that the applicant should contact the registering authority of the State in advance.

The Registering authority shall satisfy himself/herself about the compliance of the provisions of the Act and correctness of the documents and only thereafter certify in his/her hand that the Society is registered under the main Act or the corresponding Act of the State. On registration, the society becomes a legal entity or a judicial person apart from its members (*K.C. Thomas v. R.L. Gadeock AIR 1970 Pat. 160/163*). Its Rules & Regulations bound its members. It must confine its activities to the sphere embraced by its objects (*Ram Kumar v. State of West Bengal AIR 1953 Cal 534*). Any inconsistent object with the provisions of the applicable Act shall be inoperative even after registration (*Radhaswami Satsang Sabha Dayal Bag Vs. Hans Kumar Kishan Chand AIR 1959 MP 174*). A non-registered society may exist in fact but not in law. A unregistered society cannot claim benefits under the Income tax Act, 1961.

Rules & Regulations

The Rules & Regulations help and guide the members and management of the society in carrying out its objects. They also bind members of the society. The Rules that are inconsistent with the provisions of the Act are inoperative although registered with the Registrar of Societies. The Rules & Regulations of a society may provide for—

- (i) the conditions of admissions of members,
- (ii) the liability of members for fines, forfeitures under certain circumstances,
- (iii) the consequence of non-payment of any subscription or fine registration and expulsion of members,
- (iv) the appointment and removal of trustees and their powers,
- (v) the manner of appointing and removing the governing body,
- (vi) the manner in which the notice of meetings may be given,
- (vii) the quorum necessary for the transactions of business at meetings of the society,
- (viii) the manner of making, altering and rescinding regulations,
- (ix) the investment of funds, keeping of accounts and for annual or periodical audit of account,
- (x) the manner of dissolving the society,
- (xi) the determination upon the dissolution that the property be utilised by the Government or others in particular manner,

- (xii) matters to be provided in bye-laws and the manner in which they shall be made,
- (xiii) such other matters as may be thought expedient having reference to the nature and objects of the society.

Society may make bye-laws

A society can make its bye-laws in accordance with the Rules and Regulations of the society. If the rules do not provide for the making of bye-laws, bye-laws can be made at a general meeting of the society at which concurrent votes of three-fifths of the members present shall be necessary. If any penalty is imposed for the breach of any rule or bye-law of the society, such penalty can be recovered through the Court.

The bye-laws of a society may provide for:

- (a) The business hours of the society;
- (b) The objects of the society;
- (c) The activities of the society in furtherance of its objects;
- (d) The name of the person or officer, if any, authorised to sue or to be sued on behalf of the society;
- (e) The name of other person or officer who is empowered to give directions in regard to the business of the society;
- (f) Enrolment of members –
 - (i) Qualifications for membership, classification, restrictions and conditions, if any, therefor,
 - (ii) The entrance and other fee, or subscription, if any, to be collected from members,
 - (iii) The dates prescribed for payment of the amount specified in sub-clause (ii) above and levy of penalties or fine, if any, imposed on defaulting members.
- (g) Removal of members, the circumstances under which members could be removed from the rolls and the procedure for such removal and appeal, if any, against such removal;
- (h) Rights, applications, privileges of members;
 - (i) The manner in which the society shall transact its business;
 - (j) The constitution of the Committee and qualifications of the members of the Committee, their term of office and the procedure for their appointment and reappointment;
- (k) The preparation and filing with the concerned Registrar, of records, annual lists or other statements;
- (l) Audit of accounts and the balance-sheet for the financial year;
- (m) The supply of copies of bye-laws, the receipt and expenditure account and of the balance sheet to the members on application and the fee payable for the same;
- (n) Imposition of fine, if any, for breach of the provisions of the bye-laws by any member or officer;

- (o) The mode of custody, application and investment of the funds of the society and the extent and conditions of such investment;
- (p) Funds earmarked specifically for the purpose of making provisions for dependent of a deceased or disabled member and the quantum of payment to be made thereof;
- (q) Arrangements for transactions of day-to-day business of the society, the expenditure to be incurred therefor, the staff to be employed and condition of services of such employees;
- (r) (i) Conduct of annual general meetings and procedure therefor,
(ii) Conduct of extraordinary general meetings and procedure therefor and the number of members required for making a requisition in writing, calling for such a meeting,
- (s) Exhibition of the Register of Members, the books containing minutes and the books of accounts at the registered office of the society during business hours for inspection by its members free of charge.

The bye-laws may also deal with such other matters incidental to the organisation and working of the society and the management of its business as may be deemed necessary.

Members — Their Rights and Liabilities

A member means a person who has —

- (a) been admitted to the society according to its rules and regulations;
- (b) paid subscription provided in the rules;
- (c) signed the roll or list of members of the society, and
- (d) not resigned or ceased from the membership of the society.

Any arrear of subscription amount for a period of exceeding three months is disqualification for continuing to be a member and vote.

No one can claim admission to a society as a matter of right on payment of the prescribed subscription. The discretion of the governing body is final concerning grant or refusal of admission to a person [*Abhoy Pado Bose v. Queen's Anglo Sanskrit School, Lucknow* 34.1.C.263 (Oudh)].

Choose the correct answer

Which of the following must be adhered to by a society while making its bye-laws?

- (a) The rules and regulations of the society
- (b) The shape and size of the society
- (c) The power and stability of the society
- (d) None of the above

Correct Answer: a

When members treated as strangers?

A member of the society is liable to be sued as stranger in the following cases:

- (i) When he is in arrear of a subscription which he is bound to pay according to the rules, or
- (ii) When he has detained any property of the society, or
- (iii) When he has destroyed any property of the society.

In above cases the member may be sued for such, arrears and damages. But he can recover the costs if he is successful in the suit (Section 10).

A member is subject to prosecution and punishment as stranger for committing the following offences:

If he (i) steals, or purloins, or embezzles any money or other property or (ii) willfully and maliciously destroy or injures any property of the Society or (iii) forges any deed, bond, security for money, receipt or other instrument whereby the funds of the Society may be recovered when accrued in any Court having jurisdiction where the defendant resides or the Society is situated, as is deemed expedient by the governing body (Section 11).

Members guilty of offences are punishable as strangers. A member of the society may be prosecuted for wilful and malicious destruction or injury to the property of the society or for forgery, exposing the funds of the society to loss.

The members of a society have rights to —

- receive notice of all special and annual general meetings;
- vote at all meetings.
- resolve all disputes among members and society or *inter se*;
- receive copies of the rules and regulations and bye-laws.

Their liabilities are –

- A member may be sued as a stranger by the society.
- Member, guilty of an offence to the society, is punishable as a stranger;
- Member causing breach of any rule or regulation or bye-law of the society is liable to pay penalty under the Bye-Laws.
- Member who is guilty of misfeasance or breach of trust or misapplication of funds in relation to the society shall be accountable to make good the loss so caused to the society.

Property of Society: Where it vests?

Section 5 of the Act lays down the provisions for vesting of property of the Society. It is presumed that the property, both movable and immovable, belonging to the Society, vests in trustees. But if it is not vested in trustees, Section 6 provides that then it shall be deemed to be vested in the governing body of such Society for the time being. In all civil or criminal proceedings the property may be described as the property of the governing body of such society by their proper title.

The Act does not create in the members of the registered Society any interest other than that of the bare trustees. A property, which has vested in the trustees before registration of the Society, becomes as from, the registration of the Society, a property belonging to the Society and must be deemed to be the property of the Society. As a matter of fact there is no transfer of ownership that which belonged to a registered Society continues after the change in status of that Society on being registered, as belonging to the registered Society (AIR 1953 Cal. 140).

In the case of *Board of Trustee, Ayurvedic and Unani Tibbia College v. State of Delhi, A.I.R. 1962, SC 458*, the Board of Trustees of Tibbia College was dissolved by the Tibbia College in 1952 and the property which had vested in the Board of Trustees, passed to the newly constituted Board.

Working and Management of Society

As the society is a legal person having no physical existence, its governing body is its brain. Its activities are managed, executed and supervised by the governing body. It has to work within the objects of the society in accordance with the rules, regulations and bye-laws and to carry out the statutory duties under the main Act or the corresponding State Act. The governing body shall also be constituted in accordance with the rules and regulations of the society. The property of the society vests in the governing body and not in the members. The filing and defending the suits by the society shall continue in the original form and the changes in the governing body shall not affect.

There should be minimum three members of the governing body. Its members are either elected or nominated as per the rules and regulations of the society. The term of office of members is three years and members can enjoy two terms. However, the term, retirement, expulsion are governed by the rules and regulations of the society.

The members of the governing body are the trustees of the properties of the society. They have to look after and manage the properties of the society. Here, property means both movable and immovable property. The properties of the society vest in the trustees and when there is no trustee, in the governing body. A trustee is a man who is the owner of the property and deals with it as principal owner and master subject only to an equitable obligation to account to some person to whom he stands in relation of trust and who is *cestric que trust*.

The members of governing body is collectively responsible and accountable to comply with the statutory provisions of the Act for carrying out the functions of the society to achieve its objective(s) for which it is set up. The duties are detailed hereunder:-

1. To hold annual general meeting as per the rules and regulations of the society for laying before such meeting the statement of activities, Income & Expenditure Account and other information as provided in the rules and regulations for the purpose;
2. A list of the names, addresses and occupations of the governors, council, directors, committee or other governing body to which the management of the society is entrusted, is to be filed with the Registrar or such authority as

prescribed once in a year either within 14 days of the date of holding such meeting or in the month of January every year.

3. To hold extra-ordinary general meeting to transact some special business, which cannot be waited or delayed, till the holding of the annual general meeting. The purposes of such meeting may be to amend, alter or change in name or address or extensions of operation etc.
4. To report changes or alterations made in the managing, governing body or in the rules of the society to the Registrar.
5. To file notice of situation of the registered office of the society and of any change therein with the Registrar.
6. To register amendment in Memorandum of Association or Bye-laws with the Registrar by way of an application with a copy of the special resolution of the amendment with filing fee.
7. To supply copies of the Bye-laws, the Receipts/Incomes & Expenditure Account and Balance Sheet to the members of the society on their application with the fees, if any, prescribed by the society.
8. To invest and apply the funds and properties of the society in a manner as a prudent man will apply his own funds.
9. To keep and maintain a register of members of the society in accordance with the rules and regulations of the society.
10. To display the name of the society prominently at its registered office and other places of business.
11. To produce or submit periodical statement of Receipts Incomes & Expenditure A/c, Assets & Liabilities of the society.
12. To file a certified copy of every special resolution duly signed by an authorised officer of the society with the Registrar within the prescribed time.
13. To keep and maintain minutes of the meetings of the governing body and general body correctly and truly at the registered office of the society.
14. To retain all the important documents permanently.
15. To prepare periodical Accounts of the society and get them audited and to file Income-Tax Return, and
16. To attend all other duties as may be provided in the rules and regulations of the society.

Amendment or Alteration

The objects of a society are its constitution and the society has to act within the framework of its objects. Any act done by the society beyond the objects clause shall be *ultra vires*. Under Section 12 of the main Act, the following steps are required for alteration, extension or abridgment of the objects of a society –

1. Submission of the proposal by the governing body to the members of the society;

2. Ten days notice to members about holding of a special general meeting;
3. Convening a special meeting for consideration and passing of the proposal by 3/5th of the members;
4. Convening second special general meeting after a month; and
5. Confirmation to the proposal by 3/5th of the members present at the second special meeting.

The above procedure is also required to be followed for alteration or amendment of the Rules and Regulations or Bye-laws, change of name, and change in the registered office. Every change is required to be registered with the Registrar or the authority as prescribed as per the rules and regulations of the society.

Suits by and against Society

A Society registered under the Act is a legal entity. It is capable of suing and be sued in the name of the president, chairman or principal, secretary or trustees as determined by the rules and regulations. If there is no such prescribed determination then in the name of such person as appointed by the governing body for the occasion. If no such person is nominated by the governing body on an application made to it, then a person having a claim against society may sue the president or chairman or secretary or trustee.

No suit or proceeding in any Civil Court shall abate or discontinue if the person in whose name the suit has been brought has died or ceased to fill the character. Such suit shall be continued in the name of or against the successor of such person.

The section is merely an enabling provision and does not take away the right of society to sue or be sued in its own name (*Govind Prasad v. Laxminarain* 1960 MPLJ 145).

The provisions contained in Sections 6 and 7 are not mandatory. The words 'for the occasion' in Section 6 of the Act are significant whereas under the rules and regulations of a Society, a general authority can be conferred on the chairman, secretary or trustee for suing or being sued on behalf of the Society. But an authority given by the governing body has to be limited to the 'occasion' concerned. The object is that registered Societies should not embark upon needless and endless litigations. They must at each distinct stage of the litigation (e.g. to file a suit, to file an appeal) decide whether to pursue the matter further or not etc.

In *Sonar Bangla Bank v. Calcutta Engineering College* (1960) Cal. 409, it was held that the provisions of Section 6 are not mandatory but permissive.

Enforcement of Judgement Against Society

It is the property of the Society against whom the judgment is enforced although the judgment is named against the person or officer on behalf of the society. It will not be enforced against the person or officer or his property. The application for execution shall set forth the fact of the party against whom it shall have been recovered. Judgements recovered against the nominees of a society are enforceable against the property of the society and not against the property or bodies of those nominees.

Amalgamation or Division of the Society

Under Section 12 of the main Act, a society may be amalgamated with any other society, either wholly or partially by the governing bodies of the societies for the better utilisation of the properties, resources or any other purpose. The procedure is mandatory (*Prasanna Venkatesa Ra v. K. Srinivasa Ra* 59 MLJ 770). The following actions are to be complied with —

1. Submission of the proposal of amalgamation by the governing body to the members of the society by a printed report;
2. Holding special general meeting by giving ten days notice to the members for consideration and passing resolution for the proposed amalgamation by 3/5th majority of the members, present thereat;
3. Convening another special general meeting after a month for confirmation to the first resolution passed at the first special general meeting by 3/5th majority of the members present thereat.

The majority of a body cannot alter the fundamental principles of the body unless such power is specially reserved. The Government may order division or amalgamation of a society after giving the society an opportunity to represent against such proposal.

Dissolution of Society

Under Section 13 of the main Act, a society can be dissolved. Dissolution of a society becomes necessary where the objects for which it is formed, has been fulfilled or where the purposes for which it is formed, have become irrelevant, invalid or inoperative or by passing of a resolution by 3/5th majority of the members present at a meeting to dissolve the society for utilisation of its assets for some other better uses. A society may be dissolved forthwith or within the agreed time. The following steps are to be taken:—

1. Decision of the governing body;
2. Convene a special general meeting of the members by giving a requisite notice for consideration and passing resolution by 3/5th majority of the members present thereat;
3. Decision as to dissolve it forthwith or at a later time agreed upon by them.
4. Decision for the actions to be taken for disposal of properties and settlement of claims and liabilities as per the rules and regulations of the society; and
5. Delegate authority to the person(s) of the governing body to comply with the decisions accordingly.

Where any Government is a member of the society or has contributed the funds to the society or is otherwise interested therein, the society shall have to obtain prior consent of such Government for the purpose.

Where any dispute arises on dissolution of a society relating to adjustment of its affairs, it should be referred to the principle Court of the original civil jurisdiction of the District where the chief building of the society is situated. The District Civil Court has the jurisdiction to decide the dispute of a society.

The main Act does not provide for dissolution of societies by the Registrar. Various States, of course, have made provisions for dissolution by the Registrar under the following circumstances—

- (1) Where the office of the society has ceased to be in the State of registration, or
- (2) Where the society has shifted its office from the State of registration to some other State, or
- (3) Where the activities of the society are considered subversive, or
- (4) Where it is carrying on any unlawful activity, or
- (5) Where it has allowed any unlawful activity to be carried on within any premises under its control,
- (6) Where the registered society has contravened any of the provisions of the Act or the rules made thereunder, or
- (7) Where the registered society is insolvent or must necessarily become so, or
- (8) Where the business of such registered society is conducted fraudulently or not in accordance with the bye-laws or the objects specified in the memorandum of the society, or
- (9) Where the society contravened any provision of any other law for the time being in force, or
- (10) Where the number of members of the society is reduced below seven, or
- (11) Where the society has ceased to function for more than three years, or
- (12) Where the society is unable to pay its debts or meet its liability, or
- (13) Where the registration of the society has been cancelled on the ground that its activities or proposed activities have been or will be opposed to public policy.

The Registrar normally inquires or investigates into the activities of the society and calls upon the society to show cause why it should not be dissolved. The Registrar may move the Court for making an order for dissolution of the society, if the cause shown by the society is not satisfactory.

Similarly, the main Act does not provide for dissolution by the Court. But in some States, the Court may order for dissolution of a society on application by 10% of its members or the Registrar on having been satisfied that any one or more of the following circumstances exist:—

- (1) If there is any contravention by the society of the provisions of the Act, or
- (2) If the number of members is less than seven, or
- (3) If the society has ceased to function for more than three years, or
- (4) If the society is unable to pay its debts or meet its liabilities, or
- (5) If it is proper that the society has to be cancelled on the ground of its activities or

- (6) If proposed activities have been or will be opposed to the public policy.
- (7) If the activities of the society constitute a public nuisance,
- (8) If the activities of the society are otherwise opposed to public policy.

The Government may by written order containing detailed reasons, dissolve a society. Before passing such order an opportunity has to be given to the society for representation against dissolution. Any order of withdrawal of registration without notice or opportunity to the society for representation in the matter shall be against the rule of natural justice.

Consequences of Dissolution

Dissolution of a society results in cessation of its activities. Its liabilities are to be settled suitably and its surplus assets are to be given to another society or the Government in terms of its rules and regulations. If the rules do not provide in the matter, the governing body of the society shall take appropriate steps with requisite majority vote or as directed by the Registrar or the Court. But in no circumstances, the surplus assets of the dissolved society can be paid or distributed amongst its members or any of them.

Registrar of Societies — Powers & Duties

The main Act makes an indirect reference to the powers of the Registrar under Sections 1,2,3,4,17,18 and 19. Under the corresponding Acts of various States different powers and duties are given to the Registrar. These are —

1. Allow inspection of documents by any person and provide certified copy thereof on payment of fees as prescribed,
2. Call information, explanation or returns from the societies relating to the affairs, employees, documents filed, accounts etc,
3. Hold inquiries and settle disputes *suo moto* or at the request of the members of the governing body or other members,
4. Investigate into the affairs of the society,
5. Cancel registration on happening of certain events,
6. Refuse registration, if the name is undesirable or identical or the objects are contrary to any other law etc,
7. Order amendment of Memorandum of Association, rules and regulations, bye-laws of society,
8. Seize and take possession of the books and records, funds and property of the society,
9. Summon and enforce attendance of witness including the parties interested for giving evidence and producing documents,
10. Order for auditing of the accounts of the society,

11. Compounding offences on application with fee,
12. Settle disputes regarding election of the office bearers,
13. Restoration of the property or money of the society,
14. Removal of the defunct society from the register of societies,
15. Condonation of delay in filing of documents,
16. Appointing liquidator.

Offences and Penalties

The main Act does not provide for any offences and penalties for breach or contravention of its provisions. However, various State Governments have amended the main Act to provide for offences and penalties for non-compliance. No Court inferior to that of a Magistrate of the first class shall try any offence punishable under the main Act. No Court shall take cognizance of any offence except upon complaint made by the Registrar of Societies or any authorised person by him.

3. LAW RELATING TO TRUSTS

Introduction

The concept of 'trust' relates to the ancient times. When the properties were dedicated for charitable, pious, religious, social welfare, educational, medical purposes. Now a days, it has gained a greater significance for various tax exemptions made available to a trust which is treated as a separate legal entity.

A 'trust' is an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another or of another and the owner.

The following are the essential elements of a trust :-

1. the author or the settler of the trust;
2. the trustee;
3. the beneficiary;
4. the trust property or the subject-matter of trust
5. the object of the trust;
6. the instrument of trust.

Trust Laws in India

The Trust laws came to India via English Trust law which stipulate dual ownership of trust property i.e. legal title vests with the trustee while equitable title vests with the beneficiary. On this basis, Indian Trusts Act 1882 was enacted. It governs Private or Family Trusts and excludes Wakfs and public or private charitable or religious endowments [*Advocate General of Bombay v. Yusuf Ali* AIR 1921 Bom 328].

Hindu charitable or religious trusts are mainly governed by the provisions of

Hindu Laws which have been passed by several States under Article 25 (2) of the Constitution of India, like, The Bombay Public Trust Act, 1950, Rajasthan Public Trust Act, 1959, Madras Hindu Religious and Charitable Endowment Act, 1959 etc.

The Charitable and Religious Trust Act 1920 is only a Central Legislation which applies to all religious and charitable trusts but it does not provide any effective control over public charitable and religious trusts and endowments.

The Wakf Act 1995 regulates muslim Wakfs for public benefit. There are also several States laws for regulating the proper administration of Wakfs in India.

There are other trust laws like, Sikh Gurdwara Act, 1925 governing Sikh Gurdwaras; Indian Trustees Act, 1866 relating to conveyance and Transfer of property vested in trustees and mortgagees; Religious Endowments Act 1863 enabling the Government to divest itself of the management of religious endowments; Trustees and Mortgagees Powers Act, 1866 relating settlements, mortgages and Wills; Societies Registration Act, 1860 for registration as societies; the Companies Act, 1956 for trust registered as companies under Section 25 thereof.

Indian Trust Act

In view of a plethora of Trust laws, Indian Trust Act 1882 has been considered desirable to be discussed hereunder and for brevity it is referred hereinafter as "The Trust Act".

The Act is divided into the following parts:

- (i) preliminary;
- (ii) the creation of trusts;
- (iii) the duties and liabilities of trustees;
- (iv) their rights and powers;
- (v) their disabilities;
- (vi) the rights and liabilities of the beneficiary;
- (vii) vacating the office of trustee;
- (viii) the extinction of trusts; and
- (ix) certain obligations in the nature of trusts.

Scope

As is clear from the preamble, the Act has no application to public or private, religious or charitable endowment.

The Indian Trusts Act is exhaustive in respect of any matter specifically provided for in it, but it is not exhaustive of all matters relating to private trusts. Therefore, in cases covered by the Act, its provisions must be applied but if a case is not covered by it, the Court is entitled to apply rules of English law, as laid down by judicial decisions in that country and which are not inconsistent with the Act, as the rules of justice, equity and good conscience.

Choose the correct answer

Which of the following is not an essential element of a trust?

- (a) The trustee
- (b) The beneficiary
- (c) The name of the trust
- (d) The instrument of trust

Correct Answer: c

Definition of Trust

The Act defines the term 'trust' in Section 3 as (i) an obligation annexed to the ownership of property and (ii) arising out of confidence reposed in and (iii) accepted by the owner or declared and accepted by him, (iv) for the benefit of another or of another and the owner.

The person who reposes or declares the confidence is called the 'author of the trusts', the person who accepts the confidence is called the 'trustee', the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called 'trust property' or 'trusts money'; the 'beneficial interest' is beneficiary's right against the trustee as owner of the trust property; and the instrument declaring the trust is called the 'instrument of trust'.

The word 'trust' in its legal sense has a technical and definite meaning which is very much different from the sense in which this word is used in daily parlance. Trust connotes a legal concept or relationship similarly as other relationships created by law, e.g., Contract, Agency.

Trust and Contract

Trust in its origin was a form of contract distinctively enforced in equity. A contract creates a trust where it has brought into existence an obligation annexed to the ownership of property for the benefit of a person other than the owner. No technical words are required to create a trust.

There is always a fiduciary relationship between trustee and beneficiary, but not between the parties to a contract.

Difference Between Trust and Bailment, Trust and Agency

The definition of Bailment is given in Section 148 of the Indian Contract Act, 1872. The following is the difference between a trust and a bailment.

- (i) A trustee becomes the full owner of trust property. A bailee acquires special property only.
- (ii) The obligation of the bailee is legal, whereas that of a trustee is equitable.
- (iii) A bailment may be created for movable property only. A trust may be created for both movable and immovable properties.

Difference between Trust and Agency

- (i) An agent has no title to the property. A trustee is the full owner of the trust property.
- (ii) An agent acts on behalf of his principal and is subject to his control. A trustee acts in his own right.
- (iii) An agent is generally not personally liable, a trustee is.

Classification of Trusts

Trusts are divisible into several classes according to the mode of their creation. Some of the important classes are as follows:

Simple and Special Trusts

Where the trustee is merely to hold the estate without having any active duties to perform it is called a simple trust. Where, however, the trust has been created for a particular object or purpose there is a special trust. Thus, in a simple trust, the trustee is merely to hold the property for the benefit of the beneficiary and in a special trust, the trustee has duties to perform.

Oral and Written Trusts

A trust may be declared either orally or through an instrument in writing. However, a trust in relation of movable property can be declared orally by transferring the possession of the property with a direction that the property be held in trust. In regard to a private trust for immovable properties, a written trust deed is pre-requisite.

Charitable or Religious Trust

In order to determine whether a deed of trust is a valid public or charitable trust, it is necessary to see what is the dominant intention of the testator, namely, who are the real objects of his bequest and secondly whether the class indicated as the object of charity forms at least a section of the public. Where the main and paramount intention of the settler was to benefit the members of his family and thereafter the members of his caste who might need assistance from such funds there could be no public or charitable trust created.

It is one of the cardinal rules governing execution of charitable trusts that the intention of the donor must be observed. This principle has been evolved as an auxiliary to this rule and is never allowed to defeat it. If the charity can be administered according to the directions of the founder, the law requires that it should be so administered. The Courts will not allow any departure from them on the grounds of expediency.

Cy pres means near to it. The doctrine of *Cy pres* applies only to charitable trusts. The reason is that a public charity is perpetual and the rule against perpetuity does not apply to it. It can never die though its nature may be changed. In *Halsbury's Law of England, in 3rd Edn.* Vol. 4, P. 317, it is stated:

"Where a clear charitable intention is expressed, it will not be permitted to fail

because the mode, if specified, cannot be executed, but the law will substitute another mode *Cy pres*, that is, as near as possible to the mode specified by the 'donor'.

However, the above doctrine is subject to the doctrine of severability, i.e., the doctrine of *Cy pres*, applies if the nature of the charitable object is general and not specific.

Express and Implied Trusts

Express trusts are created by the act of parties either in words or in writing. While an implied trust is one which is deduced from the conduct of the parties and the circumstances of the transactions.

Public and Private Trusts

The criterion for deciding whether a particular trust is or is not of a private nature, is whether the said trust is or is not for the benefit of individuals. Where the intention of the founder, as shown by the recitals in his Will, was that the property was to be dedicated for the benefit of idols, the trust is undoubtedly of a public nature and not for the benefit of the individual members of family.

The essential difference between a private and a public trust is that in the former the beneficiaries are definite and ascertained individuals or individuals who within definite time can be definitely ascertained but in the latter the beneficial interest must be vested in an uncertain and fluctuating body of persons either the public at large or some considerable portion of it answering a particular description.

Revocable and Irrevocable Trusts

A revocable trust is one which is revocable when it is created by a non-testamentary instrument or orally and a power of revocation has been expressly reserved by the settler. A trust may be revoked by the consent of all the beneficiaries who are competent to contract (Section 78).

All other trusts are irrevocable. Besides if a trust is created for charitable or religious purposes, such a trust cannot be revoked.

Public-cum-Private Trust

A Public-cum-Private Trust is one in which a religious trust is created for the immovable property like a Temple, Durgah etc. in the nature of a public trust but there is a direction for use of income through offerings or otherwise for public purposes and also a part thereof to person(s) in charge of the Temple, Durgah etc. A public-cum-private trust may become a fully public trust when the private beneficiary(ies) renounces his/their rights to which they are entitled.

Constructive Trust

A constructive trust is one which is not created by the express or implied act of the settler, but which is deemed by operation of law or arises by construction of law. A constructive trust is a relationship with respect to a property subjecting the person by whom the title to the property is held by an equitable duty to convey it to another

on the ground that his acquisition or retention of the property would be wrongful and that he would be unjustly enriched if he were permitted to retain the property.

Resulting Trust

A resulting trust is one, which is implied in favour of the settler or his representative. It comes into existence where the property is incompletely conveyed or where on a conveyance, the beneficial interest in the property is not completely disposed of and the property or the undisposed beneficial interest in it reverts back to the settler. When a trust is bad as a charitable trust, a resulting trust comes into existence in favour of the settler. [*Dwarkadas Bhimji v. CIT* (1948) 16/TR 160 Bom.].

Executed and Executory Trust

An executed trust is one in which the limitation of the estate and the beneficiaries are prescribed by the settler in the trust deed itself and no further instrument is required.

An executory trust is not complete in itself and its execution is left to the judgement of the trustees. Here, the settler instead of expressing exactly what he means, tells the trustees to do their best to carry out his intentions.

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

A trust cannot be declared orally and must always be in writing

- True
- False

Correct Answer: False

Creation of Trusts

(i) Creation of Trusts for lawful purposes only

The Act allows creation of a trust for any lawful purposes. What is lawful can be gathered from the provisions of Section 4 of the Act which provides that purpose of a trust is lawful unless it is

- (a) forbidden by law, or
- (b) is of such a nature which will defeat the provisions of any law, or
- (c) is fraudulent, or
- (d) involves or implies injury to the person or property of another, or
- (e) the Court regards it as immoral or opposed to public policy.

Thus a trust which does not fall in any of the above prohibitions, is deemed to be for lawful purpose. A trust for an unlawful purpose is void. Where a trust is created for two purposes one lawful and another unlawful, and the purposes are inseparable from one another, the whole trust is void. On the other hand if one of the objects of a trust is lawful and the expenses on it are fixed, and that object is not dependent upon and is separate from the other objects, the trust to that extent will be valid.

The expression 'law' includes the law of a foreign country in which immovable property of a trust is situated.

(ii) Trust of immovable property

Section 5 of the Act lays down the formalities which are to be observed for creation of a trust. It provides that a trust of immovable property can be created by an instrument in writing and registered, signed by the author of the trust or by Will.

Trust of movable property requires no writing or registration. The mere transfer of possession coupled with the intention of the parties that such delivery of possession should vest the property in the trustee is sufficient to create a trust.

(iii) Creation of a trust

Section 6 lays down provisions for creating a trust. It provides that subject to the provisions of Section 5 a trust is created when the author of the trust indicates with reasonable certainty by any words or acts: (a) an intention on his part to create thereby a trust; (b) the purpose of the trust; (c) the beneficiary, and (d) the trust property; transfer the trust property to the trustee except where a trust is declared by Will or the author of the trust is himself to be the trustee. If a trust is to be valid and enforceable, it is material to ascertain the author of the trust. Next the intention to create a trust, the purpose of the trust, the trust-property and the beneficiaries must be indicated and in such a way that the trust could be administered by the Court if the occasion arose.

Certainties of a Trust

For creating a trust the author of the trust should indicate with reasonable certainty the following:

- (1) *Certainty in words*: The words used to create a trust must be clear and certain so as to explain a clear intention to create a trust. Recommensatory words like "I hope" "I wish" are not sufficient.
- (2) *Certainty in the object of the trust* : The beneficiary, for whose benefit the trust is created, must be shown clearly.
- (3) *Certainty in the subject-matter of the trust* : The subject matter of the trust must be clear, i.e., the property, in respect of which a trust is created, must be shown clearly. Purpose of the trust should be certain.

If the trust instrument is lacking in first and third certainties, no trust is created but if the second certainty is absent, resulting trust will be created in favour of the author of the trust.

Illustrations:

- (a) A bequeaths certain property to B, "having the fullest confidence that he will dispose of it for the benefit of C". This creates a trust so far as regards A and C. B is not bound as a trustee.
- (b) A bequeaths certain property to B, "hoping he will continue it in the family". This does not create a trust as the beneficiary is not indicated with reasonable certainty.

- (c) A bequeaths certain property to B, requesting him to distribute it amongst such members of C's family as B should think most deserving. This does not create a trust, for the beneficiaries are not indicated with reasonable certainty.
- (d) A bequeaths certain property to B desiring him to divide the bulk of it among C's children. This does not create a trust, for the trust property is not indicated with sufficient certainty.
- (e) A bequeaths a shop and stock-in-trade to B on condition that he pays A's debts and a legacy to C. This is condition, not a trust for A's creditors and C.

Who can create a Trust

A trust may be created (i) by every person competent to contract, and (ii) with the permission of a Principal Civil Court of original jurisdiction, by or on behalf of a minor (Section 7). Thus, generally any person competent to contract and competent to deal with the property can create a trust.

Who may be a Trustee

Every person capable of holding property may be a trustee. But if the trust involves the exercise of discretion, he cannot execute it unless he is competent to contract (Section 10).

No one is bound to accept a trust. Acceptance of the trust by a trustee may be express or implied.

Illustrations:

- (a) A bequeaths certain property to B and C, his executors as trustees for D. B and C prove A's will. This is in itself an acceptance of the trust, and B and C hold the property in trust for D.
- (b) A transfers certain property to B in trust to sell it, and to pay out of the proceeds, A's debts. B accepts the trust and sell the property. So far as regards B, a trust proceed is created for A's creditors.
- (c) A bequeaths, a lakh of rupees to B upon certain trusts, and appoints him his executor. B serves the lakh of rupees from the general assets, and appropriates it to the specific purpose.

This is an acceptance of the trust.

Duties of Trustee

Sections 11 to 22 of the Act deal with the duties of trustee. They are as under:

- (1) The Trustee should execute the trust and obey the directions given in the instrument of the trust. He can make any alteration in those directions only with the consent of beneficiaries who are competent to contract. If a beneficiary is incompetent to enter into a contract, the Principal Civil Court of original jurisdiction may give consent on behalf of the minor.

Illustrations:

- (a) A, a trustee, is simply authorised to sell certain land by public auction. He cannot sell the land by private contract.

- (b) A, a trustee of certain land for X, Y and Z, is authorized to sell the land to B for a specified sum. X, Y and Z, competent to contract, consent that A may sell the land to C for a lesser sum. A may sell the land accordingly.
 - (c) A, a trustee, for B and her children, is directed by the author of the trust to lend, on B's request, trust property to B's husband, C on the security of his bond. C becomes insolvent and B requests A to make the loan. A may refuse to make it.
- (2) It is a duty of a trustee to acquaint himself with the nature of the trust property.
 - (3) The trustee must protect and preserve the trust property.

Illustration:

The trust property is immovable property which has been given to the author of the trust by an unregistered instrument. The trustee's duty is to cause the instrument to be registered.

- (4) The trustee must not set up a title to the trust property, which is adverse to the interest of the beneficiary. Nor should he allow any person to do so.
- (5) He must deal with the trust property in such a manner as a man of ordinary prudence would deal with such property as if it were his own.

Illustration:

- (a) A, a trustee for B, in execution of trust sells trust property but for want of due diligence on his part, fails to receive part of the purchase money. A is bound to make good the loss.
 - (b) A, trustee for B, allows the trust to be executed solely by his co-trustee C. C misapplies the trust property. A is personally answerable for the loss resulting to B.
- (6) If a trust is created in favour of several persons in succession and the trust property is of wasting nature or consists of a future or reversionary interest, the trustee is bound to convert it into property of permanent nature. However, this is subject to any contrary intention which could be inferred from the trust instrument.

Illustration:

A bequeaths to B all his property on trust for C during his life, and on his death for D, on D's death for E. A's property consists of three leasehold houses and there is nothing in A's will to show that he intended the houses to be enjoyed in *specie*. B should sell the houses and invest the proceed in trust securities as per Section 20.

- (7) The trustee must act impartially where there are more than one beneficiary.
- (8) Where the trust is created for the benefit of several persons in succession and one of them is in possession of the trust property, if that person commits any act destructive or injurious to the trust property, the trustee must take the steps to prevent it.

- (9) The trustee must keep an accurate account of the trust property. At the request of the beneficiary he must furnish him the account and the state of trust property.
- (10) The trustee must invest the trust property and funds in the securities mentioned in Section 20 of the Act. This is subject to any contrary directions in the trust instrument.
- (11) The trustee must sell the trust property within the specified or extended time without prejudice to the beneficiary or as authorized by the Court.

Liabilities of Trustees

1. **Liability for a breach of Trust:** If a trustee commits a breach of the trust, he is liable to make good the loss which the trust property of the beneficiary has suffered. However, in two cases he is not liable for such a loss. (i) Where the breach of the trust has resulted due to any fraud committed by the beneficiary; and (ii) Where the beneficiary, being competent to contract, has given his consent for that breach without any coercion or undue influence or subsequently acquiesced therein, with full knowledge of the facts (Section 23).

Illustration:

- (a) A trustee improperly leaves trust property outstanding, and if it is consequently lost he is liable to make good the property lost, but he is not liable to pay interest thereon.
 - (b) A trustee is guilty of unreasonable delay in investing trust money in accordance with Section 20, or in paying it to the beneficiary. The trustee is liable to pay interest thereon for the period of the delay.
 - (c) The instrument of trust directs the trustee to invest trust money either in any of such securities or on mortgage of immovable property. The trustee does neither. He is liable for the principal money and interest.
 - (d) The trust property consists of land. The trustee sells the land to a purchaser for a consideration without notice of the trust. The trustee is liable at the option of the beneficiary, to purchase other land of equal value to be settled upon the like trust, or to be charged with the proceeds of the sale with interest.
2. **No right of set-off:** A trustee who is liable for a loss because of a breach of trust committed by him in respect of one portion of the trust property is not allowed to set-off against his liability, a gain which he has accrued to another portion of the trust property through another and distinct breach of the trust property (Section 24).
 3. A trustee is not liable for the acts and defaults of his predecessor.
 4. Generally a trustee is not liable for a breach of the trust committed by his co-trustee. However, such a trustee will be liable in the following cases:
 - (i) Where he delivers his trust property to his co-trustee without seeing to its proper application;

- (ii) Where he allows his co-trustee to receive the trust property and fails to make due inquiries about his co-trustee's dealing therewith; and
- (iii) Where after he comes to know of the breach of the trust committed by his co-trustee, he either actively conceals it or does not take proper steps to protect the interest of the beneficiary.

However, a co-trustee who joins in signing a receipt for the trust property for sake of conformity without actually receiving it shall not be liable merely by reason of his signature only.

A trustee is liable for money and property actually received by him.

5. *Nature of liability of a co-trustee* : When co-trustees jointly commit a breach of trust, and when one of them, by his negligence, enables another trustee to commit a breach of trust, each trustee is liable to the beneficiary for the whole loss sustained by the beneficiary.
6. Under Section 23 of the Act, in certain circumstances, a trustee is liable to pay simple or compound interest to the beneficiary.

Rights, Powers and Disabilities of Trustees

The rights, powers and disabilities of a trustee are discussed in Chapter IV of the Act. The important *rights* are as under:

1. The right to have the possession of the instrument of trust and the title-deed relating to the trust property.
2. The right to reimburse himself of all costs, expenses and liabilities incurred in administration of the trust.
3. In case of a breach of the trust, the person who derives any benefit out of such a breach, must indemnify, the trustee to the extent of the amount actually received by him.
4. A trustee has a right to take opinion, advice or direction from the Court on questions relating to the management and administration of the trust.
5. When a trustee, properly completes his duties, he is entitled to get a discharge to the effect in writing.
6. A trustee has a general right to do all necessary acts (i) for preservation and protection of the trust property, and (ii) to protect the interest of a beneficiary who is not competent to contract but he cannot give on lease any trust property for more than twenty-one years without the permission of a Court.

Powers of Trustee

1. He can sell the trust property where instrument of the trust so empowers him.
2. A trustee has a power to vary investments.
3. A trustee has a power to apply the trust property for the maintenance of property as provided in the instrument of trust.
4. A trustee can compromise claims unless a contrary intention appears from the instrument of the trust.

5. A trustee can give receipt for the money received on account of the trust.
6. In case of death of one of the trustees, the other trustees have a right to act, unless contrary intention appears from the instrument of the trust.

Disabilities of Trustees (Chapter V)

1. A trustee who once accepted the trust, cannot renounce it except:
 - (i) with the permission of the Court,
 - (ii) with the consent of the beneficiaries who are competent to contract,
 - (iii) by virtue of a special power in the instrument of the trust.
2. A trustee cannot delegate his office or any of his duties either to a co-trustee or to a stranger, except in the following cases:
 - (1) When the instrument of the trust so provides,
 - (2) When such a delegation is in the regular course of business,
 - (3) When such a delegation is necessary, and
 - (4) The beneficiary, being competent to contract, consents to such a delegation.

Illustrations:

- (a) A bequeaths certain property to B and C on certain trust to be executed by them or the survivor of them or the assigns of such survivor, B dies. C may bequeath the trust property to D and E upon the trusts of A's will.
 - (b) A is a trustee of certain property with power to sell the same. A may employ an auctioneer to effect the sale.
 - (c) A bequeaths to B fifty houses let at monthly rents in trust to collect the rents and pay them to C. B may employ a proper person to collect these rents.
3. Where there are more trustees than one, all must join in the execution of the trust unless the trust instrument or any law for the time being in force provides otherwise.
 4. The trustees cannot exercise their discretionary powers arbitrarily.
 5. In the absence of express direction to the contrary contained in the instrument of trust or of a contract entered into with the beneficiary or of the sanction of the Court, the trustee has no right to remuneration.
 6. A trustee may not use or deal with the trust property for his own use.
 7. No trustee whose duty is to sell the trust property may directly or indirectly buy the trust property.
 8. No trustee and no person who has recently ceased to be a trustee may, without the permission of the Court, buy, or become mortgagee or lessee of the trust property.
 9. The trustee and the co-trustee may not lend the trust amount to themselves.

Vacating the office of trusteeship

The office of a trustee is vacated on his death or by his discharge. He may be

discharged from his office by the extinction of the trust or by the completion of his duties or by new appointee etc.

Meaning of a Beneficiary

The person or persons for whose benefit, a trust has been created, is called the beneficiary or beneficiaries. While the trustees hold the legal title in trust property, the beneficiary holds the beneficial interest in that property.

Who may be a beneficiary

A beneficiary may be any person, so specified by the author of the trust, a beneficiary may be a near or distant relative of the author or a person not related to the author at all or general public or a class thereof. A minor, woman and even an unborn person can be a beneficiary. In case of a charitable or religious trust, there need not be a specific beneficiary; the beneficiary thereunder is the object or the purpose of the trust.

If the beneficiaries under a trust are not specified and they are not capable of being ascertained, no trust can come into existence [*Allahabad Bank v. CIT AIR 1953 476*].

A beneficiary may renounce his interest under the trust by (i) a disclaimer addressed to the trustee or (ii) by setting up a claim inconsistent with the trust. On the disclaimer by a beneficiary and the trust deed does not provide for such disclaimer, the trust would revert to the author or settler as a resulting trust.

Choose the correct answer

Which of the following persons can be a beneficiary?

- (a) A minor
- (b) A woman
- (c) An unborn person
- (d) All of the above

Correct Answer: d

Doctrine of Cypres

Where the object of the charitable trust, specified by the settler, is or subsequently becomes impossible or impracticable or unlawful, the trust will not necessarily fail, but the Court has power to apply the trust to some other charitable object as nearly as possible resembling the intention of the author. This power of the Court is known as "doctrine of cypres". When a particular mode of charity indicated by the author is not capable of being carried out, yet a general intention of charity, is indicated by the author of the trust, the Court would execute it 'cypres' i.e. in a way as nearly as possible to that which testator specified.

Rights and Liabilities of Beneficiaries (Chapter VI)

Important rights of the beneficiary of the trust are:

1. Right to rents and profits of the trust-property;
2. Right to the specific execution of the trust;

3. Right to inspect and take copies of the instrument of trust;
4. Right to transfer the beneficial interest, if he is competent to contract;
5. Right to sue for execution of trust;
6. Right to proper trustees; and proper number of trustees;
7. A beneficiary has a right to follow the trust property in the hands of a third person. Even where a trustee disposes of the trust property and acquires some other property with the help of the disposal money, the beneficiary is entitled to have the latter property, the same rights or as nearly as possible the same rights, he had over the trust property.

Illustrations:

- (a) A, a trustee for B wrongfully invests ₹ 10,000 in the purchase of certain land, B is entitled to the land.
 - (b) A, a trustee, wrongfully purchases land in his own name, partly with his own money, partly with money subject to a trust for B. B is entitled to a charge on the land for the amount of the trust money so misemployed.
8. Right to compel to any act of duty.

Liabilities:

If a beneficiary commits a breach of trust or obtains any advantage, the other beneficiaries may attach the interest of such a beneficiary until the loss caused by the breach has been compensated.

Extinction of a Trust (Section 77)

A trust is extinguished:

- (a) When its purpose is completely fulfilled; or
- (b) When its purpose becomes unlawful; or
- (c) When the fulfillment of its purpose becomes impossible by destruction of the trust property or otherwise; or
- (d) When the trust being revocable, is revoked.

Revocation of a Trust (Section 78)

If a trust is created by a Will, it may be revoked by the revocation of the Will. A trust which has been created otherwise, by an instrument other than a Will or orally, can be revoked only:

- (a) with the consent of all the beneficiaries competent to contract;
- (b) by the exercise of power of revocation expressly reserved by the author of the trust (in cases of trusts declared orally or by non-testamentary instruments); or
- (c) where the trust is created for the payment of debts of the author of the trust, and has not been communicated to the creditors, at the pleasure of the author of the trust.

A conveys property to B in trust to sell the same, and pays out of the proceeds

the claims of A's creditors. A reserves no power of revocation. If no communication has been made to the creditor. A may revoke the trust. But if the creditors are parties to the agreement, the trust cannot be revoked without their consent.

A trust is generally irrevocable unless a power of revocation is expressly reserved.

Certain Obligations in the Nature of Trust

Chapter IX of the Act deals with resulting and constructive trust under the heading "Of certain obligations in the nature of a trust". Here the intention to create a trust is not expressed but is implied and presumed. Following are the instances of such resulting and constructive trusts:

(i) Transfers not intended to dispose of Beneficial Interest

Where the owner of the property transfers or bequeaths it and it cannot be inferred consistently with the attended circumstances that he intended to dispose of beneficial interest therein, the transferee or legatee, must hold the property for the benefits of the owner or his legal representative (Section 81) [Note : However this Section has been omitted by the Benami Transactions (Prohibitions) Act, 1988 w.e.f. 19.5.1988].

Illustrations:

- (a) A transfers certain property to B without consideration and he does not make any declaration of a trust about it. The attending circumstances do not warrant an intention to transfer. Here B must hold the property in trust for A.
- (b) A conveys to B two fields Y and Z and declares a trust of Y, but says nothing about Z. It cannot, consistently with the circumstances under which the transfer is made, be inferred that A intended to transfer the beneficial interest in Z. B holds Z for the benefit of A.
- (c) A makes a gift of certain land to his wife B. She takes the beneficial interest in the land free from any trust in favour of A for it may be inferred from the circumstances that the gift was for B's benefit.

(ii) Purchases in the Name of Third Persons

Where property is transferred to one person for a consideration paid or provided by another person, and it appears that such person did not intend to pay or provide such consideration for the benefit of the transferee, the transferee must hold the property for the benefit of the person paying or providing consideration (Section 82).

[Note : However this Section has been omitted by the Benami Transactions (Prohibition) Act, 1988 w.e.f. 19.5.1988].

(iii) Imperfect Dispositions

Where a trust is incapable of being executed or where it has been executed without exhausting the whole of the trust property, the trustee must hold the trust property or the remaining trust property for the benefit of the author of the trust or his legal representatives. This is subject to contrary direction in the trust instrument.

(iv) Transfer for Illegal Purposes

Where a property is transferred for an illegal purpose and that purpose is not carried out or the transferor is not as guilty as the transferee or the effect of permitting the transferee to retain the property would be to defeat the provision of any law, the transferee must hold the property for the benefit of the transferor (Section 84).

Section 85 lays down a similar provision in respect of bequests for illegal purpose.

Under Section 86, if a property is transferred in pursuance of a rescindable contract, the transferee must hold the property for the benefit of the transferor, on receiving the notice to that effect.

(v) Constructive Trusts

According to Section 88, if a person obtains advantage because of his fiduciary character, like a trustee, executor, partner, agent, director of a company, he must hold that advantage for the benefit of the person, at whose expenses such an advantage has been obtained. There is a similar provision in respect of an advantage gained by the exercise of undue influence.

If a trustee, uses the trust property in his own business and derives any profit out of it, he must hold that profit in trust for the beneficiary.

(vi) Advantage Gained by Exercise of undue Influence

Whereby the exercise of undue influence, any advantage is gained in derogation of the interest of another, the person gaining such advantage without consideration, or with notice that such influence has been exercised, must hold the advantage for the benefit of the person whose interest have been prejudiced.

(vii) Advantage obtained by a Qualified Owner

Where a qualified owner of the property like a tenant for life, co-owner or mortgagee, obtains an advantage in derogation of the rights of other persons interested in the property, he must hold the advantage so gained for the benefit of all the persons so interested.

In case of land belonging to a Joint Hindu family, if one of the co-parcners by paying the Government revenue, procures his name entered as the owner of that land, he must hold that land for the benefit of the Joint Hindu family.

Properties acquired with notice of existing contract:

Where a person acquires property with notice of the contract existing in favour of another person, which is specifically enforceable, the former must hold the property for the benefit of latter to give effect to the contract.

Illustrations:

- (a) A enters into a contract in favour of land with B, C with notice of the contract in favour of A, purchases that property. C must hold it for the benefit of A to give effect to the contract.

If one of the compounding creditors obtains an undue advantage for himself he must hold it for the benefit of his co-creditors.

However, it must be noted that these obligations in the nature of a trust do not impair or effect the rights of a *bona fide* purchaser for value without notice.

- (b) A, the tenant for life of leasehold property, renews the lease in his own name and for his own benefit. A holds the renewed lease for the benefit of all those interested in the old lease.
- (c) A mortgages land to B, who enters into possession. B allows the Government revenue to fall into arrear with a view to the land being put up for sale and his becoming himself the purchaser of it. The land is accordingly sold to B. Subject to the repayment of the amount due on the mortgage and of his expenses properly incurred as mortgagee. B holds the land for the benefit of A.

Express and Constructive Trusts

For the purposes of the Act, the trust is confined to trusts created by act of parties in accordance with the provisions of Sections 5 and 6. It may be by express words or by inference from the conduct of parties and the circumstances of a particular case. But, where no trust has been created by an author of the trust either by express terms or by implications but the facts and circumstances are such that the law infers that there is a trust, which is called the Constructive Trust. The Act contemplates two categories:

- (a) trust strictly so called falling within the definition in Section 3 whether arising by express intention or arising by implication of fact,
- (b) obligations which are not strictly trusts but in the nature of a trust arising by operation of law which fall within the provisions of Chapter IX of the Act.

The trust arising by operation of law:

- (a) **Resulting Trusts** : These are inferred by the Court and rest upon the presumed intention of the parties, for example: a owner transfers the property without intending to dispose of the beneficial interest. A transfers his property to B without any consideration. At that time A is pressed by creditors. A satisfies his creditors afterwards and asks P to re-transfer the property to him. It may be reasonably inferred that A wanted B merely to hold the property for A's own benefit. So resulting trust arises in favour of A.
- (b) **Constructive Trusts** : This is a trust imposed by the law without having regard to the intention of the parties, for example, when a trustee, agent, executor, partner, director of a company, legal adviser or other person bound in a fiduciary character to protect the interests of another, gains some pecuniary advantage for himself by availing himself of that character, he should hold the advantage so gained for the benefit of such other person. A, a partner, negotiating a transaction on behalf of the firm, clandestinely stipulates with the party with whom he is negotiating for payment to himself of a lakh of rupees. He should hold the amount for the benefit of the

partnership. Suppose A, a trustee, is holding a leasehold interest on behalf of the beneficiary. The lease expires. The lessor refuses to renew the lease. The trustee offers to take lease in his own individual capacity. Then the lease is executed in favour of A. The leasehold interest endures to the benefit of the beneficiary. A continues only to be a trustee.

ANNEXURES

SCHEDULE II

[Section 3(r) and 116]

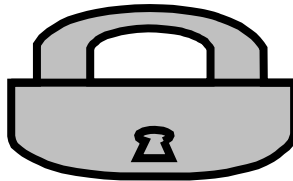
LIST OF NATIONAL CO-OPERATIVE SOCIETIES

1. National Co-operative Land Development Banks Federation Limited, Mumbai.
2. National Federation of State Co-operative Banks Limited, Mumbai.
3. National Co-operative Union of India Limited, New Delhi.
4. National Agricultural Co-operative Marketing Federation of India Limited, New Delhi.
5. National Co-operative Consumers' Federation of India Limited, New Delhi.
6. National Federation of Co-operative Sugar Factories Limited, New Delhi.
7. National Federation of Industrial Co-operatives Limited, New Delhi.
8. National Co-operative Housing Federation Limited, New Delhi.
9. Indian Farmers' Fertilizer Co-operative Limited, New Delhi.
10. All India Federation of Co-operative Spinning Mills Limited, Mumbai.
11. All India Industrial Co-operative Banks Federation Limited, Bangalore.
12. National Co-operative Dairy Federation of India Limited, Anand.
13. Petrofils Co-operative Limited, Vadodara.
14. National Heavy Engineering Co-operative Limited, Pune.
15. All India Handloom Fabrics Marketing Co-operative Society Limited, New Delhi.
16. National Federation of Urban Co-operative Banks and Credit Societies Limited, New Delhi.
17. Krishak Bharati Co-operative Limited, New Delhi.
18. National Federation of Fishermen's Co-operative Limited, New Delhi.
19. National Federation of Labour Co-operative Limited, New Delhi.
20. National Co-operative Tobacco Growers' Federation, Anand.
21. Tribal Co-operative Marketing Development Federation of India Limited, New Delhi.

LESSON ROUND-UP

The lesson broadly contains following issues and matters relating to societies and Trusts:

- Law relating to Co-operative Societies.
- Principles and objectives of Co-operative Societies.
- Registration aspects of Co-operative Societies.
- Functions and Role of members in the Co-operative Societies.
- Management of Co-operative Societies.
- Amalgamation and Dissolution of society.
- Registrar of Societies.
- Trust Laws in India.
- Trust and its classifications.
- Role and Duties of Trustees/Beneficiaries.
- Doctrine of Cypess.
- Certain obligations in the nature of trust.

SELF-TEST QUESTIONS**Law Relating to Co-operative Societies**

1. Who can become member of a Multi-State Co-operative Society?
2. What are the matters which are to be discussed in the Annual General Meeting of a Multi-State Co-operative society?
3. Explain the procedure relating to election of Board members.
4. Under what circumstances a Multi-State Co-operative Society may be wound-up?
5. What are powers and functions of Board of directors?

Law Relating to Societies

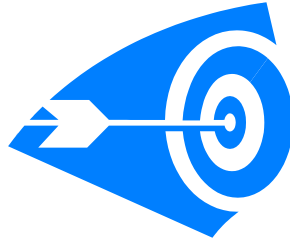
1. Discuss the status of a Society registered under the Act.
2. Briefly explain the procedure for formation and registration of Societies.
3. Who is a member of society?
4. What are the powers of a Society? How its' property vests?
5. Discuss briefly the dissolution of a Society.
6. Discuss the powers of a Society to alter its purposes.

Law Relating to Trusts

1. Define a 'trust'. Distinguish a trust from a contract.
 2. How a trust is created and by whom it is created?
 3. Briefly discuss the provisions relating to rights and duties of trustees.
 4. Who is a beneficiary? What are his rights and liabilities?
 5. Write short notes on
 - (i) Extinction of a trust
 - (ii) Revocation of a trust
 - (iii) Constructive trust
 - (iv) Doctrine of *Cy Pres.*
 6. Discuss the certainties of a trust.
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STUDY XXX
PRODUCER COMPANIES

LEARNING OBJECTIVES



This lesson explains the concept of Producer Companies introduced by the Companies (Amendment) Act, 2002. The newly inserted provision not only provides an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. The lesson also describes the provisions which enable the conversion of an existing co-operative society into a company as also the incorporation of a Producer Company. It also gives the provisions relating to membership, management, meetings, share capital etc. of Producer Companies.

At the end of the lesson, you should be able to understand in respect of the Producer Company:

- Its concept along with its objects, formation and registration.
- Membership and voting rights of members.
- Memorandum of Association, Articles of Association and their content.
- Conversion of inter-state co-operative society into Producer Company.
- Appointment of directors, vacation of office, liability of directors, their committee.
- Powers and functions of the board, meetings of the board and quorum.
- Chief executive and his functions.
- Secretary of Producer Company.
- Annual general meetings.
- Share capital, transferability of shares and surrender, issue of bonus shares.
- Amalgamation, merger or division to form new Producer Companies.
- Disputes and striking off name..

1. GENESIS

The Companies (Amendment) Act, 2002 *vide Notification No. S.O. 135(E) dated 5.02.02* has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies. Rural producers have been at a potential disadvantage given their generally limited assets, resources, education and access to advanced technology. In the present scenario, there is an emerging need of

changing the terms of trade between rural and urban, labour and industry, finance and commerce. Therefore, if cooperative enterprises are to continue to serve rural producers, they require an alternative to the institutional form presently available under law. The Companies (Amendment) Act, 2002 is a step in this direction.

The newly inserted provision, by virtue of Companies (Amendment) Act, 2002 not only provides an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. The conversion to producer companies will enable them to invite greater investments and modernize themselves. They can take advantage of the provisions to reinvent themselves, and function more efficiently. Accordingly, it is specified that a 'producer' shall mean any person engaged in any activity connected with or relatable to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.

The Amendment Act also includes the insertion of the provisions which enables the conversion of an existing co-operative society into a company as also the incorporation of a Producer Company. This part contains specific provisions relating to incorporation, management, meetings, share capital etc. of Producer Companies.

2. OBJECTS OF PRODUCER COMPANY

A Producer company means a body corporate, having objects or activities specified in Section 581B and registered as Producer Company. Hence, the objectives for which Producer Companies may be formed are laid down in Section 581B. These include *inter alia*, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/ consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.

However, in terms of Section 581B of the Companies Act, 1956, the objects of the Producer company shall relate to all or any of the following matters, namely:

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import of goods or services for their benefit:

Provided that the Producer company may carry on any of the activities specified in this clause either by itself or through other institution;

- (b) processing including preserving, drying, distilling, brewing, vinting canning and packaging of produce of its Members;
- (c) manufacture, sale or supply of machinery, equipment or consumables mainly to its Members;
- (d) providing education on the mutual assistance principles to its Members and others;

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

Every Producer Company shall deal primarily with the produce of its active members for carrying out any of its specified objects. This means there is an obligation on the producer company to deal primarily with the active members in conducting its activities. The expression 'active member' has been defined in Clause (a) of Section 581A to mean a member who fulfils the quantum and period of patronage of the producer company as may be required by the articles of the producer company. The patronage means the use of services offered by the Producer Company to its members by participation in its business activities.

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

There is an obligation on the Producer Company to deal primarily with the produce of its active members in carrying out its specified objects.

- True
- False

Correct answer: True

3. FORMATION OF PRODUCER COMPANY AND ITS REGISTRATION

Section 581C of the Act provides that, any ten or more individuals, each of them being a producer or two or more producer institutions or a combination of ten or more individuals and producer institutions, desirous of forming a producer company may form an incorporated company as such having its objects, specified in Section 581B as producer company under this Act after complying with the requirements and the provisions of the Act in respect of registration. 'Producer institution' means a Producer Company or any other institution having only producer or producers or Producer Company or Producer Companies as its member whether incorporated or not, having any of the objects referred to in Section 581B and which agrees to make use of the services of the Producer Company or Producer Companies as provided in its articles.

The Registrar on being satisfied that all requirements relating to registration and incidental matters have been complied with, shall register the memorandum, articles and other documents and issue a certificate of incorporation within 30 days of the receipt of the documents for registration. On registration, the Producer Company shall be deemed to be a private company limited by shares without any limit on the number of members.

The direct costs associated with the promotion and registration of the company may be reimbursed by the Producer Company.

4. MEMBERSHIP AND VOTING RIGHTS OF MEMBERS OF PRODUCER COMPANY

Section 581D of the Act provides that unless the membership of the Producer Company consists of a Producer institution only, every member shall have a single vote irrespective of the number of shares held. In case, where the membership consists solely of Producer Institutions, the voting rights of such Producer institutions shall be determined on their previous year's participation in the business of the company. However, during the first year of its regulation, the voting rights in a Producer Company shall be determined on the basis of shareholding by producer institutions.

Where the membership of Producer Company consists of a combination of individuals and Producer Institutions, every member shall exercise a single vote. The Articles may however, authorize the Producer Company to restrict the voting rights to active members only.

No person, who has any business interest which conflicts with the business of Producer Company, shall become a member of that Producer Company and if subsequently a member acquires any business interest which is in conflict with the business of the Producer Company, he shall cease to be a member.

5. BENEFITS TO MEMBERS

Section 581E states that, initially every member shall receive only such value of the produce or products pooled and supplied as is determined by the Board of Producer Company and the withheld price may be disbursed later in cash or in kind or by allotment of equity shares. Every such member shall be entitled to receive a limited return and may be allotted bonus shares. 'Withheld price' for this purpose means part of the price due and payable for goods supplied by any member to the Producer Company, and as withheld by the Producer Company for payment on a subsequent date.

Patronage bonus may be disbursed proportionately, if any, surplus remains after making provision for limited return and reserves. Patronage bonus refers to the payment by Producer Company out of its surplus income to the members in proportion to their respective patronage.

The approval of Board of directors is necessary for disbursing 'withheld price' whereas for disbursing the 'patronage bonus', either in cash or by way of allotment of equity shares or both, the approval of members at the general meeting is required.

6. MEMORANDUM OF ASSOCIATION, ARTICLES OF ASSOCIATION

The Memorandum of Association and the Articles of Association of the Producer Company, duly signed by the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.

The Memorandum and Articles shall contain the disclosures as provided under the provisions of Sections 581F and 581G respectively and are as under:

Contents of Memorandum of Producer Company

In terms of the provisions of Section 581F, the Memorandum of Association of every Producer Company shall state the following:

- (a) the name of the company with "Producer Company Limited" as the last words of the name of such Company;
- (b) the State in which the registered office of the Producer Company is to situate;
- (c) the main objects of the Producer Company shall be one or more of the objects specified in Section 581B;
- (d) the names and addresses of the persons who have subscribed to the memorandum;
- (e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount;
- (f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with Sub-section (2) of Section 581J;
- (g) that the liability of its members is limited;
- (h) opposite to the subscriber's name the number of shares each subscriber takes:
 Provided that no subscriber shall take less than one share;
- (i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

Contents of Articles of Association of Producer Company

The contents, as per Section 581G, of the Articles of a Producer Company shall contain Mutual Assistance Principles and other provisions, which are as under:

Mutual Assistance Principles

The articles shall contain the following mutual assistance principles, namely:

- (a) the membership shall be voluntary and available to all eligible persons who, can participate or avail of the facilities or services of the Producer Company, and are willing to accept the duties of membership;
- (b) each Member shall, save as otherwise provided in Part IX of the Act, have only a single vote irrespective of the shareholding;

- (c) the Producer Company shall be administered by a Board consisting of persons elected or appointed as directors in the manner consistent with the provisions of this Part and the Board shall be accountable to the Members;
- (d) save as provided in this Part, there shall be limited return on share capital;
- (e) the surplus arising out of the operations of the Producer Company shall be distributed in an equitable manner by:
 - (i) providing for the development of the business of the Producer Company;
 - (ii) providing for common facilities; and
 - (iii) distributing amongst the Members, as may be admissible in proportion to their respective participation in the business;
- (f) provision shall be made for the education of Members, employees and others, on the principles of mutuality and techniques of mutual assistance;
- (g) the Producer Company shall actively co-operate with other Producer Companies (and other organisations following similar principles) at local, national or international level so as to best serve the interest of their Members and the communities it purports to serve.

Other Provisions or Contents of Articles of Producer Company

The Articles shall also contain the following provisions, namely:

- (a) the qualifications for membership, the conditions for continuance or cancellation of membership and the terms, conditions and procedure for transfer of shares;
- (b) the manner of ascertaining the patronage and voting right based on patronage;
- (c) subject to the provisions contained in Sub-section (1) of Section 581N, the manner of constitution of the Board, its powers and duties, the minimum and maximum number of directors, manner of election and appointment of directors and retirement by rotation, qualifications for being elected or continuance as such and the terms of office of the said directors, their powers and duties, conditions for election or co-option of directors, method of removal of directors and the filling up of vacancies on the Board, and the manner and the terms of appointment of the Chief Executive;
- (d) the election of the Chairman, term of office of directors and the Chairman, manner of voting at the general or special meetings of Members, procedure for voting by directors at meetings of the Board, powers of the Chairman and the circumstances under which the Chairman may exercise a casting vote;
- (e) the circumstances under which, and the manner in which, the withheld price is to be determined and distributed;
- (f) the manner of disbursement of patronage bonus in cash or by issue of equity shares, or both;
- (g) the contribution to be shared and related matters referred to in Section 581Z(1)(2);

- (h) the matters relating to issue of bonus shares out of general reserves as set out in Section 581ZJ;
- (i) the basis and manner of allotment of equity shares of the Producer Company in lieu of the whole or part of the sale proceeds of produce or products supplied by the Members;
- (j) the amount of reserves, sources from which funds may be raised, limitation on raising of funds, restriction on the use of such funds and the extent of debt that may be contracted and the conditions thereof;
- (k) the credit, loans or advances which may be granted to a Member and the conditions for the grant of the same;
- (l) the right of any Member to obtain information relating to general business of the company;
- (m) the basis and manner of distribution and disposal of funds available after meeting liabilities in the event of dissolution or liquidation of the Producer Company;
- (n) the authorisation for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith;
- (o) laying of the memorandum and articles of the Producer Company before a special general meeting to be held within ninety days of its registration;
- (p) any other provision, which the Members may, by special resolution recommend to be included in articles.

Amendment to Memorandum and Articles

Amendment in the provisions/clauses of the Memorandum can be done by way of passing a Special Resolution as per Section 581H, whereas, the amendment in the Articles is required to be proposed by not less than two-third of the elected directors or by not less than one-third of the members and adopted by passing a Special Resolution in the general meeting under Section 581-I.

A copy of the amended Memorandum or Articles along with a duly certified copy of Special Resolution thereof are to be filed with the Registrar of Companies within thirty days from the date of its adoption at the general meeting.

7. OPTION TO INTER-STATE CO-OPERATIVE SOCIETIES TO BECOME PRODUCER COMPANIES

An 'Inter-State Co-operative Society' means a Multi-State Co-operative Society as defined in Section 3(p) of Multi-State Co-operative Societies Act, 2002 and includes any co-operative society registered under any other law in force and which has after its formation, extended any of its objects to more than one State.

Section 581J provides that any Inter-State Co-operative Society whose objects are not confined to one state may submit an application together with the prescribed documents to the Registrar for registration as Producer Company. The Registrar on being satisfied, that all the requirements relating to registration have been complied with, shall within 30 days of receipt of the application, issue a certificate of incorporation and the words "Producer Company Limited" shall form part of its name to explain its identity.

Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith following enclosures and documents:

1. a copy of the Special Resolution passed with 2/3rd majority of the members;
2. a statement showing names, addresses and occupation of the directors and the chief executive;
3. a list of the members;
4. a statement indicating that the Inter-State Cooperative Society is engaged in any one or more of the objects specified in Section 581-B;
5. a declaration by two or more directors certifying that the particulars given as per Para (1) to (4) above are correct.

Upon registration as a producer company, the ROCs who registers the company shall immediately intimate the Registrar with whom the Inter-State Cooperative Society was earlier registered, for appropriate deletion of the society from its register.

The 'Inter-State Co-operative Society' shall, upon registration stand transformed into a Producer Company, and shall be governed by the provisions of Part IX-A of the Companies Act, 1956.

8. VESTING OF UNDERTAKING IN PRODUCER COMPANY

Section 581L provides that all properties, assets, movable or immovable, and all rights, debts, liabilities, interests, privileges and obligations of the Inter-State Co-operative Society shall vest in the Producer Company with effect from the transformation/registration date.

Similarly all sums of money due to Inter-State Co-operative Society immediately before the transformation date, shall be deemed to be the dues due to the Producer Company. Every organisation managed by the erstwhile co-operative society, shall henceforth, be managed by the so incorporated Producer Company.

Every organisation getting financial, managerial or technical assistance from the Inter-State Co-operative Society before the 'transformation date', may continue to get such assistance by the Producer Company.

Any pending suit, arbitration, appeal or other legal proceeding, of whatever nature, by or against, the Inter-State Co-operative Society on transformation date may be continued, prosecuted and enforced by or against the Producer Company.

9. CONCESSION, ETC. TO BE DEEMED TO HAVE BEEN GRANTED TO PRODUCER COMPANY

All fiscal and other concessions, licences, benefits, privileges and exemptions granted to the Inter-State Co-operative Society in connection with its affairs and business of the Inter-State Cooperative Society under any law for the time being in force shall be deemed to have been granted from transformation date to the Producer Company. [Section 581M]

10. PROVISIONS IN RESPECT OF OFFICERS AND OTHER EMPLOYEES OF INTER-STATE CO-OPERATIVE SOCIETY

As per Section 581N all directors in the Inter-State Co-operative Society before

its incorporation as Producer Company, shall continue to be in office for a period of one year from the date of transformation.

Every other officer or employee of such a society (other than a director, chairman or managing director) shall continue to hold office in the so formed Producer Company for the same tenure, at the same remuneration, terms and conditions as he would have held in the Inter-State Co-operative Society.

Any officer or employee of the earlier society opting not to remain in the employment of the newly formed Producer Company, shall be deemed to have resigned.

Officers and employees who have been so transferred from their services shall not be provided any compensation. Similarly no compensation shall be provided to any director, chairman or managing director of the society on account of premature termination of their contract with the society.

Retired officers and employees of the co-operative society shall continue to receive the same benefits, rights or privileges from the Producer Company.

11. NUMBER OF DIRECTORS

Section 581-O provides that, every Producer Company shall have minimum five and not more than fifteen directors. Provided that in the case of an Inter-State Co-operative Society as a Producer Company, such company may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

12. APPOINTMENT OF DIRECTORS

The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors consisting of not less than five, who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of Section 581P(2). However, such designation shall remain effective for a period of 90 days only.

The election of directors shall be conducted within a period of ninety days of registration of Producer Company. However, in the case of an Inter-State Co-operative Society, which has been registered as a Producer Company, election of directors should be conducted within a period of three hundred and sixty-five days.

A director shall hold office as such for not less than one year but not exceeding five years and every director who retires shall be eligible for re-appointment. The tenure of such directors shall not exceed such period as may be specified in the Articles.

13. VACATION OF OFFICE BY DIRECTORS

The office of director of a Producer Company shall become vacant under the following circumstances as have been provided in Section 581Q of the Act viz.:

- (a) if he is convicted by a court of any offence involving moral turpitude and sentenced in respect thereto with imprisonment for not less than six months;

- (b) if the Producer Company, in which he is a director, has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for ninety days;
- (c) if he has made a default in repayment of any advances or loans taken from the Producer Company in which he is a director;
- (d) if the Producer Company, in which he is a director:
 - (i) has not filed the annual accounts and annual return for any continuous three financial years commencing on or after the 1st day of April, 2002; or
 - (ii) has failed to, repay its deposit or withheld price or patronage bonus or interest thereon on due date, or pay dividend and such failure continues for one year or more;
- (e) if default is made in holding election for the office of director, in the Producer company in which he is a director, in accordance with the provisions of the Companies Act and its Articles;
- (f) if the annual general meeting or extraordinary general meeting of the Producer Company, in which he is a director, is not called in accordance with the provisions of the Act except due to natural calamity or such other reasons.

The above provisions of vacation of the office of a director, shall also, apply to the director of that Producer Institution, which is a member of such Producer Company.

14. POWERS AND FUNCTIONS OF BOARD

The Board of directors of a Producer Company shall exercise all such powers and do all such acts and things, as a Producer Company is authorized so to do. [Section 581R(1)]

However, in terms of the provisions of Section 581R(2), the directors may exercise the following powers without prejudice to the generality of the foregoing powers:

- (a) determination of the dividend payable;
- (b) determination of the quantum of withheld price and recommend patronage to be approved at general meeting;
- (c) admission of new Members;
- (d) pursue and formulate the organisational policy, objectives, establish specific long-term and annual objectives, and approve corporate strategies and financial plans;
- (e) appointment of a Chief Executive and such other officers of the Producer Company, as may be specified in the Articles;
- (f) exercise superintendence, direction and control over Chief Executive and other officers appointed by it;
- (g) cause proper books of account to be maintained; prepare annual accounts to be placed before the annual general meeting with the auditor's report and the replies on qualifications, if any, made by the auditors;

- (h) acquisition or disposal of property of the Producer Company in its ordinary course of business;
- (i) investment of the funds of the Producer Company in the ordinary course of its business;
- (j) sanction any loan or advance, in connection with the business activities of the Producer Company to any Member, not being a director or his relative;
- (k) take such other measures or do such other acts as may be required in the discharge of its functions or exercise of its powers.

All the above powers can be exercised only by means of a resolution passed by the Board at its meeting on behalf of the Producer Company.

15. MATTERS TO BE TRANSACTED AT THE GENERAL MEETING

Section 581S states that the following powers shall be exercised by the Board of directors on behalf of the company only by means of passing of resolutions at the annual general meeting of the company:

- (a) approval of budget and adoption of annual accounts;
- (b) approval of patronage bonus;
- (c) issue of bonus shares;
- (d) declaration of limited return and decision on the distribution of patronage;
- (e) specify the conditions and limits of loans that may be given by the Board to any director; and
- (f) approval of any transaction of the nature as is to be reserved in the Articles for approval by the Members.

16. LIABILITY OF DIRECTORS

Section 581T, provides that anything done by the directors, whether by way of voting on a resolution or approving by any other means, anything, in contravention of the provisions of this Act or any other law for the time being in force, or its Articles, shall make them jointly and severally liable towards the Producer Company to make good the loss or damage suffered by such company.

Where as a result of the above, such director has made any profit, the Producer Company shall have the right to recover an amount equal to said profits from such director.

The liability so imposed shall be in addition to and not in derogation of a liability imposed under this Act or any other law for the time being in force.

17. COMMITTEE OF DIRECTORS

Section 581U states that the Board may constitute such number of committees as it may deem fit for the purposes of assisting the Board in efficient discharge of its functions. However, the Board of directors shall not delegate any of its powers or assign the powers of the Chief Executive, to any committee of directors.

The committee of the Board may, with the approval of the Board, co-opt such number of persons, as it deems fit, as the members of the committee. Provided that

the Chief Executive appointed under Section 581W or a director of Producer Committee shall be a member of such committee. [Section 581U(2)]

Every such committee shall function under general superintendence, direction and control of the Board as may be specified. Further the fees and allowances to be paid to the members of the committee and the tenure of the committee shall be such as may be determined by the Board. The minutes of every Committee meeting shall be placed before the next Board meeting.

18. MEETINGS OF THE BOARD AND QUORUM

As per Section 581V the Board meeting of a Producer Company shall be held at least once in every three months and at least four such meetings shall be held in every year. The Chief Executive shall give notice to every director for the time being in India, and at his usual address in India to every other director at least seven days prior to the date of meeting. However, a Board meeting may also be called at a shorter notice after recording reasons thereof in writing.

The quorum for the meeting shall be one-third of the total strength of directors, subject to a minimum of three.

Unless otherwise provided in the Articles, such sitting fees and allowances may be paid to the directors attending the meetings, as decided by the members.

19. CHIEF EXECUTIVE AND HIS FUNCTIONS

As per Section 581W, a full time Chief Executive shall be appointed by the Board by whatever name called who, shall not be a member of the company. He shall be the ex-officio director, and shall not retire by rotation. The qualifications, experience and the terms and conditions shall be such as may be determined by the Board. The chief executive, who shall be entrusted with substantial powers of the management, shall manage the affairs of the Producer Company but subject to the superintendence, direction and control of the Board and shall be accountable to the Board for the performance of the Producer Company.

The various functions that may be discharged by a chief executive may *inter alia* include managing the day to day affairs of the company, maintaining proper books of accounts, furnishing members with periodic information, assisting the Board with respect to legal and regulatory matters making appointments and discharge of such other functions as may be delegated by the Board.

20. SECRETARY OF PRODUCER COMPANY

Section 581X of the Act provides that every Producer Company having an average annual turnover exceeding five crore rupees in each of three financial years shall appoint a member of the Institute of Company Secretaries of India as a whole-time Secretary of the company.

If a Producer Company fails to appoint Company Secretary, the company and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues. However, in any proceedings against a person in respect of an offence for failure to appoint a Company Secretary, it shall be a defence to prove that all reasonable

efforts were taken to comply with the provisions or that the financial position of the company was such that it was beyond its capacity to appoint a whole time secretary.

21. QUORUM OF THE GENERAL MEETING

Section 581Y of the Act provides that unless Articles of Association require a larger number, one-fourth of the total membership shall constitute the quorum at a general meeting.

22. VOTING RIGHTS

Section 581Z states that except as provided in Section 581D(1) (regarding voting rights of individual members and Producer Institutions), and 581D(3) (regarding voting rights to active members), every member of the Producer Company shall have one vote irrespective of the number of shares held by him. In the case of equality of votes, the Chairman or the person presiding over the meeting shall have a casting vote, except in the matter of election of the Chairman.

23. ANNUAL GENERAL MEETINGS [SECTION 581ZA]

Every Producer Company shall hold its first Annual General Meeting (AGM) within a period of ninety days from the date of its incorporation.

Not more than fifteen months shall elapse between the date of one AGM (the AGM held after the first AGM) and that of the next AGM. The Registrar may, for any special reason, permit the extension of time for holding of an AGM (not being the first AGM) by a period not exceeding three months. Notice in writing indicating date, time and place of the meeting shall be given at least fourteen days before the meeting and shall also be accompanied by the following documents which shall be sent to every member and auditor of the company:

- (a) agenda of the meeting;
- (b) minutes of the previous annual general meeting or extraordinary general meeting;
- (c) names and qualifications of candidates for election of directors;
- (d) audited balance sheet, profit and loss account and Board's report of the company in respect of specified disclosures and its subsidiaries, if any;
- (e) draft resolution for appointment of auditors;
- (f) draft resolution for proposed amendment, if any, in memorandum or articles.

The Annual General Meeting shall be held during business hours, on a day not being a public holiday at the registered office of the company or at any other place within the city, town or village where the registered office of the company is situated.

Unless the Articles provide for a larger number, the quorum of the general meeting shall be one-fourth of the total number of members.

Within sixty days from the date of the annual general meeting, the company is required to file the proceedings of the meeting, the audited balance sheet, the profit and loss account and the Director's report together with the filing fees with the Registrar.

On the requisition made in writing and duly signed by not less than one-third of the members, the Board of directors shall call an EGM in accordance with the provisions of Section 169 and Section 186 of this Act.

Where a Producer Company is formed by Producer Institutions then such Institutions shall be represented in the general body through the Chairman or the Chief Executive thereof who shall be competent to act on its behalf, except in case of default under Section 581Q(1).

Choose the correct answer

Within how many days from the date of its incorporation should a Producer Company hold its first Annual General Meeting ?

- (a) Sixty
- (b) Eighty
- (c) Ninety
- (d) Thirty

Correct answer: c

24. SHARE CAPITAL

As per Section 581ZB of the Act, a Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company.

However, in terms of Section 581ZC, the Producers who are active members may, if so provided in the articles, have special rights and the Producer Company may issue appropriate instruments to them in respect of such special rights.

Transferability of shares and attendant rights

A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board under Section 581ZD. Special rights for this purpose means any rights relating to supply of additional produce by the active member or any other rights relating to his produce conferred on him by the Board.

Within three months from the date of his becoming a member, such person shall nominate his nominee, to whom the shares shall vest in the event of his death.

Surrender of shares

If the Board of a Producer Company is satisfied that any member has ceased to be a primary member, or he has failed to retain his qualifications, necessary to enable him to remain the member of the Producer Company, then Board may direct him to surrender his shares to the company together with Special Rights, if any, attached therewith, at the value determined by the Board. Alternatively, the Board may direct the issuance of a notice to such member. [Section 581ZD(5)]

25. BOOKS OF ACCOUNT

Every producer company shall keep at its registered office proper books of

account with respect to matters specified under Section 581ZE of the Act. The balance sheet and profit and loss account of the Producer Company shall be prepared in accordance with Section 211.

The matters specified under Section 581ZD are as under:

1. Sums of money received and expended.
2. Sales and Purchase of goods.
3. Instruments of liability executed by or on behalf of the company.
4. Assets and liabilities.
5. Utilisation of materials or labour or other items of cost.

26. INTERNAL AUDIT

As per Section 581ZF of the Act, every Producer Company shall have internal audit of its accounts at such intervals in such manner as may be specified in its Articles, by a chartered accountant.

27. DONATIONS OR SUBSCRIPTION BY PRODUCER COMPANY

Section 581ZH provides that a Producer Company, by passing a special resolution, may make donation for promoting social and economic welfare and mutual assistance principles in a financial year to the extent of three percent of the net profit of the company in the preceding financial year. However, a Producer Company is strictly prohibited from making donation for political purposes.

28. GENERAL AND OTHER RESERVES

In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by Section 581ZI.

The Department of Company Affairs has issued Producer Companies (General Reserve) Rules, 2003 vide F.No. 1/1/2003-CL.V dated 7.8.2003, which shall be applicable to the companies formed and registered under Section 581C of the Companies Act, 1956.

These Rules have defined a “co-operative society” to mean a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State.

A Producer Company shall make investments from and out of its general reserves in the following manner, maintained by it in terms of the provisions of Section 581ZI of the Act:

- (a) in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or Cooperative Societies or scheduled bank, or
- (b) in a cooperative bank, State Cooperative Bank, Cooperative land development bank or Central cooperative bank, or
- (c) with any other scheduled bank, or
- (d) in any of the securities specified in Section 20 of the Indian Trust Act, 1882, or

- (e) in the shares or securities of any other multi-state cooperative society or any cooperative society, or
- (f) in the shares, securities or assets of a public financial institutions specified under Section 4A of the Companies Act, 1956.

Ministry of Company Affairs has vide Notification No. GSR 146(E) dated 9.03.2006 amended the Procedure Companies (General Reserves) Rules, 2003 to provide that investments may be made in any one or in combination of the above.

29. ISSUE OF BONUS SHARES

- A Producer company may, after
- the recommendation of the Board, and
 - passing of a resolution in General Meeting,

issue bonus shares to its members in proportion to the shares held by them, on the date of the issuance of such shares, by capitalising the amounts from its general reserves. [Section 581ZJ].

30. LOAN, ETC., TO MEMBERS [SECTION 581ZK]

The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members. However, any loan or advance to any director or his relative shall be granted only after the approval of members by a resolution.

31. INVESTMENT IN OTHER COMPANIES, FORMATION OF SUBSIDIARIES ETC. [SECTION 581ZL]

The Producer Company may invest its general reserves in approved securities, fixed deposit, units, bonds issued by the government or a cooperative or scheduled bank or in such other mode as may be prescribed. It may, for the promotion of its objectives also acquire shares of other Producer Companies. However, special resolution is required to be passed for acquisition of shares of any other Producer Company or entering into agreement for the formation of subsidiaries or joint venture.

Investment in shares of any other company other than Producer Company cannot exceed thirty per cent of the aggregate of its paid-up capital and free reserves, except where a special resolution has been passed and the prior approval of the Central Government has been obtained. However, such investments should be in consistence with the objects of the Producer Company. For disposal of any investments, special resolution shall be passed. A register containing prescribed particulars of all investment shall be kept in the registered office and shall be open to the members of the company for inspection and taking extracts therefrom.

32. AMALGAMATION, MERGER OR DIVISION, ETC., TO FORM NEW PRODUCER COMPANIES

Section 581ZN provides comprehensive provisions for the schemes of amalgamation, merger or division etc. of Producer Company.

- A Producer Company may, by a resolution passed at its general meeting:
- (a) transfer its assets and liabilities, wholly or partly, to any other Producer

Company, for any of the objectives specified in Section 581B if other Producer Company so agrees by passing a resolution at its general meeting;

- (b) divide itself into two or more Producer Companies;

Also, two or more Producer Companies may, by a resolution passed at general or special meetings of its members, decide to:

- (a) amalgamate and form a new Producer Company; or
- (b) merge one Producer Company with another Producer Company.

The resolutions referred to above shall be passed by not less than two-thirds of its members present and voting. However, prior to such resolution a copy of proposed resolution shall be forwarded to all the members and creditors for their consent.

Section 581ZN(5) makes provisions to satisfy the claims of dissenting members and creditors of such amalgamating Producer Companies.

33. DISPUTES

As per Section 581ZO, any dispute relating to the formation, management or business of a Producer Company shall be settled by conciliation or by arbitration as provided under the Arbitration and Conciliation Act, 1996.

34. STRIKING OFF NAME OF PRODUCER COMPANY

Section 581ZP states that the Registrar can after making an inquiry strike off the name of a company where the company:

- (i) has failed to commence its business within one year of its registration;
- (ii) ceases to transact business;
- (iii) is no longer carrying on its objectives;
- (iv) is not following the mutual assistance principles.

The Registrar shall, before passing the order issue a show cause notice to the company with a copy to the directors and give a reasonable opportunity of being heard. Any member of the Producer Company aggrieved by an order may appeal to CLB within sixty days of passing an order.

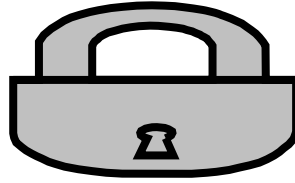
35. RE-CONVERSION OF PRODUCER COMPANY TO INTER-STATE CO-OPERATIVE SOCIETY

Any Producer Company may make an application, after a resolution has been passed in the general meeting by not less than two-third of its members present and voting or on request by its creditors representing three-fourth of its value of creditors, to the High Court for its re-conversion to Inter-State Co-operative Society, and follow the procedure as laid down in Section 581ZS of the Act.

LESSON ROUND-UP

- The Companies (Amendment) Act, 2002 has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies.
- A 'producer' shall mean any person engaged in any activity connected with or relating to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.
- Objectives for which Producer Companies may be formed include *inter alia*, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.
- The Act provides that, any ten or more individuals, each of them being a producer or two or more producer institutions or a combination of ten or more individuals and producer institutions, desirous of forming a producer company may form an incorporated company, as such having its objects specified under this Act after complying with the requirements and the provisions of the Act in respect of registration.
- Unless the membership of the Producer Company consists of a Producer institution only, every member shall have a single vote irrespective of the number of shares held. Further, every such member shall be entitled to receive a limited return and may be allotted bonus shares.
- The Memorandum of Association and Articles of Association of the Producer Company, containing the disclosures as required under the Act and duly signed by the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.
- Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith enclosures and documents as required under the Act.
- The Act gives provisions regarding concessions deemed to have been granted to Producer Company and in respect of officers and other employees.

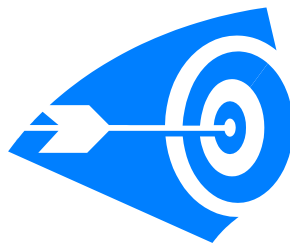
- The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of the Act. Minimum and maximum number of directors has been given under the Act as also their powers and the circumstances under which the office of director of a Producer Company shall become vacant. Provisions for meeting of the board and quorum are also given therein.
- The Board may constitute such number of committees as it may deem fit for the purpose of assisting the Board in efficient discharge of its functions.
- A full time Chief Executive shall be appointed by the Board by whatever name called who shall not be a member of the company.
- Every Producer Company having an average annual turnover exceeding Rs. Five crores in three consecutive financial years shall appoint a whole-time Secretary of the company.
- Provisions for conducting an Annual General Meeting along with notice contents have also been provided under the Companies Act.
- A Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company. A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board. The board may direct a member to surrender his shares to the company if he ceases to be a primary member or fails to retain his qualifications essential for being a member.
- Every Producer Company having an average annual turnover exceeding five crore rupees in each of three financial years shall appoint a member of the Institute of Company Secretaries of India as a whole-time Secretary of the company.
- Every Producer Company shall keep proper books of account with respect to matters specified in the Act and shall have internal audit of its account as may be specified in its Articles, by a chartered accountant.
- In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by the Companies Act. A Producer Company may issue bonus shares to its members by capitalizing the amount from its general reserves. It may also invest in other companies or in formation of subsidiaries in accordance with the Act.
- The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members.
- The Act provides comprehensive provisions for the schemes of amalgamation, merger or division etc. of Producer Company.
- Any dispute relating to the formation, management or business of a Producer Company shall be settled by conciliation or by arbitration. Further, the Registrar can after making an inquiry strike off the name of a company under conditions given in the Act.
- Any Producer Company may make an application for its re-conversion to Inter-State Co-operative Society, following the procedure laid down in the Act.

SELF-TEST QUESTIONS

1. The objectives of Producer Company must satisfy the requirements laid down in Section 581B of the Companies Act, 1956. Discuss.
2. Discuss the membership and voting rights of member of Producer Company.
3. State the contents of Memorandum of Association of Producer Company.
4. What powers can be exercised by directors of Producer Company?
5. State the matters to be transacted at the general meeting of the Producer Company.

LIMITED LIABILITY PARTNERSHIPS

LEARNING OBJECTIVES



Limited Liability Partnership is a new form of legal entity which is viewed as an alternative corporate business vehicle which provides the benefits of limited liability as well as allows its partners to be flexible in organising the internal structure.

At the end of this lesson you should be able to understand:

- The features of Limited Liability Partnerships
- The important terms as per the Limited Liability Partnership Act, 2008
- The important requirements for formation of a Limited Liability Partnership
- Partners and Designated Partners
- Roles and responsibilities of Designated Partners
- Limited Liability Partnership (LLP) Agreement.
- LLP for the professionals
- Statement of Account ad Solvency
- Audit of Limited Liability Partnership
- Filing of Annual Return
- Foreign Limited Liability Partnership
- Electronic filing of documents
- Investigation of the affairs of LLP
- Winding up of LLP.

1. INTRODUCTION

Limited Liability Partnership (LLP) is an incorporated partnership formed and registered under the Limited Liability Partnership Act 2008 with limited liability and perpetual succession. The Act came into force, for most part, on 31st March 2009 followed by its Rules on 1st April 2009 and the registration of the first LLP on 2nd April 2009.

The arrival of the much-desired and long-awaited LLP on the Indian business and professional scene marks yet another significant step in our decade-old journey towards globalization of the Indian Economy. It also marks the culmination of the efforts of several expert committees which recommended its introduction starting with

the Bhatt Committee of 1972, Naik Committee of 1992, Abid Hussain Committee of 1997, Gupta Committee of 2001, Naresh Chandra Committee of 2003 and the JJ Irani Committee of 2005.

This new form of legal entity is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its partners the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement.

The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be a suitable vehicle for small and medium enterprises and for investment by venture capitalists.

The total no. of registered LLP in India as on date April 3, 2012 is 8651.

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

The Indian Partnership Act 1932 shall be applicable to LLPs.

- True
- False

Correct Answer: False

2. SALIENT FEATURES

The salient features of the Limited Liability Partnership are as follows:—

- (i) The LLP is a body corporate and a legal entity separate from its partners. Any two or more persons, associated for carrying on a lawful business with a view to profit, may by subscribing their names to an incorporation document and filing the same with the Registrar, form a Limited Liability Partnership. The LLP has a perpetual succession;
- (ii) The mutual rights and duties of partners of an LLP *inter se* and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the proposed legislation. There would be flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the proposed legislation;
- (iii) A LLP is a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be tangible or intangible in nature or both tangible and intangible in nature. No partner would be liable on account of the independent or unauthorized acts of other partners or their misconduct;
- (iv) Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India.
- (v) A LLP shall maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with

the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government;

- (vi) The Central Government has power to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose;
- (vii) The Indian Partnership Act, 1932 shall not be applicable to LLPs. A partnership firm, a private company and an unlisted public company may convert themselves to LLP in accordance with provisions of the proposed legislation;
- (viii) The Central Government has made rules for carrying out the provisions of the LLP Act.

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

The Central Government does not have any powers whatsoever to investigate the affairs of an LLP.

- True
- False

Correct Answer: False

The Central Government shall have powers to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose.

3. DISTINCTION BETWEEN LLP AND PARTNERSHIP

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

1. LLP is a separate legal entity and therefore, can be sued or it can sue others without involving the partners. A partnership firm is not distinct from the several persons who compose it.
2. The partners of a LLP would have limited liability i.e. they would not be liable beyond the money contributed by them. Whereas, partners of a firm would have unlimited liability.
3. The retirement or death of a partner would not dissolve the LLP. On the other hand, the death or retirement of a partner would dissolve the partnership firm.
4. In a partnership, the property of the firm is the property of the individuals comprising it. In a LLP, it belongs to the LLP and not to the individuals comprising it.
5. Whereas a partnership can be formed either orally or by a deed of agreement whether registered or not, LLP is formed by an incorporation document and an LLP agreement, thus, giving it a legality.
6. Whereas a registered or unregistered partnership cannot have more than 20 partners, LLP can have more than that number since no upper limit has been laid down by the Act.
7. A LLP has perpetual succession, i.e. the death or insolvency of a

shareholder or all of them does not affect the life of the LLP, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

8. Whereas an individual partner would not be able to conduct business transaction with the partnership firm of which he is a partner, a partner of LLP in his separate capacity as a legal person can do business with the LLP since the LLP is a separate legal entity by itself.

4. DISTINCTION BETWEEN LLP AND COMPANY

1. In case of LLP, the need for classifying the object clauses into main, ancillary and other objects as well as framing the Share Capital clause in the Memorandum for incorporating a Company is reduced into a simple procedure of filling of the prescribed information in the Incorporation document and statement in Form No. 2.
2. In case of LLP, a 'limited liability partnership agreement' (LLPA) is prepared which is a variant of the 'articles of association' of a company.
3. Whereas the memorandum of a Company is required to name the State in which it is required to be incorporated, there is no such obligation in the case of LLP. Consequently, the detail procedure involved in changing the registered office from the state of Incorporation to another state is not required to be followed in case of a LLP.
4. In the LLP Act, there is no such stipulation for meeting of partners either periodically or compulsory at the year end as stipulated for directors and shareholders meetings in the Companies Act.
5. There is no separation between management of the company and the ownership as is observed in a company since all the partners, unlike all the directors, can take part in the day to day affairs of the LLP.
6. In case of a company no individual director can conduct the business of the company but in an LLP, each partner has the authority to do so unless expressly prohibited by the partnership terms.
7. Whereas, the Companies Act contemplates regulating the remuneration payable to directors, there are no corresponding provisions in the LLP Act for remuneration payable to designated partners. The same could be as per the LLP Agreement.
8. In the case of LLP, unlike in the case of companies, there are no restrictions on the borrowing powers.
9. The LLP can choose to keep the accounts on cash basis whereas under the Companies Act, accrual method is compulsory.
10. Audit of a company is compulsory. Conversely, the audit of LLP is not compulsory if the capital contributed does not exceed ₹ 25 lakh or if the turnover does not exceed ₹ 40 lakhs.
11. Cost audit as contemplated in section 233B of the Companies Act, 1956 has not been prescribed for LLPs.
12. The appointment of Company Secretaries as is required under section 383A

of the Companies Act, 1956 is not provided in the LLP Act. However, the annual return of a LLP in form 11 is to be certified as 'true and correct' by a Company Secretary in practice.

5. INCORPORATION OF LIMITED LIABILITY PARTNERSHIP

According to section 11 (1) of the Limited Liability Partnership Act, 2008, for a limited liability partnership to be incorporated—

- (a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;
- (b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the limited liability partnership is to be situated; and
- (c) a statement in the prescribed form shall be filed along with the incorporation document, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the limited liability partnership and by any one who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

2. The incorporation document shall—

- (a) be in form 2 as per rule 11.
- (b) state the name of the limited liability partnership;
- (c) state the proposed business of the limited liability partnership;
- (d) state the address of the registered office of the limited liability partnership;
- (e) state the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (f) state the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
- (g) contain such other information concerning the proposed limited liability partnership as may be prescribed.

3. If a person makes a statement under clause (c) of Sub-Section (1) which he—

- (a) knows to be false; or
- (b) does not believe to be true,

shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

Subject to prior compliance with the requirements of section 11(1) of the Act, section 12(1) mandates the Registrar to register the incorporation document and issue a certificate of incorporation within 14 days. The certificate of incorporation shall be conclusive evidence that the limited liability partnership is incorporated by the name specified in the incorporation document.

Registered Office of LLP

Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received. [(Section 13(1)]

Rule 17 (1) of the Limited Liability Partnership Rules, 2009 provides that the limited liability partnership may change its registered office from one place to another by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide for such procedure, consent of all partners shall be required for changing the place of registered office of limited liability partnership to another place:

Provided that where the change in place of registered office is from one State to another State, the limited liability partnership having secured creditors shall also obtain consent of such secured creditors.

Name of LLP

According to section 15(1), every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name. Section 15 (2) prohibits registration of a LLP with a name that is either undesirable in the opinion of the Central Government or that is identical with or that which too nearly resembles to the name of any existing partnership firm or a LLP or a body corporate or a trade mark registered or pending registration under the Trade Marks Act, 1999.

Rule 18 (1) of the LLP Rules, 2009 provides that the name of the limited liability partnership shall not be one prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950. Further, Rule 20 (1) provides that the limited liability partnership may change its name by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide such procedure, consent of all partners shall be required for changing the name of the limited liability partnership.

6. PARTNERS AND DESIGNATED PARTNERS

There are no shareholders in a Limited Liability Partnership. Instead there are partners.

As already discussed, any individual or body corporate may be a partner in a limited liability partnership.

Section 5 provides that any individual or body corporate may be a partner in limited liability partnership. However, an individual shall not be capable of becoming a partner of a limited liability partnership, if—

- (a) He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- (b) he is an undischarged insolvent; or
- (c) he has applied to be adjudicated as an insolvent and his application is pending.

Section 7 provides that every limited liability partnership shall have at least two

designated partners who are individuals and at least one of them shall be a resident in India. Provided that in case of a limited liability partnership in which all the partners are body corporates, at least two partners shall nominate their respective individuals who are to act as "designated partners" and one of the nominees shall be a resident of India.

Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (PIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply *mutatis mutandis* for the said purpose.

The Central Government, vide Notification No. GSR 506(E) dated **5th July, 2011**, notified Limited Liability Partnership (amendment) Rules, 2011 whereby it has integrated the Director's Identification Number (DIN) issued under Companies Act, 1956 with Designated Partnership Identification Number (DPIN) issued under Limited Liability Partnership (LLP) Act, 2008 **with effect from 9.7.2011**.

Pursuant to aforesaid notification:-

- **With effect from 9.7.2011, no fresh DPIN will be issued.** Any person, who desires to become a designated partner in a Limited Liability Partnership, has to obtain DIN by filing e-form DIN-1.
- If a person has been allotted DIN, the said DIN shall also be used as DPIN for all purposes under Limited Liability Partnership Act, 2008.
- If a person has been allotted DPIN, the said DPIN will also be used as DIN for all the purposes under Companies Act, 1956.
- If a person has been allotted both DIN and DPIN, his DPIN will stand cancelled and his DIN will be used as DIN as well as DPIN for all purposes under Limited Liability Partnership Act, 2008 and Companies Act, 1956.
- Every designated partner, shall intimate his consent to become a designated partner to the limited liability partnership and DPIN, in Form 9 and the LLP shall intimate such DPIN to Registrar in Form 4.
- Every designated partner, who has been allotted DPIN under the old rules, shall in the event of any change in particulars of as stated in erstwhile Form 7 or DIN-I, as the case may be, shall intimate such change(s) to the Central Government within 30 days of such change(s) in Form DIN-4 under Companies (Director Identification Number) Rules, 2006.
- The concerned designated partner shall fill-in the relevant changes to the limited liability partnership(s) on which he is a designated partner within 30 days of such changes.
- *The Form 7 and 10 shall stand deleted.*

According to Section 8, a designated partner shall be—

- (a) answerable for all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and

- (b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

Rule 9 of the Limited Liability Partnership Rules, 2009 provides that a person cannot be appointed as a designated partner if he –

- (a) Has at any time within the preceding five years been adjudged insolvent; or
- (b) Suspends, or has at any time within the preceding five years suspended payment to his creditors and has not at any time within the preceding five years made, a composition with them;
- (c) has been convicted by a Court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months; or
- (d) has been convicted by a Court for an offence involving section 30 of the Act.

(Section 30 deals with punishment for carrying out acts by the LLP or its partners with intent to defraud its creditors or for a fraudulent purpose).

7. ROLES AND RESPONSIBILITIES OF DESIGNATED PARTNERS

Amongst the Designated Partners, atleast one must be an Indian Resident which means that a non-resident partner could also be appointed as Designated Partner.

The various obligations laid down in the LLP Act has to be fulfilled solely by the Designated Partners by filing the required information through the relevant forms prescribed by the Limited Partnership Rules, 2009.

The designated partner would be responsible for filing the following information in the prescribed Forms mentioned against each:-

- (i) Incorporation document and statement in Form No. 2 (under Rule 2).
- (ii) Information with regard to Limited Partnership Agreement and changes, if any, made therein in Form 3 (under Rule 21).
- (iii) Notice of Appointment of Partners/designated partner and changes among them, intimation of DPIN by LLP to Registrar and consent of Partner to become partner/Designated Partner in Form No. 4 [under Rules 8, 10(8), 22(2) and 22(3)].
- (iv) Notice of change of name of LLP in Form No. 5 [under Rule 20(2)].
- (v) Intimation of particulars of name or address of a partner/change in such particulars by a Partner to the Limited Liability Partnership in form 6 [under Rule 22(1)]
- (vi) Statement of Account & Solvency in Form 8 (under Rule 24).
- (vii) Consent to act as Designated Partners in Form No. 9 [under Rule 7 and 10(8)].
- (viii) Intimation of changes in particulars of Designated Partners in form DIN-4
- (ix) Annual Return of Limited Liability Partnership in Form 11 [under Rule 25(1)].
- (x) For intimating other address for service of documents in Form 12 [under rule 16(3)].

- (xi) Application to the Registrar for striking off name in form 24 [under Rule 37(1)(b)].
- (xii) Application for compounding of an offence under the Act in Form 31 [under Rule 41(1)].

The Designated Partner, unless otherwise expressly provided in the Act, shall be—

- (1) Responsible for the doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of the Act including filing of any document, return, statement and the like report pursuant to the provisions of the Act and as may be specified in the Limited liability partnership agreement,
- (2) liable to all penalties imposed on the LLP for the contravention of the provisions of the Act and in the LLP agreement.

In conformity with the duty designated above, a designated partner of an LLP is also required to sign the following :

- Annual Accounts of the LLP (section 34)
- Annual Return of the LLP (section 35)
- Form 3 – Information with regard to Limited Partnership Agreement and changes, if any, made therein.
- Form 4 – Notice of Appointment of Partners/designated partner and changes among them, intimation of DPIN by the LLP to the Registrar and consent of partner to become a partner/designated partner.
- Form 5 – Notice of change of name.
- Form 8 – Statement of Account and Solvency.
- Form 11 – Annual Return of LLP.
- Form 12 – Intimating other address for service of documents.
- Form 18 – Application and statement for conversion of a private limited company/unlimited public company into LLP.

Moreover, it would be seen from what has been stated above that as per the Act the designated partner would be liable to all penalties imposed on the LLP for the contravention of the provisions of the Act and as such the designated partner would be required to pay all the monetary fines imposed on the LLP. There is no provision in the Act providing for the reimbursement of such monetary penalties to him by the LLP. Further in the following instances apart from the LLP, the designated partner would also be imposed monetary penalties under the Act:-

- For non-compliance with the directions of the Central Government for change of name under Section 17 of the Act,
- For non-maintenance of books of accounts, non-filing of accounts, duly audited where such an audit is mandatory under Section 34 of the Act,
- For non-filing of the annual return of the LLP with the Registrar under Section 35 of the Act.

What is the minimum limit for appointment of designated partners in a limited liability partnership?

- (a) Maximum two designated partners
- (b) At least two designated partners
- (c) Any number of designated partners
- (d) None of the above

Correct answer: b

8. PARTNERS' OBLIGATIONS

All partners, not just the designated partners, are agents of the LLP, but not of other partners. As such, all partners owe the duties of an agent to the LLP. The LLP shall not be bound by anything done by a partner in dealing with a person if that partner has no authority to act for LLP in doing a particular act and the person with whom he is dealing also knows that the partner has no authority for such act and to provide that an obligation of LLP, whether arising out of contract or otherwise will solely be the obligation of LLP. It is also provided that liabilities of LLP are to be met from the property of LLP. Further the LLP shall be liable for a wrongful act or omission by a partner in the course of the business of the LLP or with its authority. The obligation of a LLP shall not affect the personal liability of a partner for his own wrongful act or omission but a partner shall not be personally liable for wrongful act or omission of any other partner. No partner is personally liable directly or indirectly for an obligation of LLP solely by reason of his being a partner of the LLP.

9. LLP AGREEMENT

No provision has been made for directors or a board structure on the lines of Company Law. The LLP agreement determines the mutual rights and duties of the partners and their rights and duties in relation to limited liability partnership. This LLP agreement is required to be filed with the Registrar.

It has been provided under Section 23 – Save as otherwise provided by this Act, the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.

Limited liability partnership agreement should be filed with the Registrar within 30 days of incorporation in form 3. A person becomes a Partner by virtue of LLP agreement. This means that the LLP agreement is a must and it serves as a basic document and , to a certain extent, takes the place of MOA and AOA applicable in the case of a company registered under the Companies Act, 1956. Any change in the LLP agreement is also required to be notified to the Registrar of Companies. The importance of the said document lies in the fact that it is a public document and it is open to public inspection being on the records of the Registrar.

In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the limited liability partnership and the partners shall be determined by the provisions relating to that matter as are set out in the First Schedule.

10. LLP FOR THE PROFESSIONALS

LLPs are eminently suited to the professionals like Company Secretaries and others. They will get the benefit of limited liability and insulate them from third party claims against professional negligence or deficiency. A cross section of the professionals may come together under the banner of LLP to carry on the professional work in their respective field of specialisation, with the respective statutes according sanction for such a dispensation. Such an arrangement will bring the professionals closer and this will benefit the corporate and other clients, as they may be able to get solutions to their problems under one roof. This will also create a strong organisation of professionals and acts as a bulwark against keen competition expected to happen from the professionals abroad, with the opening of legal field under the WTO dispensation.

11. ADVANTAGES & DISADVANTAGES OF LLP

The *advantages* of a LLP include:

- Separate legal entity: A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- Perpetual Succession: A limited liability partnership shall have perpetual succession. In other words, partners may come and partners may go but a LLP will go on till the winding up of its affairs.
- Limited Liability: reduced risk to personal wealth from creditors' claims.
- Internal flexibility: allows for participation in management and maintenance of ethos of partnership.

The *disadvantages* include:

- Lack of privacy: Disclosure of financial information required under Section 34.
- Requirement of a LLP agreement: A LLP agreement is a necessity so as to avoid the application of default provisions (First Schedule) and to provide for matters not covered in the default provisions.
- Legal uncertainty: This being a newly introduced concept in the corporate world, it is yet to prove itself as a commercial entity.

12. CONTRIBUTION OF CAPITAL

As per Rule 23(1) of the LLP Rules, 2009, the contribution of each partner shall be accounted for and disclosed in the Accounts of the LLP along with nature of contribution and amount. Further, Rule 23 (2) provides that the contribution of a partner consisting of tangible, movable or immovable or intangible property or other benefits brought or contribution by way of an agreement or contract for services shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government.

13. STATEMENT OF ACCOUNT AND SOLVENCY (RULE 24 OF LLP RULES)

(1) Every limited liability partnership shall keep books of accounts which are sufficient to show and explain the limited liability partnership's transactions and are

such as to —

- (a) disclose with reasonable accuracy, at any time, the financial position of the limited liability partnership at that time; and
- (b) enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act. [Rule 24(1)]

(2) The books of account shall contain—

- (a) particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;
- (b) a record of the assets and liabilities of the limited liability partnership;
- (c) statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and
- (d) any other particulars which the partners may decide. [Rule 24(2)]

(3) The books of account which a limited liability partnership is required to keep shall be preserved for eight years from the date on which they are made. [Rule 24(3)]

(4) Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. [Rule 24(4)]

(5) A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners. [Rule 24(6)]

14. AUDIT OF LIMITED LIABILITY PARTNERSHIP (RULE 24 OF LLP RULES)

The accounts of every limited liability partnership shall be audited in accordance with these rules:

Provided that a limited liability partnership whose turnover does not exceed, in any financial year, forty lakh rupees or whose contribution does not exceed twenty-five lakh rupees shall not be required to get its accounts audited.

Provided further that if partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited in accordance with these rules.

Provided also that where the partners of such LLP do not decide for audit of the accounts of the LLP, such LLP shall include in the Statement of Account and Solvency a statement by the partners to the effect that the partners acknowledge their responsibilities for complying with the requirements of the Act and the Rules with respect to preparation of books of account and a certificate in the form specified in Form 8. [Rule 24(8)]

A person shall not be qualified for appointment as an auditor of a limited liability partnership unless he is a Chartered Accountant in practice. [Rule 24(9)]

An auditor or auditors of a limited liability partnership shall be appointed for each financial year of the LLP for auditing its accounts. [Rule 24(10)]

15. FILING OF ANNUAL RETURN (RULE 25 OF LLP RULES)

(1) For the purposes of sub section (1) of section 35, every limited liability partnership shall file an annual return with the Registrar in Form 11.

(2) The annual return of an LLP having turnover upto Rs. five crore rupees during the corresponding financial year or contribution upto Rs. fifty lakh rupees shall be accompanied with a certificate from a designated partner, other than the signatory to the annual return, to the effect that annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in practice to the effect that he has verified the particulars from the books and records of the limited liability partnership and found them to be true and correct.

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

A partner shall not be personally liable for the wrongful act or omission of any other partner of the Limited Liability Partnership.

- True
- False

Correct answer: True

16. ELECTRONIC FILING OF DOCUMENTS

Rule 36(1) of LLP Rules provides that every form or application or document or declaration required to be filed or delivered under the Act and rules made there under, shall be filed in computer readable electronic form, in portable document format (pdf) to the Registrar through the portal maintained by the Ministry of Corporate Affairs(MCA) on its website www.mca.gov.in or through any other website approved by the Central Government and authenticated by a partner or designated partner of the limited liability partnership for such purpose by the use of a valid digital signature. MCA has launched a separate portal www.llp.gov.in for filling of form/application/document etc required under the Act and rules made there under.

Every designated partner, partner or person specified in the Act for authentication of e-form, documents or application etc., which are required to be filed or delivered under the Act or rules made thereunder, shall obtain a digital signature certificate from the Certifying Authority for the purpose of such authentication and such certificate shall not be valid unless it is of class II or Class III specification under the Information Technology Act, 2000.

17. INVESTIGATION OF THE AFFAIRS OF LIMITED LIABILITY PARTNERSHIP (SECTION 43)

(1) The Central Government shall appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report thereon in such manner as it may direct if—

- (a) the Tribunal, either *suo motu* or on an application received from not less

than one-fifth of the total number of partners of limited liability partnership, by order declares that the affairs of the limited liability partnership ought to be investigated; or

- (b) any Court, by order, declares that the affairs of limited liability partnership ought to be investigated.

(2) The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.

(3) The appointment of inspectors pursuant to sub-section (2) may be made—

- (a) if not less than one-fifth of the total number of partners of the limited liability partnership make an application along with supporting evidence and security amount as may be prescribed; or
- (b) if the limited liability partnership makes an application that the affairs of the limited liability partnership ought to be investigated; or
- (c) if, in the opinion of the Central Government, there are circumstances suggesting—
 - (i) that the business of the limited liability partnership is being or has been conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the limited liability partnership was formed for any fraudulent or unlawful purpose; or
 - (ii) that the affairs of the limited liability partnership are not being conducted in accordance with the provisions of this Act; or
 - (iii) that, on receipt of a report of the Registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the limited liability partnership ought to be investigated.

18. FOREIGN LIMITED LIABILITY PARTNERSHIP

As per rule 34(1) of the LLP Rules, a foreign limited liability partnership shall, within thirty days of establishing a place of business in India, file with the Registrar in Form 27 —

- (a) a copy of the certificate of incorporation or registration and other instrument(s) constituting or defining the constitution of the limited liability partnership;
- (b) the full address of the registered or principal office of the limited liability partnership in the country of its incorporation;
- (c) the full address of the office of the limited liability partnership in India which is to be deemed as its principal place of business in India; and
- (d) list of partners and designated partners, if any, and the names and addresses of two or more persons resident in India, authorized to accept on behalf of the limited liability partnership, service of process and any notices or other documents required to be served on the limited liability partnership.

19. WINDING UP OF LIMITED LIABILITY PARTNERSHIP

The winding up of a limited liability partnership may be either voluntary or by the Tribunal. Limited liability partnership, so wound up may be dissolved.(Section 63)

Circumstances in which limited liability partnership may be wound up by Tribunal (Section 64)

A limited liability partnership may be wound up by the Tribunal—

- (a) if the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;
- (b) if, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two;
- (c) if the limited liability partnership is unable to pay its debts;
- (d) if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
- (e) if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or
- (f) if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

20. COMPARISON OF LLP WITH PRIVATE LIMITED COMPANY

A comparison of a LLP with a Private Limited Company reveals that such companies have:

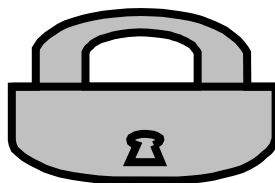
- Limited Liability: Similar to LLP.
- Internal flexibility: The Company Law requires a formal board structure and decision making at validly constituted meetings, passing of resolutions and maintenance of minutes of meetings.
- Privacy: Similar to LLP.
- Requirement of a LLP agreement: The Memorandum and Articles of Association are the default standard provisions doing away with the need for a separate agreement similar to a LLP agreement.
- Legal uncertainty: Private Limited companies have long been in existence and being tried and tested vehicles of business entities, there is no legal uncertainty which is not true in case of a LLP.

The LLP structure seems most suited for partnership concerns set up by professionals such as company secretaries in practice and others, by offering them the benefits of limited liability on one hand and the flexibility in internal management that is akin to partnerships on the other. Venture capitalists might also be attracted to the LLP structure owing to the ability of the partners to participate in management without the risk of losing limited liability, the absence of capital maintenance rules and the likely advantageous tax position. The laws of U.S.A., U.K., Singapore and Australia permit formation of LLPs.

LESSON ROUND-UP



- Any two or more persons associated for carrying on a lawful business with a view to earn profit may form a limited liability partnership by subscribing their names to an incorporation document and registration with the registrar of companies.
- Salient features of the Limited Liability Partnership
 - Body corporate with a separate legal entity.
 - Mutual rights and duties of partners of an Limited Liability Partnership *inter se* and those of the Limited Liability Partnership and its partners shall be governed by an agreement between the partners.
 - Limited liability of the partners.
 - Every Limited Liability Partnership shall have atleast two partners.
 - The Indian Partnership Act, 1932 shall not be applicable to LLPs.
- Every Limited Liability Partnership shall have at least two designated partners who are individuals and atleast one of them shall be a resident of India.
- The mutual rights and duties of the partners of limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.
- Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners.
- A limited liability partnership whose turnover exceed forty lakh rupees, in any financial year or whose contribution exceed twenty-five lakh rupees shall be required to get its accounts audited.
- Every limited liability partnership shall file an annual return with the Registrar in Form 11.
- The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.
- The winding up of a limited liability partnership may be either voluntary or by the Tribunal.

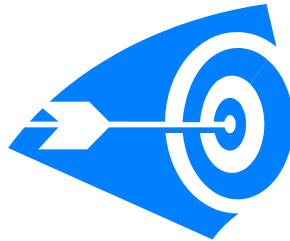
SELF-TEST QUESTIONS

1. What do you mean by Limited Liability Partnership. State the salient features of Limited Liability Partnerships.
2. Who is a designated partner? Give the relevant provisions of the LLP Act 2008 with regard to designated partners.
3. Write short notes on:
 - (i) LLP Agreement (ii) LLP for the professionals.
4. State the circumstances in which LLP may be wound up by the Tribunal.

STUDY XXXII

APPLICATION OF COMPANY LAW TO DIFFERENT SECTORS

LEARNING OBJECTIVES



This study covers the application of company law to banking and insurance sector.

At the end of this study you should be able to:

- Define a banking company, list out the requirements for setting up a banking business in India.
- State the regulatory provisions in regard to setting up an insurance business in India.

APPLICATION OF COMPANY LAW TO BANKING AND INSURANCE SECTOR:

Section 616 of the Companies Act, 1956 deals with the provision relating to application of company law to different sectors it provides that:-

- (a) The provision of the Companies Act, 1956 shall apply to Banking Companies, so far the said provisions are not inconsistent with the provisions of their governing law i.e. Banking Companies Act, 1949.
- (b) The provision of the Companies Act, 1956 shall apply to Insurance Companies, so far the said provisions are not inconsistent with the provisions of their governing law i.e. Insurance Act, 1938.

Description of structural and legal requirement pertaining to banking and insurance sectors in India is given below-

1. BANKING

As per the Banking Regulations Act, 1949, 'banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise; [Section 5 (b)].

Similarly, a 'banking company' means any company which transacts the business of banking in India [Section 5(c)]. However, any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking.

A banking company may be engaged in activities like borrowing, lockers, letter of

credit, traveller cheques, mortgages etc. Banking companies carrying on banking business in India are required to use at least one word - "bank", "banker" or "banking" in their name.

In India, banks may be set up in either of the following ways:

- (a) as a company incorporated under a special act of the Parliament;
- (b) as a company incorporated under the Companies Act, 1956.

The State Bank of India (constituted under the State Bank of India Act, 1955) and the Industrial Development Bank of India¹ are examples of banks constituted under special Acts of the Parliament.

Bank of Rajasthan, Catholic Syrian Bank, City Union Bank, - Dhanlaxmi Bank, Development Credit Bank, Federal Bank, HDFC Bank, ICICI Bank, IndusInd Bank, ING Vysya Bank, Jammu & Kashmir Bank, Karnataka Bank, Karur Vysya Bank, Lakshmi Vilas Bank, South Indian Bank, AXIS Bank etc. are examples of private sector banks incorporated as a company under the provisions of the Companies Act, 1956.

The Indian financial system currently consists of commercial banks, co-operative banks, financial institutions and non-banking financial companies (NBFCs). The commercial banks can be divided into categories depending on the ownership pattern, viz. public sector banks, private sector banks, foreign banks. While the State bank of India and its associates, nationalised banks and Regional Rural Banks are constituted under respective enactments of the Parliament, the private sector banks are banking companies as defined in the Banking Regulation Act, 1949.

Private Sector Banks are fast emerging as an important segment of Indian financial system. They perform financial intermediation in a variety of ways, like accepting deposits, making loans and advances, leasing, hire purchase, etc. They raise funds from the public, directly or indirectly, and lend them to ultimate spenders. They advance loans to the various wholesale and retail traders, small-scale industries and self-employed persons. Thus, they have broadened and diversified the range of products and services offered by a financial sector. Gradually, they are being recognised as complementary to the banking sector due to their customer-oriented services; simplified procedures; attractive rates of return on deposits; flexibility and timeliness in meeting the credit needs of specified sectors; etc.

The Reserve Bank of India has been entrusted with the responsibility under the Banking Regulation Act, 1949 to regulate and supervise banks' activities in India and their branches abroad.

Section 22 of the Banking Regulation Act, 1949 provides that no company shall carry on banking business in India unless it holds a licence issued in that behalf by the Reserve Bank and any such licence may be issued subject of such conditions as the Reserve Bank may think fit to impose. Before granting any licence, RBI may require to be satisfied that the following conditions are fulfilled:

- (i) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;

¹ With Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003, IDBI attained the status of a limited company viz. "Industrial Development Bank of India Limited"

- (ii) that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;
- (iii) that the general character of the proposed management of the proposed bank will not be prejudicial to the public interest or the interest of its depositors;
- (iv) that the company has adequate capital structure and earning prospects;
- (v) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the licence would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;

Policy of issuing licence to banks in India

A. Private Banks

For the registration with the RBI, a company incorporated under the Companies Act, 1956 and desirous of commencing business of banking, should also fulfill the conditions as enumerated in the RBI Guidelines on entry of new banks in the private sector. The important provisions of guidelines are as follow:-

- (i) The initial minimum paid-up capital for a new bank shall be Rs.200 crore. The initial capital will be raised to Rs.300 crore within three years of commencement of business. The overall capital structure of the proposed bank including the authorised capital shall be approved by the RBI.
- (ii) The promoters' contribution shall be a minimum of 40 per cent of the paid-up capital of the bank at any point of time. Promoters' contribution of 40% of the initial capital shall be locked in for a period of five years from the date of licensing of the bank.
- (iii) NRI participation in the primary equity of a new bank shall be to the maximum extent of 40 per cent. In the case of a foreign banking company or finance company (including multilateral institutions) as a technical collaborator or a copromoter, equity participation shall be restricted to 20 per cent within the above ceiling of 40 per cent. In cases of shortfall in foreign equity contributions by NRIs, designated multilateral institutions would be allowed to contribute foreign equity to the extent of the shortfall in NRI contribution to the equity. The proposed bank shall obtain necessary approval of Foreign Investment Promotion Board of the Government of India and Exchange Control Department of RBI.
- (iv) The new bank should not be promoted by a large industrial house. However, individual companies, directly or indirectly connected with large industrial houses may be permitted to participate in the equity of a new private sector bank up to a maximum of 10 per cent but will not have controlling interest in the bank.

The 10 per cent limit would apply to all inter- connected companies belonging to the concerned large industrial houses. In taking a view on whether the companies, either as promoters or investors, belong to a large industrial house or to a company connected to a large industrial house, the decision of the RBI will be final.

- (v) The promoters, their group companies and the proposed bank shall accept the system of consolidated supervision by the Reserve Bank of India.
- (vi) The new bank shall not be allowed to set up a subsidiary or mutual fund for at least three years from the date of commencement of business.
- (vii) The new bank will be governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, other relevant Statutes and the Directives, Prudential regulations and other Guidelines/Instructions issued by RBI and the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies.

B. Licensing of foreign banks

Foreign banks are required to apply to RBI for opening their branches in India. Foreign banks' application for opening their maiden branch is considered under the provisions of Sec 22 of the Banking Regulation Act, 1949. Before granting any licence under this section, RBI may require to be satisfied that the Government or the law of the country in which it is incorporated does not discriminate in any way against banks from India. In addition to this other conditions as enumerated above are also required to be fulfilled.

Procedure for Applications

In terms of Rule 11 of the Banking Regulation (Companies) Rules, 1949 applications shall be submitted in the prescribed form (Form III). In addition, the applications should furnish a project report covering business potential and viability of the proposed bank, the business focus, the product lines, proposed regional or locational spread, level of information technology capability and any other information that they consider relevant. The project report should give as much concrete details as feasible, based on adequate ground level information and avoid unrealistic or unduly ambitious projections. Applications should also be supported by detailed information on the background of promoters, their expertise, track record of business and financial worth, details of promoters' direct and indirect interests in various companies/industries, details of credit/other facilities availed by the promoters/promoter company(ies)/other Group company(ies) with banks/financial institutions, and details of proposed participation by foreign banks/NRI/OCBs.

Private banking in India was practiced since the beginning of banking system in India. The first private bank set up in India was IndusInd Bank.

The Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector, as part of the RBI's liberalisation of the Indian Banking Industry in 1994. The bank was incorporated in August 1994 in the name of 'HDFC Bank Limited', with its registered office in Mumbai, India. HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995.

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

Banks raise funds from the public and lend them to ultimate spenders.

- True
- False

Correct answer: True

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

Companies carrying on banking business in India are required to use at least one word “bank” , "banker" or “banking” in their name.

- True
- False

Correct answer: True

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

It is mandatory for a bank to get itself registered with the RBI.

- True
- False

Correct answer: True

2. INSURANCE

The development and growth of the insurance industry in India has gone through three distinct stages.

1. Formation of the Insurance Industry in India
2. Nationalization of the Insurance Business in India
3. Entry of Private Players

In India, insurance business may be set up in either of the following ways:

- (a) as a company incorporated under a special act of the Parliament;
- (b) as a company incorporated under the Companies Act, 1956.

The Life Insurance Corporation formed in September 1956 by the Life Insurance Corporation Act, 1956 and the General Insurance Corporation formed under the General Insurance Business (Nationalisation) Act, 1972 may be quoted as examples of insurance companies formed under special Acts of the Parliament.

An Ordinance was issued on 19th January, 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Bajaj Allianz Life Insurance Co. Ltd., Birla Sun Life Insurance Co. Ltd., HDFC Standard Life Insurance Co. Ltd., ICICI Prudential Life Insurance Co. Ltd., ING Vysya Life Insurance Co. Ltd., Max New York Life Insurance Co. Ltd., Metlife India Insurance Co. Ltd., SBI Life Insurance Co. Ltd., Tata AIG Life Insurance Co. Ltd., Bajaj Allianz General Insurance Co. Ltd., ICICI Lombard General Insurance Co. Ltd., IFFCO Tokio General Insurance Co. Ltd., Reliance General Insurance Co. Ltd., are all examples of private sector insurance companies incorporated as a company under the provisions of the Companies Act, 1956.

Insurance Regulatory and Development Authority (IRDA)

The Insurance Regulatory and Development Act, 1999 has established the Insurance Regulatory and Development Authority (“IRDA” or “Authority”) as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies. The IRD Act also carried out a series of amendments to the Act of 1938 and conferred the powers of the Controller of Insurance on the IRDA.

The members of the IRDA are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members.

Powers, Duties and Functions of the Authority

Section 14 of the IRDA Act, 1999 lays down the powers, duties and functions of the Authority. The Authority has been entrusted with the duty to regulate, promote and ensure the orderly growth of the insurance and re-insurance business in India. In furtherance of this responsibility, it has been conferred with numerous powers and functions which include issue of certificate of registration, renew, modify, withdraw, suspend or cancel such registration; protection of the interests of the policy holders; prescribing regulations on the investments of funds by insurance companies, regulating maintenance of the margin of solvency, adjudication of disputes between insurers and intermediaries, supervising the functioning of the Tariff Advisory Committee, specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations and specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector.

Registration of Insurance Company

Every insurer seeking to carry out the business of insurance in India is required to obtain a certificate of registration from the IRDA prior to commencement of business. The pre-conditions for applying for such registration have been set out under the Act of 1938, the IRD Act and the various regulations prescribed by the Authority.

The following are some of the important general registration requirements that an applicant would need to fulfill:

- (a) The applicant should be a company registered under the provisions of the Companies Act, 1956. Consequently, any person intending to carry on insurance business in India should set up a separate entity in India.
- (b) The aggregate equity participation of a foreign company (either by itself or through its subsidiary companies or its nominees) in the applicant company cannot not exceed twenty six per cent of the paid-up capital of the insurance company. However, the Insurance Act and the regulations there under provide for the manner of computation of such twenty-six per cent.

- (c) The applicant can carry on any one of life insurance business, general insurance business or reinsurance business. Separate companies are needed if the intent were to conduct more than one business.
- (d) The name of the applicant needs to contain the words "insurance company" or "assurance company".

Minimum capital requirements for starting Insurance Business:

- (a) A minimum paid-up equity share capital of rupees one hundred crores in case of an applicant which seeks to carry on the business of life insurance or general insurance.
- (b) A minimum paid-up equity share capital of rupees two hundred crores, in case of application for business of reinsurance.

In determining the aforesaid capital requirement, the deposits to be made and any preliminary expenses incurred in the formation and registration of the company would be included.

A "promoter" of the company is not permitted to hold, at any time, more than twenty-six per cent of the paid-up capital in any Indian insurance company. However, as an interim measure has been provided that percentages higher than twenty six percent are permitted if the promoters divest, in a phased manner, over a period of ten years from the date of commencement of business, the share capital held by them in excess of twenty six per cent.

An applicant desiring to carry on insurance business in India is required to make a requisition for a registration application to the IRDA in a prescribed format along with all the relevant documents.

The applicant is required to make a separate requisition for registration for each class of business i.e. life insurance business consisting of linked business, non-linked business or both, or general insurance business including health insurance business.

The IRDA may accept the requisition on being satisfied of the bona fides of the applicant, the completeness of the application and that the applicant will carry on all the functions in respect of the insurance business including management of investments etc. In the event that the aforesaid requirements are not met with, the Authority may after giving the applicant a reasonable opportunity of being heard, reject the requisition. Thereafter, the applicant may apply to the Authority within thirty days of such rejection for re-consideration of its decision. Additionally, an applicant whose requisition for registration has been rejected, may approach the Authority with a fresh request for registration application after a period of two years from the date of rejection, with a new set of promoters and for a class of insurance business different than the one originally applied for.

In the event that the Authority accepts the requisition for registration application, it shall direct supply of the application for registration to the applicant. An applicant, whose requisition has been accepted, may make an application along with the relevant documents evidencing deposit, capital and other requirements in the prescribed form for grant of a certificate of registration.

After consideration of the matters *inter alia* capital structure, record of performance of each promoters and directors and planned infrastructure of the company, the Authority may grant the certificate of registration. The Authority would, however, give preference in grant of certificate of registration to those applicants who propose to carry on the business of providing health covers to individuals or groups of individuals. An applicant granted a certificate of registration shall commence the insurance business within twelve months from the date of registration or if the company feels that it will not be able to commence business within 12 months, it may apply for extension of time within such period. The Authority may grant extension further upto 12 months (i.e. not beyond 24 month from the date registration)

In the event that the Authority rejects the application for registration, the applicant aggrieved by the decision of the Authority may within a period of thirty days from the date of communication of such rejection, appeal to the Central Government for reconsideration of the decision and the decision of the Central Government in this regard would be final.

An insurer who has been granted a certificate of registration should renew the registration before the 31st day of December each year, and such application should be accompanied by evidence of the payment of fee that should be the higher of—

- fifty thousand rupees for each class of insurance business, and
- one- tenth of one per cent of total gross premium written direct by an insurer in India during the financial year preceding the year in which the application for renewal of certificate is required to be made, or rupees five crores, whichever is less; (and in case of an insurer carrying on solely re-insurance business, instead of the total gross premium written direct in India, the total premium in respect of facultative re-insurance accepted by him in India shall be taken into account).

This fee may vary according to the total gross premium written direct in India, during the year preceding the year in which the application is required to be made by the insurer in the class of insurance business to which the registration relates but shall not exceed one- tenth of one percent of such premium income or rupees five crores, whichever is less, or be less, in any case than fifty thousand rupees for each class of insurance business. However, in the case of an insurer carrying on solely re-insurance business, the total premiums in respect of facultative re-insurance accepted by him in India shall be taken into account.

The registration of an Indian insurance company or insurer may be suspended for a class or classes of insurance business, in addition to any penalty that may be imposed or any action that may be taken, for such period as may be specified by the Authority, in the following cases:

- conducts its business in a manner prejudicial to the interests of the policy-holders;
- fails to furnish any information as required by the Authority relating to its insurance business;
- does not submit periodical returns as required under the Act or by the Authority;

- does not co-operate in any inquiry conducted by the Authority;
- indulges in unfair trade practices/manipulating the insurance business;
- fails to make investment in the infrastructure or social sector as specified under the Insurance Act.

Choose the correct answer

Which among the following acts as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies?

- (a) Insurance Regulatory Authority
- (b) Insurance Development Authority
- (c) Insurance Regulatory and Development Authority
- (d) None of the above

Correct answer: c

Choose the correct answer

The aggregate equity participation of a foreign company cannot exceed _____ percent of the paid-up capital of the insurance company.

- (a) twenty six
- (b) thirty
- (c) forty nine
- (d) fifty one

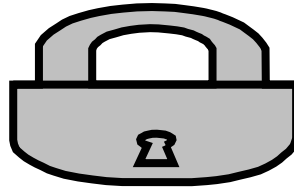
Correct answer: a

LESSON ROUND-UP

- 'Banking' means accepting for the purpose of lending or investment of deposits of money from public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise.
- 'Banking company' means any company which transacts the business of banking.
- In India, banks may be set up either as a company incorporated under a special act of the Parliament; or as a company incorporated under the Companies Act, 1956.

- The working and operations of banks are regulated by the Reserve Bank of India (RBI) within the framework of the Reserve Bank of India Act, 1934/Banking Regulation Act, 1949 and the directions issued by it under the Act.
- It is mandatory for a bank to get itself registered with the RBI. For the registration with the RBI, a company incorporated under the Companies Act, 1956 and desirous of commencing business of banking:
 - (a) should have a initial minimum paid-up capital of Rs. 200 crore which is to be raised to Rs. 300 crore within three years of commencement of business.
 - (b) The promoters' contribution shall be a minimum of 40% of the paid-up capital of the bank at any point of time.

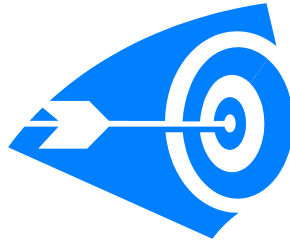
SELF-TEST QUESTIONS



1. Define a banking company and list out the requirements for setting up a banking business in India.
2. Briefly explain the role of Insurance Regulatory Development Authority.

OFFENCES AND PENALTIES — AN OVERVIEW

LEARNING OBJECTIVES



Contravention of the provisions of the Companies Act, 1956 are considered as offences. After going through this chapter, you will be able to understand what are the various sections under the Companies Act which impose penalty, the nature of offence and the amount of penalty imposed under those sections under the Act. The topics covered are:

- Introduction
- List of sections imposing penalty (as an Annexure)

1. INTRODUCTION

Defaults, breaches, violations, failures, contraventions or non-compliances under the Companies Act are called ‘offences’ which give rise to a penal liability. The Companies Act prescribes punishments for offences committed by the companies under the Act. There are four different types of punishments prescribed under the Act. These are:

- (a) fine of a maximum fixed amount;
- (b) fine of a specified amount for each day during which the offence continues;
- (c) fine of a maximum fixed amount with an additional fine for each day during which the offence continues;
- (d) imprisonment of a stated term with or without fine.

The persons who may be made liable for the offences and punished under the Act are:

- (a) the company;
- (b) directors and officers of the company; and
- (c) any person committing an offence.

2. OFFICER IN DEFAULT

In various provisions of the Companies Act, 1956, the term used for fixing liability of offence is “officer who is in default” The term officer which is defined in Section 2(30) of the Act, includes directors. The expression “officer who is in default” is

defined in Section 5 of the Act to include all the following officers of the company, namely –

- (a) managing director(s);
- (b) whole-time director(s);
- (c) the manager;
- (d) the secretary;
- (e) any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act;
- (f) any person charged by the Board with responsibility of complying with that provision:
Provided that the person so charged has given his consent in this behalf to the Board;
- (g) where any company does not have any of the officers specified in clauses (a) to (c), any director/directors who may be specified by the Board in this behalf or where no director is so specified, all the directors:

Provided that where the Board exercises any power under clause (f) or clause (g), it shall, within thirty days of the exercise of such powers, file with the Registrar a return in e-form 1AA and e-form 1AB of General rules and forms.

Ordinarily, in offences under the Companies Act, the Complainant has either to be the Registrar or a shareholder of the company or the Central Government through some authorized person (Section 621)

As per section 621A of the Companies Act, 1956, any offence punishable with imprisonment or with fine or with both as alternatives is compoundable with the permission of the court. However, an offence punishable with imprisonment only or with imprisonment and fine, is not compoundable under any situation.

In the context of provisions of Section 621A, to „compound’ means to settle by mutual agreement or to condone a liability or offence in exchange for money; to forbear from prosecuting; to forbear prosecution of offence for a consideration.

The Compounding of an offence will act as a bar to the prosecution where compounding was done before the institution of the prosecution. Where composition of any offence is made after institution of any prosecution, the company or officer in default is required to bring that fact to the notice of the court in which the prosecution is pending. Thus, the prosecution in such a case would not be maintainable.

Choose the correct answer:

Which section of the Companies Act defines the expression: „officer who is in default’?

- (a) Section 5
- (b) Section 6
- (c) Section 7
- (d) Section 8

Correct Answer: a

Choose the correct answer:

Which one of the following officers is not included under the expression ‚officer in default’ in Section 5 of the Companies Act?

- (a) Managing Director(s)
- (b) Treasurer
- (c) The Manager
- (d) The Secretary

Correct Answer: b

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

‚Compound’ means to settle by mutual agreement or to condone a liability or offence in exchange for money.

- True
- False

Correct Answer: True

List of Sections imposing penalty is given in Annexure I.*ANNEXURE I*

The offences for violation of the provisions of the Companies Act, 1956 can only be tried in the court which is not inferior to that of a Presidency Magistrate or a Magistrate of the First Class. The court shall take cognizance of the offence which is alleged to have been committed by company or any officer thereof only on a complaint in writing made by the Registrar of Companies or Securities and Exchange Board of India (in respect of matters covered by section 55A) or a shareholder of the company or by a person authorized in this behalf by the Central Government. Every offence under the Act shall be deemed to be non-cognizable, except offences connected with, or arising out of acceptance of deposits under sections 58A and 58AA. In case of prosecution by a shareholder arising out of false and frivolous or vexatious accusation, the complainant shareholder may be required to pay compensation as may be directed by the Magistrate, while discharging the accused company and its officers. List of penalty alongwith Sections and nature of offence is as follows:

Section	Nature of offence	Penalty
11(5)	Being a member of a company, association or partnership formed exceeding certain numbers (illegal association)	Fine upto ₹ 10,000/-
22(2)	Failure to comply with any direction given by Central Govt. to change the name of an existing company	Fine up to ₹ 1,000/- for every day during which default continues
25(10)	Failure to remove words "chambers of commerce" from its name consequent upon revocation of licence by Central Govt.	Fine upto ₹ 5,000 for every day during default continues
39(2)	Failure to send copied of memorandum, Articles or agreement to members on demand	Fine upto ₹ 500/-
40(2)	Issue of non-altered copy of memorandum, articles, resolutions or agreements	Fine upto ₹ 100/- each copy so issued
44(3)	Failure to file the prospectus or statement in lieu of prospectus by a private company on ceasing to be private company.	Fine upto ₹ 5,000 per day
49(9)	Failure to comply with the provisions of Sub-Section (1) to (8) relating to investments by company to held in its own name	Fine up to ₹ 50,000
56(3)	Issue of application form without salient features of prospectus or non-supply of copy of prospectus on demand	Fine upto ₹ 50,000
58A(5)(a)	Failure by a company to make repayment of deposit in terms of Sub-Section (3)(c) or (4)	Fine not less than twice the amount of deposit not repaid
58A(6)(a)(i)	Acceptance of deposits in excess of prescribed limits and contrary to rules	Fine not less than the amount of deposits accepted
58A(6)(a)(ii)	Invitation of deposits in excess of prescribed limits and contrary to rules	Fine upto ₹ 10,00,000 but not less than ₹50,000
58A(5)(b)	Failure of repay deposit in accordance with the provisions of Sub-Section 3(c) or (4)	Imprisonment upto 5 years and also fine
58A(6)(b)	Invitation or acceptance of deposit in excess of the prescribed limits and contrary to rules	Imprisonment upto 5 years and also fine

Section	Nature of offence	Penalty
58A(10)	Failure to comply with the order of CLB granting extension of time for making repayment of deposit	Imprisonment upto 3 years and fine of not less than ₹ 500 per day
58AA(9)	Failure to comply with the provisions of this section and order of CLB	Imprisonment upto 3 years and fine for not less than ₹ 500 for each day of non-compliance
59(1)	Issue of prospectus in contravention of section 57 or 58	Fine upto ₹ 50,000
60(5)	Issue of prospectus without the copy thereof being filed with the Registrar	Fine upto ₹ 50,000
63(1)	Prospectus issued includes any untrue statement	Imprisonment upto two years or fine upto ₹ 50,000 or with both
68	Fraudulently inducing persons to invest money.	Imprisonment upto five years or fine upto ₹ 1,00,000 or with both.
68A(1)	Application made for subscription of shares in a fictitious name	Imprisonment upto 5 years
69(4)	Failure to keep application moneys in Scheduled Bank	Fine upto ₹ 50,000
70(4)	Failure to file statement in lieu of prospectus	Fine upto ₹ 10,000
70(5)	Statement in lieu of prospectus delivered to the Registrar includes any untrue statement.	Imprisonment upto two years or fine upto ₹50,000 or with both
72(3)	Prohibition for allotment of shares unless the conditions as specified in the section are fulfilled.	Fine upto ₹ 50,000
73(2B)	(i) Default in repayment of application moneys and interest (ii) Failure to comply with the provisions of sub-section (2A) where the payment is not made within 6 months from the expiry of the eighth day	Fine upto ₹ 50,000 and also imprisonment upto one year

Section	Nature of offence	Penalty
73(3)	Failure to keep application moneys in Scheduled Bank	Fine upto ₹ 50,000
75(4)	Failure to comply with the provisions of Section 75 relating to return of allotment	Fine upto ₹ 5,000 per day
76(5)	Failure to comply with the provision relating to commission and discount	Fine upto ₹ 5,000
77(4)	Contravening provisions on purchase by company or loans by company for purchase of its own or its holding company's shares	Fine upto ₹ 10,000
77A(11)	Contravention of provisions of section 77A or any rules made thereunder, or any regulations made under clause (f) of sub-section (2).	Imprisonment upto two years or with fine upto ₹ 50,000 or with both
79(4)	Omitting to include in prospectus certain particulars relating to the issue of shares at a discount contained in sub-section (4)	Fine upto ₹ 500
80(6)	Non-compliance with the provisions of the section relating to issue of redeemable preference shares	Fine upto ₹ 10,000
80A(3)(a)	Failure to comply with the provisions of section 80A regarding Redemption of irredeemable preference shares	Fine upto ₹ 10,000 per day
80A(3)(b)	Failure to comply with the provisions of section 80A regarding Redemption of irredeemable preference shares by officers of the company in default.	Imprisonment upto three years and also fine
84(3)	Fraudulently renewing or issuing of duplicate share certificates by a company	Fine upto ₹ 10,000 on company. Imprisonment of six months or fine upto 100,000 or with both (for officer in default)
89(3)	Non-compliance with the provisions of the sub-section relating to termination of disproportionately excessive voting rights in existing companies	Fine upto ₹ 10,000
95(3)	Failure to give to the Registrar notice of consolidation, etc., of share capital in accordance with section 95(1)	Fine upto ₹ 500 per day

Section	Nature of offence	Penalty
97(3)	Failure to file with the Registrar notice of increase of capital or of members within thirty days of passing of resolution.	Fine upto ₹ 500 per day
105	Concealing name of creditors, etc.	Imprisonment upto one year, fine or with both
107(5)	Failing to forward to the Registrar a copy of order of the court in regard to variation of shareholders' rights	Fine upto ₹ 500
111(9)	Non-compliance with the order of Company Law Board relating to registration of transfer	Fine upto ₹ 10,000 and ₹ 1,000 per day
111(12)	Default in complying with the provisions of section 111	Fine upto ₹ 500 per day
113(2)	Failure to deliver share or debenture certificate within prescribed time limit.	Fine upto ₹ 5,000 per day
115(6)	Non-compliance with the requirements of section 115 relating to entries in the register in respect of share warrants	Fine upto ₹ 500 per day
116	Deceitfully personating as an owner of any shares or interest in a company	Imprisonment upto three years and also fine
117A(3)	Not allowing inspection of Debenture trust deed by members/debentureholders.	Fine upto ₹ 500/- for every day
117C(5)	Failure to comply with the order of CLB for redemption of debentures.	Imprisonment upto three years and fine upto ₹500/- for every day
118(2)	Failure to forward a copy of debenture trust deed to members or debenture holders within seven days at their request	Fine upto ₹ 500 and further fine upto ₹ 200 per day
127(2)	Failure to deliver to the Registrar the particulars of property acquired which is subject to charge	Fine upto ₹ 5,000
133(2)	Delivering debenture or certificate of debenture stock without endorsing on it certificates of registration	Fine upto ₹ 10,000
137(3)	Default in complying with the provisions of section 137 regarding appointment of receiver or manager	Fine upto ₹ 500

Section	Nature of offence	Penalty
142(1)	Failure to file with the Registrar for registration particulars of any charge etc.	Fine upto ₹ 5,000 per day
142(2)	Not complying with any of the requirements of the Act as to registration with the Registrar of any charge etc.	Fine upto ₹ 10,000
143(2)	Failure to make entry in register of charges	Fine upto ₹ 5,000
144(3)	Refusing to allow inspection of copies of instruments creating charges and company's register of charges	Fine upto ₹ 500 and further fine upto ₹ 200 per day
146(4)	Non-compliance with the requirements of section 146 in regard to registered office	Fine upto ₹ 500 per day
147(2)	Non-compliance with the provisions of section 147(1)(a) or in regard to painting or affixing its name and address of registered office outside office or place of business	Fine upto ₹ 500 per day
147(3)	Non-compliance with the provisions of section 147(1)(b) or (c) in regard to engraving name on seal and mentioning name and registered office in business letters, etc.	Fine upto ₹ 5,000
147(4)	Misuse of seal, letterhead etc. by an Officer	Fine upto ₹ 5,000
148(2)	Non-compliance with the requirements of section 148(1) regarding publication of authorized as well as subscribed and paid-up capital	Fine upto ₹ 10,000
149(2A)	Commencement of any new business in contravention of this sub-section	Fine upto ₹ 5,000 per day
149(6)	Commencement of business or exercising borrowing powers in contravention of section 149	Fine upto ₹ 5,000 per day
150(2)	Failure to maintain register of members	Fine upto ₹ 500 per day
151(4)	Committing default in complying with the provisions of sub-sections (1) to (3) relating to index of members	Fine upto ₹ 500
152(3)	Committing default in complying with the requirements of sub-sections (1) and (2) regarding register and index of debenture-holders	Fine upto ₹ 500
154(2)	Closing register of members or debenture holders otherwise than in compliance with the provisions of section 154(1)	Fine upto ₹ 5,000 per day

Section	Nature of offence	Penalty
157(3)	Failure of file with Registrar notice of situation of office where foreign register is kept	Fine upto ₹ 500 per day
158(9)	Not transmitting to registered office in India copies of entries in foreign register and not keeping at registered office in India duplicate of foreign register	Fine upto ₹ 500
162(1)	Non-compliance with the provisions of section 150, 160 or 161 regarding annual return	Fine upto ₹ 500 per day
163(5)	Refusing inspection, making of any extract or sending any copy within specified time, of registers, returns, etc.	Fine upto ₹ 500 per day
165(9)	Non-compliance with the provisions relating to statutory meeting	Fine upto ₹ 5,000
168	Failing to hold annual general meeting in accordance with section 166 or to comply with any directions of Central Government under section 167(1)	Fine upto ₹ 50,000 and further fine upto ₹ 2,500 per day
176(2)	Omitting to state in notice of meeting that a member is entitled to appoint proxy and that proxy need not be a member	Fine upto ₹ 5,000
176(4)	Invitation to appoint proxy specified in the invitation issued at Company's expense	Fine upto ₹ 10,000
187C(5)(a)	Failure to file declaration not holding beneficial interest in any share	Fine upto ₹ 1000 per day
187C(5)(b)	Failure to file return by the company	Fine upto ₹ 100 per day
188(8)	Non-compliance with the provisions of section 188 regarding circulation of members' resolutions	Fine upto ₹ 50,000
192A(6)	Default in compliance of sub-section (1) to (4)	Fine upto ₹ 50,000
192(5)	Failure to file with the Registrar certain resolutions or agreements in accordance with section 192(1)	Fine upto ₹ 200 per day
192(6)	Failure to annex copies of certain resolutions or agreements to articles or not forwarding to members on request copy of certain resolutions or agreements	Fine upto ₹ 100 for every copy in respect of which default is made
193(6)	Non-compliance with the provisions of section 193 regarding minutes of proceedings of general meetings and of board and other meetings	Fine upto ₹ 500

Section	Nature of offence	Penalty
196(3)	Refusing inspection of minutes book of general meetings or not furnishing to member on request a copy of minutes within specified time	Fine upto ₹ 5,000 for each default
197(2)	Circulating or advertising proceedings of general meetings without including certain particulars	Fine upto ₹ 5,000
202(1)	An undischarged insolvent discharges any of the functions of a director, manager or takes part in the promotion, formation or management of any company	Imprisonment upto 2 years or with fine upto ₹ 50,000 or with both
203(7)	Acting as director in contravention of an order of the court	Imprisonment upto 2 years or with fine upto ₹ 50,000 or with both
205A(8)	Failure to transfer the amount of accumulated profits to unpaid dividend account and other provisions of section 205A	Fine upto ₹ 5,000 per day
207	Failure to distribute dividend within thirty days	Imprisonment upto 3 years and fine of ₹ 1000 for each day of default and liability to pay simple interest @ 18 p.a. during default
209(5)/(7)	Failure to keep proper books of account	Imprisonment upto 6 months or fine upto ₹10,000 or with both
209A(8)	Failure to produce books and papers, furnish information or explanation, etc., relating to inspection	Fine not less than ₹ 50,000 and also imprisonment upto one year.
210(5)/(6)	Default in laying of annual accounts at the annual general meeting.	Imprisonment upto 6 months or fine upto ₹10,000 or with both
211(7)/(8)	Failure to prepare balance sheet and profit and loss account in the form and contents specified in the section.	Imprisonment upto 6 months or fine upto ₹10,000 or with both
212(9)/(10)	Non-inclusion of certain particulars of subsidiary in the balance sheet of holding company.	Imprisonment upto 6 months or fine upto ₹10,000 or with both

Section	Nature of offence	Penalty
217(5)/(6)	Default in complying with the provisions of sub-sections (1) to (3) regarding Board's report.	Imprisonment upto 6 months or fine upto ₹ 20,000 or with both.
218	Improper issue, circulation or publication of balance sheet or profit and loss account.	Fine upto ₹ 5,000
219(3)	Failure to send to members, etc., copies of balance sheet, auditor's report, etc., twenty one days before date of meeting	Fine upto ₹ 5,000
219(4)	Default in complying with certain demands for copies of balance-sheet, etc., within seven days of such demand	Fine upto ₹ 5,000
220(3)	Failure to file with the Registrar copies of balance sheet, etc.	Fine upto ₹ 500 per day
221(4)	Failure to make disclosure of payments, etc., to the company	Imprisonment upto 6 months or fine upto ₹ 50,000 or with both
223(4)	Non-compliance by certain companies with the provisions of section 223 regarding publication of half-yearly statement in the specified form	Fine upto ₹ 500 per day
224(4)	Failure to give notice to the Central Government within seven days where no auditors are appointed at an annual general meeting.	Fine upto ₹ 5,000
232	Failure to company to comply with the provisions of sections 225 to 231 with regard to auditors	Fine upto ₹ 5,000.
233	Non-compliance by auditor with section 227 and 229	Fine upto ₹ 10,000
233A(5)	Failure to furnish information to special auditor in connection with special audit	Fine upto ₹ 5,000
233B(11)	Failure to comply with the provisions of section 233B regarding audit of cost accounts by the company	Fine upto ₹ 5,000 for company; imprisonment upto 3 years or fine upto ₹ 50,000 or both for every officer in default.

Section	Nature of offence	Penalty
234(4)	Failure to furnish information or explanation or production of books and papers	Fine upto ₹ 5,000 and further fine of ₹ 500 per day
240(3)	Failure to produce documents or furnish any information, etc., before the inspector	Imprisonment upto 6 months or fine upto ₹20,000 or with both and further fine upto ₹2,000 per day.
250(9)	Exercise of right in respect of shares and debentures in violation of restriction imposed upon shares and debentures by Company Law Board.	Imprisonment upto 6 months or fine upto ₹ 50,000 or with both.
250(10)	Otherwise contravening the restrictions imposed by the Central Government during investigation of ownership of shares and debentures	Fine upto ₹ 50,000
269(6)	Failure to vacate the office by managing director/whole time director/manager in the event of their appointment being disapproved by the Central Government	Fine upto ₹ 5,000 for each day of default.
269(10)	Order of CLB declaring that contravention of requirement of Schedule XIII has taken place	Fine upto ₹50,000 on the company and fine of ₹ 1,00,000 on the officers in default Fine upto ₹ 1,00,000 for person so appointed
269(11)	Contravention of the provisions of sub-section (10) or any direction given by the Company Law Board	Imprisonment upto 3 years and also fine upto ₹ 500 per day
272	Acting as director without holding qualification shares	Fine upto ₹ 500 per day
279	Acting as a director of more than 15 companies	Fine upto ₹ 50,000 for each company exceeding.
283(2A)	Functioning as a director after vacation of office	Fine upto ₹ 5,000 per day
286(2)	Default in giving notice of Board Meetings	Fine upto ₹ 1,000
292A	Default in complying the requirements relating to constitution etc. of Audit Committee.	Imprisonment upto 1 year or fine upto ₹ 50,000 or both.

Section	Nature of offence	Penalty
293A(5)(a)	Political contribution made in contravention of the section	Fine upto three times of the contribution
293A(5)(b)	Political contribution made in contravention of the provisions of the section.	Imprisonment upto 3 years and also fine
294(8)	Neglecting or refusing to furnish information required by Central Government or to produce any books and papers, etc.	Fine upto ₹ 50,000 and further fine not less than ₹ 500 per day
295(4)	Contravention of sub-section (1) or (3) regarding loans to directors, without Central Government's approval	Fine upto ₹ 50,000 or imprisonment upto 6 months.
299(4)	Failure to disclose interest in a contract by the Director	Fine upto ₹ 50,000
300(4)	Participation in Board meeting by interested director	Fine upto ₹ 50,000
301(4)	Non-compliance with the provisions of section 301(1), (2) and (3) in regard to register of contracts, companies and firms in which directors are interested.	Fine upto ₹ 5,000
301(5)/163(5)	Failure to maintain register of contracts	Fine upto ₹ 500 per day
302(5)	Failure to disclose of director's interest in contract appointing manager/managing director	Fine upto ₹ 10,000
303(3)	Failure to keep register of directors or to file with the Registrar return of directors, managing director, manager and secretary	Fine upto ₹ 500 per day
304(2)	Refusing inspection to any member of register kept under section 303	Fine upto ₹ 500
305(1)	Failure by a director to inform change of his particulars of directorship held.	Fine upto ₹ 5,000
307(7)	Failure to produce at annual general meeting register of directors' shareholding	Fine upto ₹ 5,000
307(8)	Failure to comply with the provisions of sections 307(1) and (2) in regard to register of directors' shareholdings	Fine upto ₹ 50,000 and further fine upto ₹ 200 per day
308(3)	Failure to make disclosure of shareholding by directors and persons deemed to be directors.	Imprisonment upto 2 years or fine upto ₹50,000 or with both

Section	Nature of offence	Penalty
320(3)	Failure to secure particulars regarding payment to directors stipulated in sub-section (1)	Fine upto ₹ 2,500
322(3)	Default in giving notice under this section	Fine upto ₹ 10,000 and damages
372A(9)	Default in complying with the provisions of this section regarding inter-corporate loans and investments, other than the provision of sub-section (5).	Fine upto ₹ 50,000 or imprisonment upto 2 years.
372A(10)	Default in keeping register of investment or loan made, guarantee given or security provided.	Fine upto ₹ 5,000 with a further fine of ₹500 per day.
383A(1A)	Failure to appoint whole-time secretary or filing of certificate of compliance from a practicing company secretary.	Fine upto ₹ 500 per day.
391(5)	Failing to annex to the copy of memorandum certified copy of court's order sanctioning any compromise or arrangement with creditors and members.	Fine upto ₹ 100 for each copy
393(4)	Failure to comply with the requirements of section 393 in regard to compromises or arrangements with creditors and members.	Fine upto ₹ 50,000
393(5)	Failure to give information by directors relating to compromise or arrangements with creditors and members.	Fine upto ₹ 5,000
394(3)	Failure to file with the Registrar a certified copy of the order of the court on application for sanctioning of a compromise of arrangement	Fine upto ₹ 500
395(4A)(b)	Issue of circular containing or recommending acceptance of offer for transfer of shares which has not been registered.	Fine upto ₹ 5,000
404(4)	Failure to file with the Registrar a certified copy of the altered memorandum of articles.	Fine upto ₹ 50,000
407(2)	Acting as managing or other director or manager, whose agreement has been terminated or set aside.	Imprisonment upto one year or fine upto ₹50,000 or with both
416(3)(b)	Non-compliance with the requirements of section 416 in regard to contract by agents of company in which company is undisclosed principal	Fine upto ₹ 2,000

Section	Nature of offence	Penalty
420	Contravention of sections 417, 418 and 419 regarding failure to collect provident fund and payment of contribution to the trust.	Imprisonment upto 6months or fine upto ₹10,000.
423	Non-compliance with the requirements of sections 421 and 422 in regard to receivers	Fine upto ₹ 2,000
424L(1)	Violation of provisions of Part VIA or any scheme or order of the Tribunal or the Appellate Tribunal or makes a false statement or give false evidence to the Tribunal or the Appellate Tribunal.	Imprisonment upto 3 years or fine upto ₹ 10 lakhs.
445(1)	Failure to file a copy of winding up order with the Registrar by the petitioner and the company.	Fine upto ₹ 1,000 for each day of default
481(3)	Default in forwarding a copy of court order of dissolution of the company by the liquidator to the Registrar.	Fine upto ₹ 500 for each day of default.
485(2)	Default in publication of resolution to wind up voluntarily by the company.	Fine upto ₹ 500 for each day of default.
488(3)	Any director of a company making a declaration under this section without having reasonable grounds for the opinion that the company will be able to pay its debts within specified period.	Imprisonment upto 6 months or fine upto ₹50,000 or with both.
493(3)	Default in giving the notice of appointment of liquidators by the company to the Registrar.	Fine upto ₹ 1,000 for each day of default.
495(2)	Failure to call creditors' meeting in case of insolvency by the liquidator.	Fine upto ₹ 5,000
496(2)	Failure in calling the general meeting at the end of each year by the liquidator.	Fine upto ₹ 1,000 in respect of each failure.
497(3)	Default in sending a return of the holding of the meeting and a copy of account by the liquidator to the Registrar and to the official liquidator.	Fine upto ₹ 500 for each day of default.
497(7)	Failure to call a general meeting of the company by the liquidator	Fine upto ₹ 5,000
500(6)	Default in calling the meeting of the creditors; to advertise the notice in the Official Gazette and newspapers and to prepare a statement of the position of the company's affairs alongwith a list of creditors.	Fine upto ₹ 10,000

Section	Nature of offence	Penalty
501(2)	Failure to give notice of resolution passed by the creditors' meeting by the company to the Registrar.	Fine upto ₹ 500 for each day of default.
508(2)	Failure to call meetings of the company of creditors at the end of each year by the liquidator.	Fine upto ₹ 1,000 in respect of each failure.
509(3)	Default in sending a return of the holding of meeting and a copy of account by the liquidator to the Registrar and to the official liquidator.	Fine upto ₹ 500 for each day of default.
509(7)	Failure to call a general meeting of the company or a meeting of the creditors by the liquidator as required by the section.	Fine upto ₹ 5,000 in respect of each such failure.
513(3)	Appointment of a body corporate as liquidator of a company in a voluntary winding up.	Fine upto ₹ 10,000
514	Corrupt inducement affecting appointment as liquidator.	Fine upto ₹ 10,000
516(2)	Failure to publish his appointment in the Official Gazette and to deliver to the Registrar for registration a notice of his appointment by the liquidator.	Fine upto ₹ 500 for each day of default.
539	Destroying, mutilating, altering, falsifying or secreting any books, papers or securities, to defraud any person of the company which is being wound up.	Imprisonment upto 7 years and also with fine.
541(1)	Failure to keep proper books of account by the company throughout the period of two years immediately preceding the commencement of winding up or the period between incorporation of the company and commencement of winding up, whichever is shorter.	Imprisonment upto one year.
547(2)	Failure to notify that the company is in liquidation in every invoice, order for goods or business letters issued etc., by or on behalf of the company.	Fine upto ₹ 5,000
550(4)	Default in disposal of books and papers of the company as per Rule 15 of the Companies (Central Government's) General Rules and Forms, 1956.	Imprisonment upto 6 months or fine upto ₹50,000 or with both.

Section	Nature of offence	Penalty
551(5)	Default in filing a statement of account in the prescribed form containing the prescribed particulars duly audited, by the liquidator with the Registrar.	Fine upto ₹ 5,000 for each day of default.
551(5) Proviso	If the liquidator makes willful default in causing the statement of account to be audited by a person qualified to act as auditor of the company.	Imprisonment upto 6 months or fine upto ₹10,000 or with both.
559(2)	Default in filing a certified copy of the order declaring dissolution of the company void by the person on whose application the order was made.	Fine upto ₹ 500 for each day of default.
581ZM(1)	Any person other than a Producer Company carries on business under any name which contains the words „Producer Company Limited’.	Fine upto ₹ 10,000/- for every day.
581ZM(2)	Director or officer of a Producer Company willfully fails to furnish information.	Imprisonment upto 6 months and fine 5% of turnover of preceding financial year.
581ZM(3)	Director or officer of a Producer Company making default in handing over the books of account and other documents to the said company or fails to convene annual general meeting or other general meeting.	Fine upto ₹ 1 lakh and additional fine of upto ₹10,000/- for every day.
581ZS(6)	Failure to file with Registrar of companies certified copy of the order of court for re-conversion of Producer Company to Inter-state Co-operative Society.	Fine upto ₹ 100/- per copy.
598	Failure by any foreign company to comply with requirements of Part XI of the Act.	Fine upto ₹ 10,000 and further fine upto ₹1,000 for each day of default.
606	Contravention of the provisions of section 603, 604 and 605 relating to prospectus of foreign companies.	Imprisonment upto 6 month or fine upto ₹50,000 or with both
614A(2)	Failure to file document with the Registrar as directed by the court.	Imprisonment upto 6 months or fine or with both

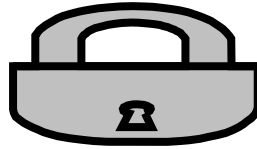
Section	Nature of offence	Penalty
615(6)	Failure to furnish information of statistics, etc. required by the Central Government.	Imprisonment upto 3 months or fine upto ₹10,000 or with both.
621A(5)	Failure to comply with the order of Central Govt. for filing any documents, return, etc.	Imprisonment upto 6 months or fine upto ₹50,000 or with both.
625(4)	Failure on the part of a shareholder to pay compensation.	Imprisonment upto 2 months.
628	False statement made in any return, balance-sheet, prospectus etc. by any person.	Imprisonment upto 2 years and also fine
629	False evidence given on oath or in any affidavit.	Imprisonment upto 7 years and also fine.
629A	Penalty for offences, for which no punishment provided elsewhere. Examples: 31(2A), 77B, 81(1), 83, 106, 117, 153, 182, 205(1), 252, 259, 267, 274, 291 etc,	Fine upto ₹ 5,000 and further fine of ₹ 500 per day.
630	Wrongful withholding of property of the company by an officer	Fine upto ₹ 10,000
630(2)	Default in delivering or refunding within a time fixed by court, any property wrongfully withheld or knowingly misapplied by an officer or employee upon trial under this section.	Imprisonment upto two years.
631	Improper use of the words "limited" and "private limited"	Fine upto ₹ 500 per day

LESSON ROUND-UP



- Companies Act provides punishments for offences in the form of imprisonment and/or fine in the various sections of the Act.
- Section 5 of the Act defines the term "officer who is in default".
- Under section 621A of the Act, the offences, the penalty for which is fine only may be compounded by the Central Government.
- List of amount of penalty along with sections and nature of offence (as an annexure) has been given in this Chapter.

SELF-TEST QUESTIONS

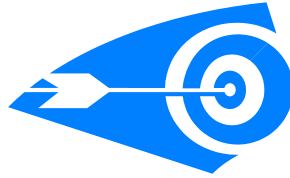


1. Explain the term „officer in default’. State the types of punishments prescribed under the Act.
2. What do you mean by „Compounding of offences’?

STUDY XXXIV

STRIKING OFF NAMES OF COMPANIES

LEARNING OBJECTIVES



Section 560 of the Companies Act, 1956 prescribes the procedure for striking off the name of defunct companies which are not carrying on any business, from the register of companies maintained by the Registrar. This is an alternative to winding up of a company subject to statutory criterion specified under the section. The powers under this section shall become transferred to the tribunal to be exercised by it in place of the court w.e.f a date yet to be notified for enforcement of companies (second amendment) Act, 2002. This chapter covers the following topics:

- Meaning of 'striking off'.
- When a company is still in operation.
- Rights of person aggrieved by company having been struck off the register.
- Effect of restoration order.
- Who can apply for restoration of name.
- Ministry of Corporate Affairs (MCA) Circulars.
- Procedure for striking off a company.

1. MEANING OF 'STRIKING OFF'

A company comes into existence by registration in the office of the Registrar of Companies. Section 34(1) of the Companies Act, 1956 provides that on the registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company, that the company is limited.

On registration of a company, the Registrar issues a certificate called Certificate of Incorporation, which certifies that the company is incorporated. The validity of the incorporation cannot be challenged thereafter.

According to Section 34(2) of the Companies Act, 1956 from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act.

Regulation 21 of the Companies Regulations, 1956 provides that in the office of each Registrar, there shall be maintained a "Register of Companies" in form III in

which the names of the companies shall be entered in the order in which they are registered. Every company so registered shall be assigned a number in one consecutive series. (Corporate Identity Number)

A company registered under the Act cannot be removed from the Register of companies maintained by the Registrar nor can the Certificate of Incorporation be cancelled unless the company is dissolved by the process of law, either as a result of its winding-up or its amalgamation with another company. However, the Companies Act provides a short-cut to the dissolution, namely striking it off the Register of Companies by the Registrar of Companies under Section 560, in case the company is a defunct company. Section 560 of the Act contains provisions for striking defunct companies off the register, which is an alternative to winding-up of a company. It is a mode of dissolution of a company without winding up, the only statutory criterion being that there should be a reasonable cause to believe that the company is not carrying on business or is not in operation. Section 560 of the Act prescribes the procedure which Registrar is required to follow in striking off any company.

‘Striking-off’ implies removal. The expression “defunct company” for the purposes of Section 560, means a company which is no longer in effect or use; not operating or functioning; not carrying on any business or is not in operation.

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, the Registrar can, on his own, exercise the power conferred upon him by Section 560 and remove the company from his Register of Companies by following the procedure laid down in that section.

Despite the striking-off, the liability, if any, of every director, manager or other officer who was exercising any power of management, and of every member of the company, shall continue and may be enforced as if the company had not been dissolved.

2. WHEN A COMPANY IS STILL IN OPERATION

A company which is in the course of being wound-up voluntarily is still in operation within the meaning of the section [*Langlagate Proprietary Co. (1912) 28 TLR 529*]. A company, although not carrying on business, may be in operation. [*Central India Mining Co. v. Society Coloniale (1920) 1 KB 753*] A company if it is operating as a company for doing something in relation to its past obligations or to avoid future pecuniary liability, it will be deemed to be in operation.

3. THE RIGHTS OF PERSON AGGRIEVED BY THE COMPANY HAVING BEEN STRUCK OFF THE REGISTER [SECTION 560(6)]

The company having been struck off the register or any member or creditor of such company, if feels aggrieved by the company having been struck off may make an application to the Court, for the restoration of the company to the register. Such an application must be made before the expiry of 20 years from the publication in the official gazette of the notice of striking-off.

The Court may order the name of the company to be restored to the register, if it is satisfied that-

- the company was, at the time of the striking off, carrying on business or in operation; or
- Otherwise that it is just that the company be restored to the register.

One of the reasons for exercising the Court's direction in favour of restoring a company must be that after restoration the company will be in a position to carry on the business of the company. Court would not exercise discretion when there is no evidence of substantial benefit to member or creditors.

In such a case the court may, by the order, give such directions and make such provision as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

The company must file electronically with the Registrar a certified true copy of the order passed by the Court, along with e-form No. 21. Upon a certified copy of the order under sub-section (6) being delivered to the Registrar for registration, the company shall be deemed to have continued in existence as if its name had not been struck off.

Choose the correct answer:

Within _____ from publication of notice of striking off in official gazette, an application be made by the company/member/creditor to the court.

- (a) 5 years
- (b) 10 years
- (c) 15 years
- (d) 20 years

Correct Answer: (d)

4. EFFECT OF RESTORATION ORDER

Where the Court orders for restoration of name of company, the effect of an order is to place the company whose name was struck off by the Registrar in the same position as if the name of the company had never been struck off during the interregnum. If a court of competent jurisdiction directs restoration of the name of the company, it shall be deemed to have continued throughout.

The effect of the provision in Section 560(7) that the company shall be "deemed to have continued in existence as if its name had not been struck off" was not only that the corporate existence of the company was preserved, but was also retrospective, so that at the date of the hearing of the application the company was to be regarded as never having been dissolved. Another consequence was that the rights of all parties would be as though there had been no cessation or interruption in the existence of the company on account of the striking off and subsequent restoration.

Company Law Board has no power to restore the company in terms of Section 560(6), as the powers under that section were vested in the High Court.

5. MODE OF SENDING LETTER/NOTICE

A letter or notice to be sent under this section to a company may be addressed by the Registrar in any of the modes mentioned below:

- (a) to the company at its registered office; or
- (b) if no office has been registered, to the care of some director, manager or other officer of the company; or

- (c) if there is no director, manager or officer of the company whose name and address are known to the Registrar, to each of the persons who subscribed the memorandum, addressed to him at the address mentioned in the memorandum.

6. WHO CAN APPLY FOR RESTORATION OF NAME?

An application for restoration can only be made by the company, member or creditor. It must be shown that at the date when the company was dissolved the petitioner was a member or creditor thereof, and anyone, whether in ignorance of the dissolution or not, who purported to become a member or creditor afterwards, was not so qualified. One who acquires shares or a debt of a company whose name has been struck off the register, and who at the time of acquisition has knowledge of that fact, is not a 'person aggrieved' within this sub-section.

A third party unless he is a creditor has no locus standi to apply. The expressions "member" or "creditor" used in sub-section (6) of Section 560 includes the personal representatives of a deceased member or creditor.

When a suit is actually pending against a company and is being contested by it at the time of removal of its name from the register, it is proper to direct the restoration of the name of the company, particularly when the directors were aware of the fact of the contested litigation and were actually taking part in it.

The Registrar is not bound to remove a company from the register, even though an application be made for the purpose where the object of the application to the Registrar under this section is to avoid liability on a suit pending against the company, the application must be rejected.

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

A third party has a locus standi to apply for restoration of the company.

- True
- False

Correct Answer: False

A third party, unless a creditor, has no locus standi to apply.

7. MINISTRY OF CORPORATE AFFAIRS' CIRCULARS

Policy followed with regard to weeding out defunct companies—The policy which is followed with regard to weeding out the defunct companies is that where it appears from the latest available balance sheet of a defunct company that it has adequate realisable assets, steps are taken to take the company into compulsory liquidation. But where the latest available balance sheet shows that the company has no assets or has such assets as would not be sufficient to meet the costs of liquidation, steps are taken to strike their names off the register under Section 560. The striking off the name of a company does not materially affect the creditors of the company, because such creditors may:

- (i) enforce their claims against every director, secretaries and treasures, manager or any other officer of the company and against every member of the company as if the name of the company had not been struck off; or

- (ii) apply to the court for the winding-up of the company whose name has been struck off; or
- (iii) apply to the court, at any time within 20 years from the date of publication of the notice intimating that the name of the company has been struck off, for the restoration of the name of the company to the Register of Companies and on such application being made, court may order the name of the company to be restored to the register.

As per section 560 of the Companies Act, 1956, Registrar of Companies may strike off the name of companies on satisfying the conditions therein. As per present practice, a company desirous of getting its name struck off, has to apply to Registrar of companies in e-form 61. All pending statutory returns are required to be filed along with e-form 61.

In order to give an opportunity for fast track exit by a defunct company, for getting its name struck off from the register of companies, the Central Government (MCA) vide its General Circular 36/2011 dated 07.06.2011, has modified the existing route through e-form – 61 and has prescribed the Guidelines for “Fast Track Exit (FTE) mode” for defunct companies under section 560 of the Companies Act, 1956.

According to new guidelines any defunct company desirous of getting its name strike off the Register under Section 560 of the Companies Act, 1956 shall make an application in ‘e-Form FTE’ accompanied by filing fee of Rs. 5,000/-

The new guidelines are available on MCA website at the following link.

http://mca.gov.in/Ministry/pdf/Circular_36-2011_07jun2011.pdf

8. PROCEDURE FOR STRIKING OFF A COMPANY

The striking off a company may be effected by following two ways:

(A) Striking-off by Registrar of his own motion

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation. If the Registrar does not receive any answer to the letter sent by him within one month, he shall send a second letter, within 14 days after the expiry of the month, to the company referring the first one and stating that no answer has been received to the first letter and if an answer to the second letter is not received within one month from the date thereof, a notice for striking off the name of the company will be published in the Official Gazette.

If the Registrar received an answer within one month (after sending the second letter) from the company to the effect that it is not carrying on business or not in operation or if the Company does not reciprocate to the second letter, the registrar send a notice to the company by registered post and also publish such notice in the Official Gazette stating that the after expiration of three month from the date of notice the name of the company will be struck off the register and the company will be dissolved.

After the expiry of time mentioned in the notice the registrar may, unless cause to the contrary is previously shown by the company, strike its name off the register and shall publish notice thereof in the Official Gazette and on the publication of this notice in the Official Gazette the Company shall stand dissolved.

(B) Striking-off on company's application

The Registrar can exercise the power conferred on him by Section 560, when an application is received by him from the company for striking it off on the ground that it is a defunct company, i.e. it is not carrying on business or in operation. After the receipt of application from the Company, the Registrar may proceed to strike its name off the register, and shall publish notice thereof in the Official Gazette.

In a recent case, the name of a company was struck off the Register of Companies, upon its failure to file necessary annual accounts, returns and other documents with the Registrar of Companies, after due compliance with the procedure prescribed under section 560 of the Companies Act, 1956. In a petition under section 560 of the Act, the company sought restoration of its name in the register of companies.

It was contended, inter alia, that the firm of chartered accountants engaged by it to perform the task of filing the returns with the office of the Registrar of Companies had failed to do so. No objection certificates of the directors as well of the shareholders for restoration of the name of the company in the register were also placed on record.

The court held that the company was a running concern and had filed the petition within the limitation period. The petition was to be allowed and the name of the company, its director and member was to be restored to the register of companies as if it had not been struck off.

In the case of *Sitaram Singh Construction P. Ltd. V. Union Of India* [2010] 156 Comp Cas 127 (Pat), the issue was whether the Registrar can strike off a company without publishing a gazetted notification in this regard?

In this case, the Registrar of Companies had neither published the notice in the Official Gazette nor sent the notice to the company by registered post as required under section 560(3) of the Companies Act, 1956. On the other hand, the company was continuously carrying on business.

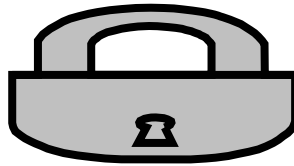
It was held that although, there was a serious omission on the part of the company in not filing its annual returns, the mandatory requirement under section 560(3) of the Act was not complied with by the Registrar. Therefore, the notice issued under section 560(5) of the Act was to be quashed and the name of the company was to be restored.

LESSON ROUND-UP

- A company which is not carrying on any business or in operation, is a defunct company and may be struck off from the register of companies under Section 560 of Companies Act, 1956.
- A Company or a member or a creditor may make an application to the court for restoration of the name of the company to the register, if they feel aggrieved by such decision of striking off.

- The effect of order of the court for restoration of the name of company is to place the company in same position as if its name had never been struck off.
- The Registrar may on its own motion proceed to strike off a company, if it has reasonable cause to believe that a company is not carrying on business.
- The Registrar can exercise the power to strike off on receiving an application from the Company for striking it off on the ground that it is a defunct company i.e. it is not carrying on business or in operation under Section 560 of the Companies Act, 1956.

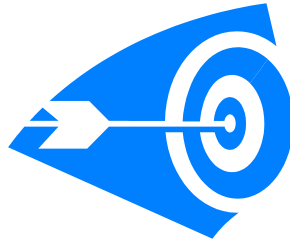
SELF-TEST QUESTIONS



1. What do you mean by 'striking off'? Who can apply for striking off name of Company under Section 560?
2. "Striking off name of company under Section 560 is an alternative to winding up of a company subject to a statutory criterion specified under the section." Explain the statutory criterion.

STUDY XXXV
WINDING UP OF COMPANIES

LEARNING OBJECTIVE



Winding up of a company is the stage, whereby the company takes its last breath. It is a process by which business of the company is wound up, and the company ceases to exist anymore. All the assets of the company are sold, and the proceedings collected are used to discharge the liabilities on a priority basis. This chapter deals with the concept and various modes of winding up. The topics covered are:

- Introduction
- Winding up and Dissolution
- Modes of winding up
- Winding up by the Court
- Voluntary winding up
- Winding up subject to the supervision of Court
- Distinction between voluntary winding up and winding up under the supervision of Court
- Commencement of winding up
- Winding up of unregistered companies

NOTE: Wherever the term 'Court' is being used in the chapter, that will be substituted by 'Tribunal' in accordance with Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

1. INTRODUCTION

Corporate Collapse implies business failure of the company, which may occur due to inadequate capital, fraudulent business practices, management inexperience and incompetence, failure to respond to change, recession, obsolescence, excessive gearing etc. The Companies Act, 1956, provides various remedies to deal with such business failures such as arrangement, reconstruction, amalgamation, winding-up. Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

In the words of Prof. L.C.B. Gower, Winding-up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors

and members. A liquidator is appointed and he takes control of the company, collects its debts and finally distributes any surplus among the members in accordance with their rights. Thus, winding-up is the process by which management of a company's affairs is taken out of its directors' hands, its assets are realized by a liquidator and its debts are discharged out of proceeds of realization. Any surplus of assets which remains after such discharge is returned to its members or shareholders.

The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law. However, the purpose must not be exploited for the benefit or advantage of any class or person entitled to submit petition for winding up of a company. It may be noted that on winding up, the company does not cease to exist as such except when it is dissolved. The administrative machinery of the company gets changed as the administration is transferred in the hands of the liquidator. Even after commencement of the winding-up, the property and assets of the company belong to the company until dissolution takes place. On dissolution the company ceases to exist as a separate entity and becomes incapable of keeping property, suing or being sued. Thus in between the winding up and dissolution, the legal status of the company continues and it can be sued in the court of law.

Company cannot be Adjudged Insolvent

The winding up of a company is not the same thing as the insolvency of a company, for the general rule in regard to winding up is that if the members of a company desire that the company should be dissolved or if it becomes insolvent or is otherwise unable to pay its debts, or if for any reason it seems desirable that it should cease to exist, it is wound up. It is obvious that a company may be wound up even when it is perfectly solvent, e.g. for purpose of reconstruction. Furthermore, a company can never be declared bankrupt although it is unable to pay its debts. Thus, we may put the proposition that in so far as inability to pay debts is concerned, a bankruptcy of an individual under the insolvency law is the same thing as a winding up of a company under the company law but a company can also be wound up for reasons other than inability to pay its debts.

Following are some of the differences between the effects of insolvency of an individual or a firm and winding up of a company:

1. In the case of insolvency, the whole of the insolvent's property is taken out of his hands and rests in the Court (under the Provincial Insolvency Act, 1920) or the Official Assignee (Under the Presidency towns Insolvency Act, 1909). In winding up, on the other hand, the property remains vested in the company, subject to its being administered for the purposes of winding up as the company retains its complete existence. Its legal death comes only when it is formally dissolved.
2. In insolvency, an insolvent individual can obtain his discharge and continue living and working free from the burden of his debts. A company in liquidation cannot obtain its discharge and continue free from the burden of its debts. The liquidator winds up its affairs and then terminates it through dissolution.
3. Although in the administration of the assets of an insolvent company the

insolvency rules apply, they are, however, not identical with those of insolvency. For example, the “reputed ownership” clause of insolvency law has no application in the case of a company in liquidation.

4. In the case of an individual, the administration of his property by the Official Assignee or the Official Receiver occurs only if he is declared an insolvent by the Court. But the assumption of the directors’ powers by the liquidator, occurs even if the company is fully solvent. Liquidation or winding up, even of an solvent company can be proceeded with the aid of the court, as in voluntary winding up.

2. WINDING UP AND DISSOLUTION

The terms “Winding up” and “Dissolution” are sometimes erroneously used to mean the same thing. But according to the Companies Act, 1956, the legal implications of these two terms are quite different and there are fundamental differences between them as regards the legal procedure involved. The main points of distinction are given below:

1. The entire procedure for bringing about a lawful end to the life of a company is divided into two stages – ‘winding up’ and ‘dissolution’. Winding up is the first stage in the process whereby assets are realised, liabilities are paid off and the surplus, if any, distributed among its members. Dissolution is the final stage whereby the existence of the company is withdrawn by the law.
2. The liquidator appointed by the company or the Court carries out the winding up proceedings but the order for dissolution can be passed by the Court only.
3. According to the Companies Act the liquidator can represent the company in the process of winding up. This can be done till the order of dissolution is passed by the Court. Once the Court passes dissolution orders the liquidator can no longer represent the company.
4. Creditors can prove their debts in the winding up but not on the dissolution of the company.
5. Winding up in all cases does not culminate in dissolution. Even after paying all the creditors there may still be a surplus; company may earn profits during the course of beneficial winding up; there may be a scheme of compromise with creditors while company is in winding up and in all such events the company will in all probability come out of winding up and hand over back to shareholders/old management. Dissolution is an act which puts an end to the life of the company.

As such winding up is only a process while the dissolution puts an end to the existence of the company. Unless and until the dissolution declared as void under Section 559 of the Act, it prevents any proceedings being taken against promoters, directors or officers of the company to recover money or property due or belonging to the company or to prove a debt due from the company. When the company is dissolved, the statutory duty of the liquidator towards the creditors and contributories is gone, but if he has committed without complying with the requirements of the Act, he is liable to damages to the creditors.

3. MODES OF WINDING UP

A company registered under the Companies Act, 1956 may be wound up by any of the following modes:

1. By the Court i.e. compulsory winding up;
2. Voluntary winding up, which may be either:
 - (a) Members' voluntary winding up; or
 - (b) Creditor's voluntary winding up;
3. Winding up subject to the supervision of the Court.

Section 425 of the Companies Act, 1956 lays down the above three modes of winding up and provides that the provisions of the Act with respect to winding up shall apply, unless the contrary appears, to the winding up of a company in any of these three modes.

In every winding up, a liquidator or liquidators is or are appointed to administer the property of the company and he or they must apply the assets of the company, first, in the payment of the creditors in their proper order, and then, in distributing the residue among the members according to their rights.

4. WINDING UP BY THE COURT

Winding up by the Court or compulsory winding up is initiated by an application by way of petition to the appropriate Court for a winding up order. A winding up petition has to be resorted to only when other means of healing an ailing company are of absolutely no avail. Remedies are provided by the statute on matters concerning the management and running of company. The extreme and irretrievable step of winding up must be resorted to only in very compelling circumstances. [*Daulat Makanmal Luthrid v. Solatire Hotels* (1993) 76 Comp. Cas. 215 (Bom. HCD)]. It is primarily the High Court which has the jurisdiction to wind up companies under Section 10 of the Companies Act, 1956 in relation to the place at which registered office of the company concerned is situated except to the extent to which jurisdiction has been conferred on any District or District Courts subordinate to the High Court. The Central Government may empower any District Court to exercise that jurisdiction, presumably to reduce the burden of the High Court, only in respect of small companies with the paid-up capital of less than one lakh rupees and having their registered office within the District, with a view to achieving expeditious and efficient disposal of winding up proceedings.

The Act, therefore, under Sections 435 to 438, confers wide powers upon the High Court to regulate the conduct of such proceedings. Accordingly the High Court which is the winding up Court may direct a District Court to retain and continue winding up proceedings which should not really have been commenced in that Court (Section 437). It may also withdraw any winding up which is in progress in a District Court from that Court and proceed with the winding up itself, or transfer it to another District Court (Section 436), and with respect to all proceedings subsequent to its own order of winding up, direct them to be had in a District Court or with the consent

of any other High Court, in such High Court or in a District Court subordinate to that High Court, whereupon the Court in respect of which such direction is given shall be deemed to be the Court with all powers and jurisdiction of the High Court under the Act (Section 435). Lastly, the High Court can pass orders under any of the foregoing sections at any time and at any stage, whether or not an application in that behalf is made by any of the parties to the proceedings (Section 438). There must be strong reasons to order winding up as it is a last resort to be adopted. Temporary difficulty cannot be ground for liquidating company when company is on path of revival. *D. Ashokan v. S.T. Reddiar & Sons* (2002) 40 SCL (Ker. HC DB).

Grounds on which a Company may be wound up by the Court

A company under Section 433 may be wound up by the Court if (a) the company has passed a special resolution of its being wound up by the Court; or (b) default is made in delivering the statutory report to the Registrar or in holding the statutory meeting; or (c) it does not commence business within a year from its incorporation or suspends business for a whole year; or (d) the number of its members in the case of a public company is reduced below seven and in the case of a private company, below two; or (e) it is unable to pay its debts; or (f) the Court is of the opinion that it is just and equitable that it should be wound up. (g) the company has made a default in filing with the registrar its balance sheet and profit and loss account or annual returns for any five consecutive financial years. (h) the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality, or (i) the court is of the opinion that the company should be wound up under the circumstances specified in Section 424G provided that the tribunal shall make order for winding up of a company under clause (h) on application made by the Central Government or a State Government.

The winding up petition is not a legitimate means of seeking to enforce payment of debt, which is bonafide disputed by the company.

In *Shakti Agencies v. Manshuk Bhai Industries Ltd.* [(2007), 74 SCL 332 (RAJ)], decided on 14.8.2006, Petitioner firm filed a winding up petition against the respondent company for the recovery of a debt which was disputed by the respondent company. The Petition was dismissed.

The instant case was of bona fide disputed debt. Even from the petition for winding up, it was evident that for the payment of ₹ 10,50,000, the petitioner firm agreed to purchase shares of the respondent company.

In the additional affidavit filed by the respondent company, it was stated that application form was signed by the proprietor of petitioner with a sole view to settle the outstanding account pursuant to which the respondent proceeded to allot 70,000 shares to the petitioner and the certificates were dispatched, which were received by the representative of petitioner. The respondent disputed the debt and it could not be held that it neglected to pay the debt within the meaning of section 433(1)(a). The winding up petition is not a legitimate means of seeking to enforce payment of debt, which is bona fide disputed by the company.

The principles, on which the Court should act is disposing of winding up petition,

may be deduced thus: (i) if the debt is not disputed on some substantial ground, the Court may make the order, (ii) if the debt is bona fide disputed, there cannot be 'neglect to pay' within the meaning of section 433(i)(a) and petition for winding up is not maintainable, (iii) dispute with regard to payment of interest is not a *bona fide* dispute, (iv) the defence of respondent company should be in good faith, one of substance and likely to succeed in point of law.

Multiple Choice Question:

Under what conditions may a Company be wound up by the court?

- (a) It does not commence business within a year from its incorporation or suspends business for a whole year.
- (b) The Court is of the opinion that it is just and equitable that it should be wound up.
- (c) The company has not been able to recruit employees from a long time.
- (d) None of the above.

Correct Answer: a & b

Who may file Petition for the Winding up

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 439 by any of the following persons:

- (a) the company; or
- (b) any creditor or creditors, including any contingent or prospective creditor or creditors; or
- (c) any contributory or contributories; or
- (d) all or any of the parties specified above in clauses (a), (b), (c) whether together or separately; or
- (e) the Registrar; or
- (f) any person authorised by the Central Government in the case falling under Section 243, i.e., following upon a report of inspectors.
- *(g) by the Central government or state Govt., in a case falling under clause (h) of Section 433.

The Official Liquidator or any of the persons mentioned above as being entitled to present a petition under Section 439, will have a right to present a winding-up petition when a company is already being wound up voluntarily or subject to the supervision of the Court, and such voluntary winding up cannot be continued with due regard to the interests of the creditors or contributories or both (Section 440). In *Mumbai Labour Union v. Indo French Time Industries* (2002) 38 SCL 924, it was held that a trade union can not file winding up petition for unpaid wages of workmen/employees. They are disentitled as other legitimate and efficacious remedy under labour laws is available. In such case, filing winding up petition is abuse of law.

* **inserted** Vide Companies (Second Amendment) Act, 2002

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

Any contributory or contributories or the Registrar may petition for the winding up of a company.

- True
- False

Correct Answer: True

Jurisdiction of Court for entertaining Winding up Petition

In terms of the provisions of Section 10 of the Companies Act, 1956, the jurisdiction for entertaining winding up petition vests either in the High Court having jurisdiction in relation to the place where the registered office of the company is situated or the District Court of the area subordinate to the High Court, in which the jurisdiction has been vested either by the Act or by the Central Government by notification in the Official Gazette. In *GTC Industries Ltd. v. Parasrampur Trading* (1999) 34 CLA 380 (All HC), it was held that only High Court where the registered office is situated has jurisdiction in winding up, even if there was agreement between parties that dispute between parties will be resolved before High Court where registered office is not situated. Regardless of where agreement is executed, Company Court having jurisdiction over the place where the registered office is situated, will have the jurisdiction to entertain a petition for winding up. *LKP Merchant Financing v. Arwin Liquid Gases* (2001) 103 Comp. Cas. 211 (Guj.).

For the purposes of jurisdiction to wind up companies, the expression ‘Registered Office’ means the place which has longest been the registered office of the company during the six months immediately preceeding the presentation of the petition for winding up. In *Kalpna Trading v. N.C.L. Industries Ltd.* [(1996) 1 Comp. LJ 152], the Orissa High Court refused to entertain the petition for winding up as the Company had its place of Registered Office at Hyderabad.

5. VOLUNTARY WINDING UP

The companies are usually wound up voluntarily as it is an easier process of winding up. It is altogether different from a compulsory winding up. In voluntary winding up the company and its creditors are left to settle their affairs without going to a Court, although they may apply to the Court for directions or orders, as and when necessary. One or more liquidators are to be appointed by the company in general meeting for the purpose of winding up the affairs and distributing the assets of the company. The remuneration of the liquidators is also required to be fixed by the company in general meeting. Unless the remuneration as aforesaid is fixed the liquidators shall not take charge of his/their offices (Section 490). The circumstances in which a company may be wound up voluntarily are:

- (a) when the period fixed for the duration of the company as mentioned in its articles has expired; or the event, on the happening of which the articles

provide that the company is to be dissolved has occurred; and the company passes a resolution in general meeting requiring the company to be wound up voluntarily;

- (b) if the company passes a special resolution that the company be wound up voluntarily [Section 484 (1)].

Thus, a company may be wound up voluntarily on the expiry of the term fixed for duration of the company or on the occurrence of the event as provided in its articles. In these two cases only an ordinary resolution may be passed in the general meeting of the company. Apart from these two cases, a company may be voluntarily wound up for any other reason for which a company has to pass a special resolution. A proper notice required for the respective meetings must be given to all the members and in the latter case the text of the special resolution to be passed together with the reason to wind up voluntarily must be explained therein.

The resolution (whether ordinary or special), when passed, must be advertised within 14 days of the passing of the resolution in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. A default in complying with the above requirements renders the company and every officer of the company, who is in default, liable to a penalty which may extend to five hundred rupees for every day during which the default continues. A liquidator of the company is deemed to an officer of the company for the purposes of the above requirements (Section 485).

A voluntary winding up commences from the date of the passing of the resolution for voluntary winding up. This is so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court.

The effect of the voluntary winding up is that the company ceases to carry on its business except so far as may be required for the beneficial winding up thereof. The corporate status and the powers of the company, however, continue until it is dissolved [Section 487].

Kinds of Voluntary Winding Up

Section 488(5) divides voluntary winding up into two kinds:

- (i) Members' voluntary winding up; and
- (ii) Creditors' voluntary winding up.

Members' Voluntary Winding Up

When the company is solvent and is able to pay its liabilities in full, it need not consult the creditors or call their meeting. Its directors, or where they are more than two, the majority of its directors may, at a meeting of the Board, make a declaration of solvency verified by an affidavit stating that they have made full enquiry into the affairs of the company and that having done so they have formed an opinion that the company has no debts or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration.

In *Shri Raja Mohan Manucha v. Lakshminath Saigal* (1963) 33 Comp. Cas. 719, it was held that where the declaration of solvency is not made in accordance with the law, the resolution for winding up and all subsequent proceedings will be null and void. Such a declaration must be made within five weeks immediately preceding the date of the passing of the resolution for winding up the company and be delivered to the Registrar for registration before that date. The declaration must be accompanied by a copy of auditor's report on the balance sheet and profit & loss account as at the latest practicable date before the making of the declaration and also embody a statement of the company's assets and liabilities as at that date. . Any director making a declaration without having reasonable grounds for the aforesaid opinion, shall be punishable with imprisonment extending up to six months or with fine extending up to ₹ 50,000 or with both [Section 488].

A winding up in the case of which such a declaration has been made and delivered in accordance with Section 488 is referred to as "a member's voluntary winding up". A winding up in the case of which such a declaration has not been so made and delivered is referred to as a "creditors' voluntary winding up" [Section 488(5)].

Choose the Correct Answer:

Who appoints the liquidator in case of Members voluntary winding up?

- (a) The court
- (b) The creditors
- (c) The members
- (d) The registrar

Correct Answer: c

Creditors' Voluntary Winding Up

As discussed earlier, where a declaration of solvency of the company is not made and delivered to the Registrar in a voluntary winding up it is a case of creditor's voluntary winding up.

Distinction between Members' and Creditors' Voluntary Winding Up

The main differences between the two are as follows:

1. A member's voluntary winding up results where, before convening the general meeting of the company at which the resolution of winding up is to be passed, the majority of the directors file with the Registrar a statutory declaration of solvency. A creditors' voluntary winding up is one where no such declaration is filed.

2. In a member's voluntary winding up, the creditors do not participate directly in the control of the liquidation, as the company is deemed to be solvent; but in a creditors' voluntary winding up, the company is deemed to be insolvent and, therefore, the control of liquidation remains in the hands of the creditors.

3. There is no meeting of creditors in a members' voluntary winding up and the liquidator is appointed by the company; whereas in a creditors' voluntary winding up, meetings of creditors have to be called at the beginning and subsequently the liquidator is appointed by the creditors.

4. In a members' voluntary winding up the liquidator can exercise some of his powers with the sanction of a special resolution of the company; but in a creditors' voluntary winding up he can do so with the sanction of the Court or the Committee of Inspection or of a meeting of creditors.

Multiple choice question:

Under what conditions a company may be wound up voluntarily?

- (a) The event, on the happening of which the Articles provide that the company is to be dissolved has occurred.
- (b) The company has made a default in filing with the Registrar its balance sheet.
- (c) The period fixed for the duration of the company as mentioned in its Articles has expired.
- (d) None of the above

Correct Answer: a, c

Powers of the Court to Intervene in Voluntary Winding Up

In voluntary winding up it is left to the company, the contributories and the creditors to settle their affairs without intervention of the Court as far as possible. However, the Companies Act, 1956, contains certain provisions which provide a means of access to the Court with a view to speed up the liquidation proceedings and to overcome the difficulties that may arise in the course of liquidation. The Court will intervene in the voluntary winding up whenever it is satisfied that such an intervention will be just and beneficial. In appropriate cases the Court can be approached for compulsory winding up (Section 440) or winding up being conducted under the supervision of the Court (Section 522).

The Court is vested with the following powers in voluntary winding up:

- (i) To appoint the Official Liquidator or any other person as liquidator where no liquidator is acting [Section 515(1)].
- (ii) To remove the liquidator and appoint the Official Liquidator or any other person as liquidator on justifiable cause being shown [Section 515(2)].
- (iii) To determine the remunerations of liquidator when the Official Liquidator is appointed as a liquidator [Section 515(3)].
- (iv) To amend, vary, confirm or set aside the arrangement entered into between a company and its creditors on an appeal being made by any creditor or contributory within 3 weeks of the completion of the arrangement (Section 517).

- (v) On an application of the Liquidator or contributory or creditor:
 - (a) to determine any question arising in the winding up of a company [Section 518(1)(a)];
 - (b) to exercise, as respects the enforcing of calls, the staying of suits or other legal proceedings or any other matter, all or any of the powers which the Court might exercise if the company were being wound up by the Court [Section 518(1)(b)].
- (vi) To set aside any attachment, distress or execution started against the estate or effects of the company after the commencement of the winding up on such terms as it thinks fit on an application made by the liquidator, creditor or contributory if the Court is satisfied that it is just and beneficial to do so [Section 518(3) and (4)].
- (vii) To order public examination of any person connected with promotion or formation of a company or any officer connected with the affairs of the company in regard to matters of promotion or formation or conduct of the business of the company or as to his conduct or dealing as officer thereof. Such an examination can be ordered on a report of the liquidator where he is of the opinion that a fraud has been committed by the persons aforesaid in the formation or promotion of the company or in the conduct of its affairs [Section 519(1)].

6. WINDING UP SUBJECT TO THE SUPERVISION OF COURT

When a company has by special or ordinary resolution resolved to wind up voluntarily, the Court may make an order that the voluntary winding up shall continue, but subject to such supervision of the Court and with such liberty for creditors, contributories or others to apply to the Court and generally on such terms and conditions, as the Court thinks just (Section 522).

The application for such intervention of the Court is made by a creditor, contributory or the voluntary liquidator, when there are irregularities or frauds in the voluntary winding up. The Court may have regard to the wishes of creditors and contributories, while making such an order. A petition for the continuance of a voluntary winding up subject to the supervision of the Court shall, for the purpose of giving jurisdiction to the Court over suits and legal proceedings, be deemed to be a petition for winding up by the Court (Section 523).

The object of the supervision order is to safeguard the interest of the company, shareholders and creditors. When an order is made for a winding up subject to supervision, the Court may, by that or any subsequent order, appoint an additional liquidator or liquidators. Generally, the old liquidator is permitted to continue by the Court if there is no complaint against him. The Court is also empowered to remove any liquidator so appointed or any liquidator continued under the supervision order and fill any vacancy by the removal or by death or resignation of the liquidator. The Court has also been empowered under the Companies (Amendment) Act, 1960 to appoint Official Liquidator as a Liquidator or to fill any vacancy caused by the removal, death or resignation of the previously appointed liquidator. The Court may also appoint or remove a liquidator on an application of the Registrar in this behalf (Section 524).

Effect of Supervision Order

(i) In supervisory winding up, the liquidator may, subject to any restrictions imposed by the Court, exercise all his powers, without the sanction or intervention of the Court, in the same manner as if the company were being wound up altogether voluntarily [Section 526(1)].

(ii) The effect of a petition for winding up subject to supervision is, that the Court Implications obtains jurisdiction over suits and legal proceedings as in the case of a petition for compulsory winding up [Section 526(2)].

(iii) The supervision order also confers full authority on the Court to make calls or to enforce calls made by the liquidators, and to exercise all other powers which it might have exercised if an order had been made for winding up the company altogether by the Court [Section 526(2)].

(iv) When an order has been made for winding up a company subject to supervision, and an order is afterwards made for winding up by the Court, the Court has power to appoint any person or persons who are then liquidators either provisionally or permanently, to be liquidator or liquidators in the winding up by the Court in addition to, and subject to the control of the Official Liquidator [Section 527].

(v) Since the supervision order has the same effect as an order for compulsory winding up, the company cannot be dissolved except by the order of the Court as in the case of compulsory winding up.

7. DISTINCTION BETWEEN VOLUNTARY WINDING UP AND WINDING UP UNDER THE SUPERVISION OF THE COURT

The points of distinction between the two modes are summarised below:

1. In pure voluntary winding up, the liquidator is appointed by the members in general meeting in the case of members' voluntary winding up and by the creditors in the case of creditors' voluntary winding up. In a voluntary winding up subject to supervision, the Court may appoint an additional liquidator, or liquidators who may be the Official Liquidator. The Court may remove the liquidator appointed by it or any liquidator continued under supervision order and fill any vacancy caused by such removal, death or resignations.
2. By virtue of Section 536, transfers of shares or any alteration in the status of the Members of the Company or any disposition of property (including actionable claim) of the company made after the commencement of winding up are void unless the Court orders otherwise in a winding up under the supervision of the Court. In a pure voluntary winding up such transfers can be agreed to by the voluntary liquidator.
3. By virtue of Section 545, if it appears to the Court either in compulsory winding up or subject to Court's supervision, that any past or present officer, or any member, of the company has been guilty of any offence in relation to the company the Court may, either on the application of any person interested in the winding up or of its own motion direct the liquidator to prosecute the offender or to refer the matter to the Registrar. But in the case

of a pure voluntary winding up, the liquidator makes a report to the Registrar in this regard.

4. For exercising certain powers conferred by Section 546, the liquidator has to get the sanction of the Court in a winding up subject to supervision whereas in a pure voluntary winding up the liquidator gets the sanction by special resolution passed in a general meeting of the company, and the power may be exercise subject to control of the court.

8. COMMENCEMENT OF WINDING UP

Section 441 of the Companies Act provides for the provisions relevant to commencement of winding up. The winding up of a company by the Court is deemed to commence at the time of the presentation of the petition for winding up. But where, before the presentation of the petition a resolution has been passed by the company, for voluntary winding up, the winding up shall be deemed to have commenced at the time of the passing of the resolution. Any proceedings taken in voluntary winding up will be deemed to have been validly taken unless the Court directs otherwise on proof of fraud or mistake.

In all other cases, the winding up of a company must be deemed to have commenced at the time of the presentation of the petition for the winding up [Section 441]. Where an order is made by the Court on more than one petition the commencement of the winding up dates from the earliest petition. [See *Kent v. Freehold Land Co.*, (1868) 3 Ch. App. 493]. It may be noted here that voluntary winding up shall be deemed to commence at the time when resolution for voluntary winding up is passed (Section 486).

In *Rishabh Agro Industries Ltd. v. PNB Capital Services Ltd.* (2000) AIR SCW 1753, it was held that the words 'shall be deemed to have commenced' clearly show the intention of legislature that although the winding up of a company does not in fact commence at the time of presentation itself, but it shall be presumed to commence from that stage. The word 'deemed' used in Section 441 would thus mean 'suspended', 'considered', 'construed', 'thought', 'taken to be' or 'presumed'.

9. WINDING UP OF UNREGISTERED COMPANIES

Section 582 of the Act specifies "unregistered companies", which may be wound up by the order of the Court under the provisions of Part X of the Act. By virtue of that section, an "unregistered company" does not include the following:

- (a) a railway company incorporated by any Act of Parliament or other Indian Law or any Act of Parliament of the United Kingdom;
- (b) a company registered under the Companies Act, 1956; or
- (c) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India.

Except as aforesaid, any partnership, association or company consisting of more than seven members at the time when the petition for winding up the partnership, association or company, as the case may be, is presented before the Court, will be

deemed to be an unregistered company and may be wound up by the order of the Court. It should be noted that if the number of members is not more than seven, the Court has no jurisdiction to wind up such a company.

Choose the correct answer:

Whose jurisdiction is it to wind up companies under Section 10 of the Companies Act, 1956?

- (a) Supreme Court
- (b) High Court
- (c) District Court
- (d) None of the above

Correct Answer: b

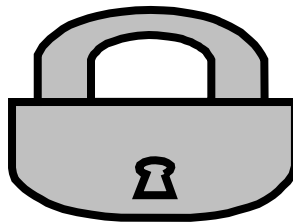
LESSON ROUND-UP



- Winding up of a Company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. An administrator called the liquidator is appointed and he takes control of the company, collects its assets, pays debts and finally distributes any surplus among the members in accordance with their rights. At the end of winding up, the company will have no assets or liabilities. When the affairs of a Company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of companies and its legal personality as a corporation comes to an end.
- Winding up is only a process while the dissolution puts an end to the existence of the company.
- There are three modes of winding up: winding up by Court (Tribunal) i.e. compulsory winding up, voluntary winding up and winding up subject to supervision of the Court.
- Section 433 lays down the grounds on which a company may be wound up, in compulsory winding up.
- Section 439 specifies the persons by whom a petition for winding up of a company may be presented to the Court (tribunal) in compulsory winding up.
- When a company is wound up by the members or the creditors without the intervention of Court (tribunal), it is called as voluntary winding up.
- Section 484 specifies the circumstances in which a company may be wound up voluntarily. Section 488 divides voluntary winding up into two kinds i.e. Member's voluntary winding up and creditor's voluntary winding up.

- When a company has by special or ordinary resolution resolved to wind up voluntarily, the Court may make an order that the voluntary winding up shall continue but subject to such supervision of the Court and with such liberty for creditors, contributories or others to apply to the Court and generally on such terms and conditions as the Court thinks fit.
- Section 583 specifies that subject to Part X of the Act unregistered companies may be wound up and all provisions with respect to winding up shall apply to an unregistered company, with the exceptions and additions as specified under the section.

SELF-TEST QUESTIONS

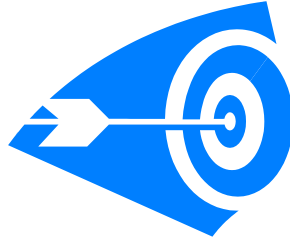


(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What are the various modes of winding up?
 2. What is compulsory winding up? Who are entitled to make a petition to the Court ?
 3. Define an unregistered company and point out how and when such a company can be wound up?
 4. Distinguish between winding up and dissolution.
 5. Distinguish between Members' and Creditors' voluntary winding up.
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STUDY XXXVI
AN INTRODUCTION TO E-GOVERNANCE

LEARNING OBJECTIVES



The concept of physical filing has given way to electronic filing. Now, the filing of forms with the Registrar of Companies is done in electronic manner with the help of internet and computer through MCA portal. This study deals with e-governance and e-filing of form.

After going through this chapter, you should be able to understand:

- Introduction
- Organisation of ROC offices under MCA-21
- Important features of e-filing of documents
- Other features of e-filing of documents
- Categories of e-forms
- Pre-certification of e-forms
- Terms used while e-filing the e-forms
- Key benefits of MCA 21 Project
- General structure of an e-form and e-filing process.

1. INTRODUCTION

MCA-21 stands for e-governance initiative of Ministry of Company Affairs (MCA) of the 21st Century. The project is named MCA-21 as it aims at repositioning MCA as an organization capable of fulfilling the aspirations of its stakeholders in the 21st Century. It is based on the Government's vision of National e-governance in the country. E-governance or Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. This project of MCA aims at moving from paper based to nearly paperless environment.

Filing and registration of documents is a statutory requirement under the Companies Act, 1956. Prior to the launch of this project, the documents/forms were filed manually at the ROC offices. The Central Government has amended the Companies (Central Government's) General Rules and Forms 1956 vide Notification No. GSR 56(E) dated 10th February, 2006 and notified e-forms to enable electronic filing of documents. Rule 3 of Companies (Central Government's) General Rules and

Forms (Amendment) Rules, 2006 provides that the forms prescribed in Annexure A of the Rules may be filed through electronic media or through any other computer readable media as referred under Section 610A of the Companies Act, 1956.

The scope of MCA-21 project covers only the offices of ROCs, Regional Directors, and the Headquarters at New Delhi at present. It does not include other offices of MCA like Official Liquidators, Company Law Board/Tribunal and Courts.

An e-form* is only a re-engineered conventional form notified and represents a document in electronic format for filing with MCA authorities through the Internet. This may be either a form filed for compliance or information purpose or an application seeking approval from the MCA.

2. ORGANISATION OF ROC OFFICES UNDER MCA-21

The major components involved in this comprehensive e-governance project are front office and back office.

Front Office

The Front Office represents the interface of the corporate and public user with the MCA21 system. This comprises of Virtual Front Office and Physical Front Office.

(i) Virtual front office

Virtual front office is one of the various channels available to stakeholders (companies and the professionals) to enable them to do the statutory filing with ROC Offices across the country. Virtual Front Office facilitates online filing of the e-Forms using Internet. It merely represents a computer facility for filing of digitally signed eForms by accessing the MyMCA portal through Internet. It also pre-supposes availability of related facilities to convert documents into PDF format and scanning of documents wherever required. When a company or user does not have these computer facilities, it can avail of these facilities at the designated facilitation centers, known as the Physical Front Offices

(ii) Physical Front Office (PFO)

To facilitate the change over from Physical Document Filing to Digital Document Filing, the Ministry of Corporate Affairs has established 53 Physical Front Office Known as facilitation centers for a initial period of three years. As on date only 4 facilitation centers are operational in the four metro cities i.e. Delhi, Mumbai, Kolkata and Chennai. PFOs has all facilities which will be required for online filing of e-forms including trained manpower, broadband connectivity, scanner, printer and related computer accessories. All the services for scanning and uploading of eForms are available free of cost at these Physical Front Offices.

Back Office

Back Office represents the offices of Registrar of Companies, Regional Directors and Headquarters' and takes care of internal processing of the forms filed by the

* The e-forms are being constantly revised to be compatible with the technical requirements. The updated forms are available at the website of MCA (www.mca.gov.in).

corporate user as per MCA norms and guidelines. The e-forms are routed dynamically to the concerned authority for processing depending upon the assigned role. All the e-forms along with attachments are stored in the electronic depository, which the staff of MCA can view depending upon the access rights.

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

The Back Office represents the interface of the corporate and public users with the MCA-21 system.

- True
- False

Correct Answer: False

The Back Office represents the offices of Registrar of Companies, Regional Directors and Headquarters.

3. IMPORTANT FEATURES OF E-FILING OF DOCUMENTS UNDER THE MCA-21 SYSTEM

Director Identification Number (DIN)

All existing and any person intending to be appointed as a director are required to obtain the Director Identification Number (DIN). DIN is also mandatory for directors of Indian Companies who are not citizens of India. However, DIN is not mandatory for directors of foreign company having branch offices in India. Only a single DIN is required for an Individual irrespective of number of directorships held by him.

"Director Identification Number" (DIN) means an identification number which the Central Government may allot to any individual, intending to be appointed as director or to any existing directors of a company, for the purpose of his identification as such and includes Designated Partnership Identification Number (DPIN) issued under section 7 of the Limited Liability Partnership Act, 2008 and rules made thereunder." (Rule 2 of the Companies (Director Identification Number) Rules, 2011).

DIN is a unique identification number and once obtained is valid for life time of a director.

The detailed procedure for getting director identification number is provided in Chapter XIV of the Study.

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

DIN is a unique identification number which needs to be validated every 5 years by the director.

- True
- False

Correct Answer: False

DIN is a unique identification number and once obtained is valid for life time of a director.

Corporate Identity Number (CIN) based Search of Companies

Every company has been allocated a Corporate Identity Number (CIN). CIN can be found from the MCA 21 portal through search based on:

- ROC Registration No.
- Existing Company Name
- Old Name of Company (in case of change of name, user is required to enter old name and the system displays corresponding current name).
- Inactive CIN [In case of change of CIN, the user is required to enter previous (inactive) CIN Number].

Foreign Company Registration Number (FCRN)

Every foreign company has been allocated a Foreign Company Registration Number (FCRN).

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

Corporate Identity Number (CIN), works as a unique identifier of a company for Indian Companies as well as foreign companies.

- True
- False

Correct Answer: False

Corporate Identity Number (CIN), works as a unique identifier of an Indian company. Foreign Company Registration Number (FCRN) is a unique identifier in the case of a Foreign Company.

Digital Signature Certificate

The e-forms are required to be authenticated by the authorized signatories using digital signatures as defined under the Information Technology Act, 2000. A digital signature is the electronic signature duly issued by a certifying authority that shows the authority of the person signing the same. It is an electronic analogue of a written signature. Every user who is required to sign an e-form for submission with MCA is required to obtain a Digital Signature Certificate. Under the MCA-21 system the following four types of users are identified as users of Digital Signatures and are required to obtain digital signature certificate:

1. MCA (Government) Employees.
2. Professionals (Company Secretaries, Chartered Accountants, Cost Accountants and Lawyers) who interact with MCA and companies in the context of Companies Act.
3. Authorized signatories of the Company including Managing Director, Directors, Manager or Secretary.
4. Representatives of Banks and Financial Institutions.

A person requiring a Digital Signature Certificate can approach any of the Certifying authorities identified by the MCA for issuance of Digital Signature Certificate.

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

Every user who is required to sign an e-form for submission with MCA is required to obtain a Digital Signature Certificate.

- True
- False

Correct Answer: True

4. OTHER FEATURES OF E-FILING OF DOCUMENTS UNDER THE MCA-21 SYSTEM**Certified Filing Centre (CFC)**

CFC is an extended arm of the Ministry which is manned by professionals from three core areas i.e., Company Secretaries, Chartered Accountants and Cost Accountants. It is one of the various channels available to the stakeholders to enable them to do the statutory filing with ROC Offices across the country. These are managed and operated by professionals on user charge basis.

Infrastructure for e-filing

The Minimum system requirements for e-filing are:

- P-4 computer with printer.
- Windows 2000/Windows XP/Windows Vista/Windows 7
- Internet Explorer 6.0 version and above.
- Above Acrobat Reader 9.4 and lower versions
- Scanner; and
- Java Runtime Environment (JRE) 1.6 updated version 30.

Mode of payment

MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank branches through DDs/Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/VISA]. In case a stakeholder chooses to pay through the off-line method (i.e. over the counter in a bank branch), it takes about two to three days time for the bank to intimate the realisation of payment to the MCA-21 system and the transaction gets passed on to the back office for processing only after payment is recognised by the banking system. On the other hand, the on-line payment through Internet banking/ Credit Card is instant.

However, the Ministry of Corporate Affairs vide its Circular dated 9th March, 2011 has decided to accept payments of value upto ₹50,000, for MCA 21 services, only in electronic mode w.e.f. 27th March, 2011. For the payments of value above ₹50,000, stakeholders would have the option to either make the payment in electronic mode, or paper challan. However such payments would also be made in electronic mode w.e.f. 1st October, 2011. This will improve the service delivery time and lead to speedier disposal of an application/e-form leading to convenience of stakeholders.

Further, in the following cases challan mode of payment is allowed for amount less than ₹50,000 (MCA Circular dated 27.05.2011):

- (i) Payment to 'Investor Education and Protection Fund' through 'Pay Misc. Fee' functionality
- (ii) Any payment made by user having category as 'Official Liquidator (OL) office'
- (iii) Any payment made by user having category as 'MCA employee'.

Service Request Number (SRN)

Each transaction under e-filing is uniquely identified by a Service Request Number (SRN). On filing of an e-form, the system will generate and provide a Service Request Number (SRN). A user can check the status of the document/ transaction, by entering the SRN.

Payment of Stamp Duty

Stamp duty is a state subject. It is payable on Memorandum and Articles of Association of every Company. In some states, duty is also payable on the authorized capital mentioned in the Memorandum of Association of the Company. Some states have authorized MCA to collect the stamp duty on their behalf and to remit the same to them.

Physical submission of Certain Documents

In view of practical constraints, certain documents requiring stamp paper or Stamp fees like stamped memorandum of association, declaration on stamp paper, original certified copy of the Company Law Board/Court order are required to be sent by the Companies in the physical form to the ROCs. The user will be providing SRN while sending these forms/documents to MCA. This would ensure the authenticity and reliability of such key documents and enable the MCA authorities to further act upon the same.

5. CATEGORIES OF E-FORMS

For the purpose of standardization and better understanding, the proposed e-Forms have been grouped under the following broad categories:

I. Company Registration

All the forms required for the purpose of incorporating companies in India are encompassed herein e.g. Form 1A, 1, 18, 32, 19, 20, 20A,44,68 etc.

II. Compliance Related Filing

All the statutory filing of e-Forms, specially event based compliance filing is grouped under compliance related filing services. This category includes the following forms:

Statement of amounts credited to investor education and protection fund (eForm 1); Return of allotment (eForm 2) ; Return in respect of buy Back of Shares (eForm 4C); Registration of resolution(s) and agreement(s)(eForm-23); Return of appointment of managing director or whole time director or manager(eForm 25C); Statutory Report (eForm 22); Form for submission of documents with Registrar of Companies (eForm 62) etc.

III. Change Services

Change services cover matters in respect of Indian companies, especially those pertaining to any change in the name of a company (e-Form 1A), Notice of consolidation, division, etc. or increase in share capital or increase in number of members (e-Form-5), the change of situation of registered office of the company (e-Form 18) and change of Directors, Manager and Secretary (e-Form 32). Foreign companies are required to intimate the ROC about the changes in the charter statutes or any instrument governing the company, changes in the registered office, principal place of business or the persons appointed as Director, Secretaries and authorized representatives. Forms for foreign companies are e-Form 49 & 52 for intimating the said changes.

IV. Charge management

Companies are required to file particulars for registration of charge created or modified with the concerned ROC.

In the case of satisfaction of charge also, an e-Form has to be filed with the ROC.

It also includes filing of e-Forms for appointment and cessation of receiver and filing of accounts by receiver. Forms in this category include e-Form 8, 17, 10 etc.

V. Investor Services

A separate e-Form has been prescribed as "Investor Compliant Form" for filing complaints against the companies by the aggrieved persons/shareholders. The nature of complaint may relate to any of the following aspects:

- Shares or dividend
- Debentures or bond
- Fixed deposits (non-receipt of amount)
- Miscellaneous non-receipt
- Director aggrieved by his cessation in the company
- Non filing of return of cessation of a director in Form 32
- Others like complaint of serious nature

No digital signature is needed for filing this e-Form. Also, no filing fee is required for submitting the e-Form for complaints.

VI. Provisions Relating to Managerial Personnel

This includes applications to the Central Government pertaining to the following:

- (a) for increase in the number of directors of the company (e-Form 24)
- (b) for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing or whole-time director(s) or manager (e-Form 25A)
- (c) for approval to modification of the terms and conditions for the appointment of Managing Directors, Whole-time Directors and Non Rotational Director (e-Form 25B)
- (f) for Removal of disqualification of directors.(e-Form DD-C)

VII. Approval Services – Head Quarters

Approval from MCA (Headquarters) is *inter alia* required in the following cases:

- (a) Exemption from attaching annual accounts of subsidiary(s),
- (b) Exemption or extension time for repayment of deposits,
- (c) Recognition as a Nidhi company,
- (d) Appointment of sole selling agent
- (e) Appointment of sole buying agent
- (f) Declaration of dividend out of reserves
- (g) Exemption from providing depreciation
- (h) Consent for holding office or place of profit
- (i) Providing loan or guarantee or security in connection with the loan to or by specified category of persons
- (j) Modification of the form and content of Balance Sheet and Profit and Loss Account
- (k) Appointment of Cost Auditor

Forms in this category include 23AAA, 65, 63, 24B, 24AB, 23C, 23AAB, DD-C etc.

VIII. Approval Services – Regional Director

The approval of the Regional Director is required in respect of the following matters:

- (a) Issue of licence under Section 25 to an existing company
- (b) Issue of licence under Section 25 to a new association
- (c) Approval for entering into contract under Section 297
- (d) Rectification of name of company
- (e) Appointment/Removal of auditor
- (f) Shifting of registered office of the company from the jurisdiction of one ROC to another within the same State
- (g) Opening of new branches by a Nidhi Company

Forms in this category include 1AD, 64 and 24A.

IX. Approval Services – ROCs

ROCs are empowered to accord approval, or to give any direction in relation to the matters pertaining to the change of name of an existing company and the conversion of a public company to private company. In addition, ROC approval is required in following cases:

- (a) Extension of time period for holding AGM
- (b) Holding AGM at place other than registered address
- (c) Declaring of company as defunct
- (d) Extension of the period of annual accounts
- (e) Amalgamation of companies
- (f) Compounding of offences

Forms in this category include 1B and 61 etc.

X. Informational Services

Informational services cover those forms, which are to be filed with ROC for informational purposes, in compliance with the provisions of the Companies Act. In following cases, forms relating to following informational services are required to be filed:

- (a) Consent and withdrawal of consent of persons charged as officers in default
- (b) Voluntary Reporting of Corporate Social Responsibility (CSR).
- (c) Resolutions and agreements
- (d) Notice of address of place where books of accounts are kept
- (e) Information in relation to any offer of scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company
- (f) Order received from Court or Company Law Board

Forms in this category include 1AA, 23, 23AA, 35A, 21 and 22B etc.

Annual filing

As a part of annual filing, companies incorporated under the Companies Act, 1956 are required to file the following documents along with the e-forms with the Registrar of Companies:

<i>S.No.</i>	<i>Document</i>	<i>E-form</i>
1.	Balance Sheet	Form 23AC to be filed by companies not covered under XBRL filing. Form 23 AC XBRL to be filed by companies for filing balance Sheet and other documents in XBRL mode.
2.	Profit and Loss Account	Form 23ACA to be filed by companies not covered under XBRL filing. Form 23ACA XBRL to be filed by companies for filing Profit & Loss account and other documents in XBRL mode.
3.	Annual Return	Form 20B to be filed by companies having share capital.
4.	Annual Return	Form 21A to be filed by companies without share capital.
5.	Compliance Certificate	Form 66 to be filed by companies with paid up capital between ₹10 lacs to ₹5 crores.

Important points to Remember

1. Balance sheet and Profit and Loss Accounts are to be filed as two separate documents with different e-forms.
2. Annual Return, Balance Sheet and Profit and Loss Account are filed as attachments to the respective e-form.

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

Balance sheet and Profit and Loss Accounts can be filed as a single document.

- True
- False

Correct Answer: False

Balance sheet and Profit and Loss Accounts are to be filed as two separate documents with different e-forms.

6. PRE-CERTIFICATION OF E-FORMS

Apart from authentication of e-forms by authorized signatories using digital signatures, some e-forms are also required to be pre-certified by practising professionals. Pre-certification means certification of correctness of any document by a professional before the same is filed with the Registrar.

This pre-certification is to be carried out by *inter-alia*, Company Secretaries, Chartered Accountants, Cost and Work Accountants, in whole-time practice.

7. TERMS USED WHILE E-FILING THE FORMS**Pre-fill**

Pre-fill is functionality in an e-Form that is used for filling automatically, the requisite data from the system without repeatedly entering the same. For example, by entering the CIN of the company, the name and registered office address of the company shall automatically be pre-filled by the system without any fresh entry.

Attachment

An attachment refers to a document that is sent as an enclosure with an e-Form by means of an attached file. The objective of the attachment is to provide details relevant to the e-Form for processing. While some attachments are optional some are mandatory in nature.

The attachments to an e-Form will be only in Adobe PDF format. MCA portal shall not accept attachment file of more than 2.5MB and the user is advised to keep the attachment size to minimum.

Check Form

By clicking “Check Form”, the user will be in a position to find out whether the mandatory fields in an e-Form are duly filled-in. For example, if the user enters

alphabets in “Date of Appointment of Director” field, he/she will be asked to correct the entered information.

If the size of attachment is much bigger then the details may be submitted in a floppy or compact disc at the ROC office. For example, In the case of Annual Return filed by the companies having large shareholders base, the list of shareholders may be submitted separately in a CD at the concerned ROC office indicating SRN No. of e-form filed

Modify

Once the user has done ‘Check Form’, the form gets locked and it cannot be edited. If the user wishes to make any alterations, the form can be overwritten by clicking “Modify” button.

Pre-Scrutiny

Pre-scrutiny is a functionality that is used for checking whether certain core aspects are properly filled in the e-Form. The user has to login on MCA portal to perform the pre-scrutiny of e-form. The necessary attachments and digital signatures should be affixed before submitting the e-Form for pre-scrutiny. The difference between check form and pre-scrutiny is that the Check form is done by internal features of the form which ensure that all the mandatory and required field are filled up and attachment are made to the e-form, while Pre-Scrutiny is a complete legal and technical scrutiny of an e-form done by the MCA portal before accepting the form.

Addendum to e-Form

The user may have to submit some additional supporting documents that are not submitted during the e-Form (application) filing but are required for the processing of the e-Form. MCA may also ask the applicant to provide some additional documents in support of the e-Form already filed so as to expedite the processing of the same.

The user can initiate this on their own by checking the track transaction status on MyMCA portal or on being notified by MCA through email. Payment of fees is not required for filing an addendum.

The supporting documents that the applicant uploads, as an addendum, gets duly associated with the e-Form that was submitted earlier with the given SRN.

Online Inspection of Documents

The documents filed online, once taken on record by ROC Offices shall be available for public viewing on payment of requisite fees. These documents, which shall be in the domain of public documents, include documents relating to incorporation, charges, annual returns and balance sheets and change in directors. A certified copy of the documents can also be obtained by anyone so interested.

8. E-STAMP

Registrars of Companies have to ensure that proper stamp duty is paid on the instruments registered with their office. Accordingly, physical submission of

documents is necessary to ascertain that applicable stamp duty has been paid. In the MCA-21 system, even though the eForm is submitted instantly, the RoC office has to wait for receipt of physical stamp papers to initiate necessary processing. It results in service delivery time getting longer. Hence, in furtherance of e-governance initiatives, provisions regarding stamp duty applicable on filing of e-forms have been amended and stakeholders shall have facility to pay stamp duty in electronic manner also. It provides that if the stamp duty on documents which are required to be filed on non-judicial stamp paper is paid electronically through Ministry of Corporate Affairs portal www.mca.gov.in, in such case, the company shall not be required to make physical submission of such documents, in addition to their submission in the electronic form.

Keeping in view the requirement of stakeholders awareness, process of e-stamp has not been made mandatory, meaning thereby, stakeholders have option to pay stamp duty in electronic manner through MCA21 system or in physical form as per the existing procedure. Further this process shall be applicable only to such States/Union Territories which have agreed to the request of Ministry of Corporate Affairs for collection of e-stamp duty on their behalf.

List of eForms to which e-Stamping will be applicable

- Form 1, (including MoA, AoA)
- Form 5
- Form 44
- Form 67

9. INTRODUCTION OF E-FORM 68

A new rule 20G has been introduced in the Companies (Central Government's) General Rules and Forms, 1956. As per this rule, an application for rectification of mistakes made while Filing Form No. 1, Form No. 1A and Form No. 44 electronically, on the Ministry's website, shall be made to the Registrar of Companies in Form No. 68 and such application shall be accompanied by fee of rupees one thousand for rectification of mistakes in Form No. 1 and Form No. 1A and rupees ten thousand for rectification of mistakes in Form No. 44 respectively.

An application in Form No. 68 complete in all respects shall be made to the Registrar within a period of three sixty five days from the date of approval of Form No. 1, Form No. 1 A and Form No. 44 respectively by the Registrar. The Registrar after approving the rectification intimate the mistakes rectified to the applicant within a period of sixty days from the date of filing of the said application. However, the rectification of mistakes shall be allowed only once in respect of one company.

10. KEY BENEFITS OF MCA 21 PROJECT

MCA 21 seeks to fulfill the requirements of the various stakeholders including the Corporates, Professionals, Public Financial Institutions and Banks, Government and the MCA employees. The key benefits of MCA 21 project are as follows:

1. On-line incorporation of companies.
2. Simplified and easy mode of filing of Forms>Returns.

3. Registration as well as verification of charges anytime and from anywhere.
4. Inspection of public documents of companies anytime from anywhere.
5. Corporate-centric approach.
6. Building up a centralized database repository of corporates operating in India.
7. Enhanced service level fulfillment and customer relationship building.
8. Total transparency through e-Governance.
9. Timely redressal of investor grievances.
10. Availability of more time for MCA employees for qualitative analysis of corporate information.

11. CLARIFICATIONS ISSUED BY MCA

1. The filing will be done only through the portal MCA 21 and not through e-mail.
2. The transaction will be deemed as completed only after clearance of the payment by the bank.
3. Pre-certification of certain e-forms by CS/CA/CWA (in whole-time in practice) is a mandatory requirement.
4. Digital Signature Certificate (DSC) is required for filing all the e-forms. Therefore, the Directors and Company Secretary of the Company who are the authorized signatories for e-filing purpose, should obtain DSC.
5. Data in e-forms is required to be given as per the format. However, additional information, if any, which is not formatted can be given by way of an attachment to the form.
6. The forms may be filled online or offline after downloading. MCA recommends that the forms be filled offline and then submitted on the portal.

12. GENERAL STRUCTURE OF AN E-FORM AND E-FILING PROCESS

An e-Form contains certain standardized features. Each e-Form contains the form reference and the description as well as the particular section of the Companies Act or the relevant rules or regulations under which it is required to be submitted. It starts with the Corporate Identity Number (CIN), which works as a unique identifier of an Indian Company and the Foreign Company Registration Number in the case of a Foreign Company that is required to be filled up. By entering the CIN, the company details to the extent these are available in static form in the database, are automatically filled in by using the pre-fill functionality.

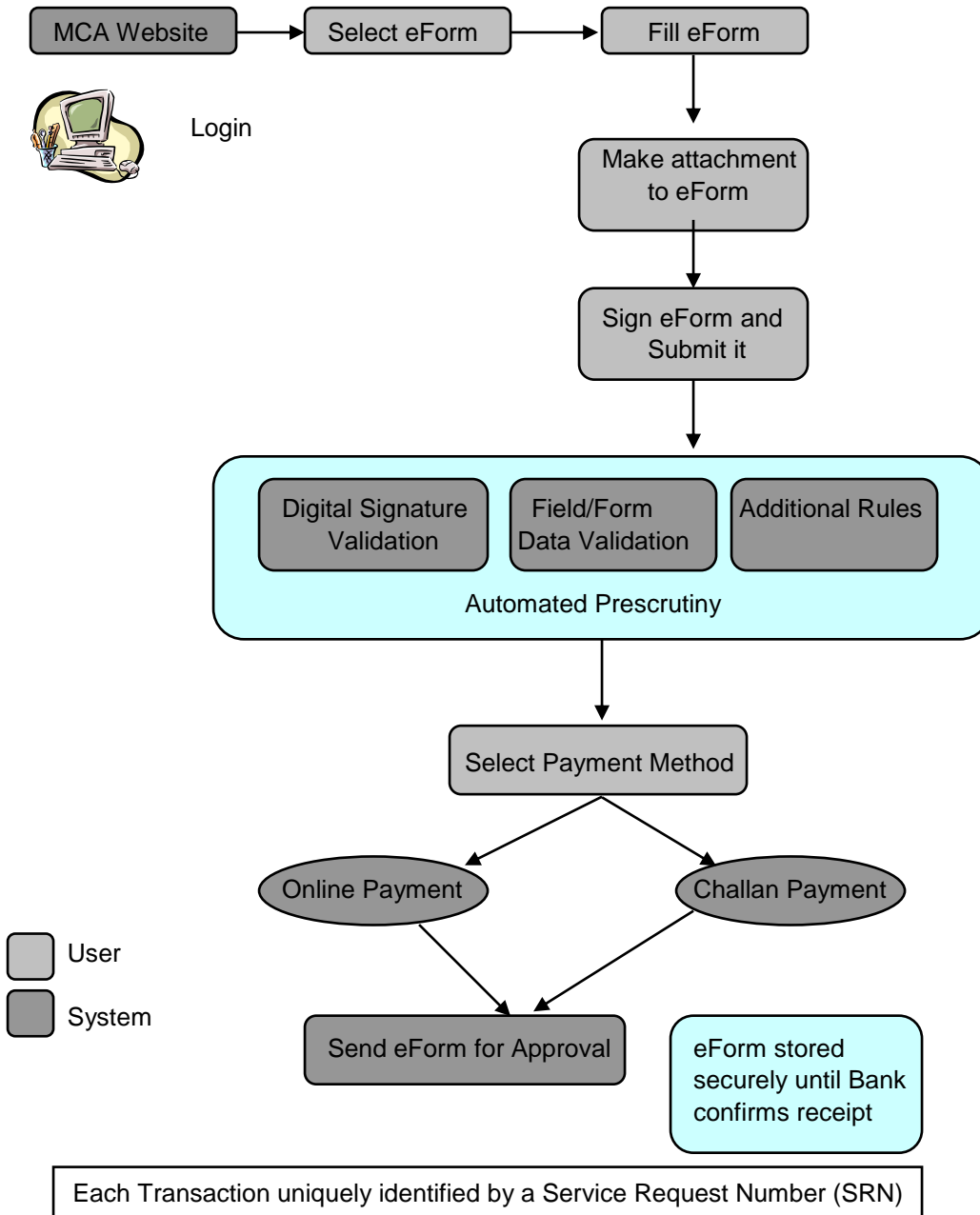
Features of e-form and e-filing process has been given as below:

- The e-Form contains a number of mandatory fields which are required to be filled-in. Certain other fields are non-mandatory in nature which may be filled-in as may be relevant in any particular case.

- An instruction kit is available for each e-Form, which contains details of the instructions for properly filling the e-Form.
- An e-Form may be filled in either online or offline. Online filling implies that the e-Form is filled while being still connected to MyMCA portal through the Internet. Offline filling denotes that the e-Form is downloaded into the user's computer and filled later without being connected to the Internet.
- An e-Form may require certain mandatory attachments to be filed along with it. Optional attachments may also be filed with an e-Form. The list of such attachments is displayed in the e-Form.
- Next to attachment, there is a declaration that is sought from the person filing the e-Form to the effect that the information given in the e-Form and the attachments is correct and complete.
- Most of the e-Forms require the digital signature of the Managing Director or Director, Manager or Secretary of the company for successful filing/submission.
- Further, the digital signature of a third party may also be required in certain cases. In the case of an e-Form for creation or modification of charges, such digital signature is also required from the Bank or Financial Institution.
- In certain cases, certification from the Chartered Accountant or Cost Accountant or Company Secretary in whole-time practice is also required to authenticate the particulars contained in the e-Form. For example, this requirement is mandatory in the case of an e-Form for creation or modification of charges.
- There are built-in facilities to check the filled-in e-Form for requisite validations, to do pre-scrutiny and to modify the e-Form when the same is required to be re-submitted.
- When the "Submitted" button is pressed, the e-Form gets uploaded into the MCA central document repository.
- Thereafter, the requisite fees as applicable for the e-Form should be paid either on-line or off-line.
- Once the e-Form has been accepted and payment of fees has been acknowledged, a work item is created and assigned to the appropriate MCA employee based on pre-defined assignment rules as part of MCA back office workflow automation.
- In the case of an e-Form, the authorized officer affixes his/her digital signature for registering/approving/rejecting the same.
- After the processing of the e-Form is completed, an acknowledgement email is sent to the user regarding its approval/rejection.

Flowchart of the Process for Filing e-Forms

Filing eForm



13. REVISION/UPDATION OF E-FORMS

The e-forms are being constantly revised by the government in line with the legal changes, so that they could be compatible with the technical requirements of the MCA-21. The latest revised eforms are available on MCA website i.e. www.mca.gov.in

14. RESPONSIBILITY OF PROFESSIONALS DIGITALLY SIGNING THE E-FORMS

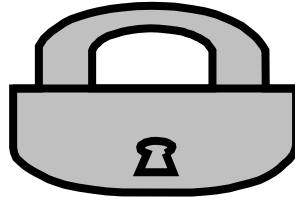
The Ministry of Corporate Affairs vide its Circular No. 14/2011 dated 08.04.2011 has entrusted practicing professionals registered as Members of the professional bodies namely, ICAI, ICSI & ICWAI with the responsibility of ensuring integrity of documents filed by them with MCA in electronic mode. Professionals are now to be responsible for submitting /certifying documents (to be signed digitally by them) and system would accept most of these documents online without approval by Registrar of Companies or other officers of the Ministry.

In addition to the penal actions against the companies and their officers in default for furnishing incorrect or false information in the documents as provided under the Companies Act, 1956, action would also be taken against such professionals who has certified a wrong information.

LESSON ROUND-UP



- An e-form is a re-engineered conventional form, represents a document in electronic format.
- Director Identification Number (DIN), Corporate Identity Number (CIN) and Digital Signature Certificate (DSC) are the important features under e-governance mode (MCA-21).
- MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank branches through DDs/ Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/ VISA].
- Each transaction under e-filing is uniquely identified by a Service Request Number (SRN). On filing of an e-form, the system will generate and provide a Service Request Number (SRN). A user can check the status of the document/ transaction, by entering the SRN.
- If the stamp duty on documents which are required to be filed on non-judicial stamp paper is paid electronically through Ministry of Corporate Affairs portal www.mca.gov.in, in such case, the company shall not be required to make physical submission of such documents, in addition to their submission in the electronic form.
- The e-forms are being constantly revised. The updated e-forms are available at the website of MCA (www.mca.gov.in).

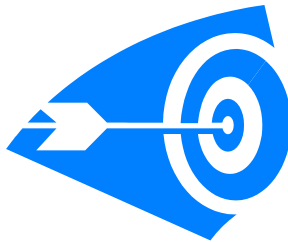
SELF-TEST QUESTIONS

1. Explain the terms CIN and DIN.
2. What are the key benefits of MCA-21 project?
3. Write short note on Digital Signature Certificate.
4. Briefly explain the general structure of an e-form and the e-filing process.

SECRETARIAL STANDARDS

Better Corporate Governance through Secretarial Standards

LEARNING OBJECTIVE



The objective of introducing Secretarial Standards is to integrate, harmonise and standardize the diverse secretarial practices for good corporate governance. The Institute of Company Secretaries of India has taken a big step towards the introduction of Secretarial Standards. This chapter will give a brief outline of the various Secretarial Standards issued by the Institute till now.

SECRETARIAL STANDARDS - ISSUED FOR THE FIRST TIME IN ANY COUNTRY- A UNIQUE AND PIONEERING EFFORT

The formulation of Secretarial Standards by the 'Secretarial Standards Board' (SSB) of the Institute of Company Secretaries of India (ICSI) is a unique and pioneering step towards standardisation of diverse secretarial practices prevalent in the corporate sector.

Companies follow diverse secretarial practices and, therefore, there is a need to integrate, harmonize and standardize such practices so as to promote uniformity and consistency.

The Secretarial Standards Board formulates Secretarial Standards taking into consideration the applicable laws, business environment and the best secretarial practices prevalent. Secretarial Standards are developed:

- in a transparent manner;
- after extensive deliberations, analysis, research; and
- after taking views of corporates, regulators and the public at large.

SSB was constituted in the year 2000. The SSB comprises of eminent members of the profession holding responsible positions in well-known companies and as senior members in practice, as well as representatives of regulatory authorities such as the Ministry of Corporate Affairs, the Securities and Exchange Board of India, the Department of Economic Affairs, Reserve Bank of India, Department of Public Enterprises, Chamber of Commerce and the sister professional bodies viz. the Institute of Chartered Accountants of India and the Institute of Cost Accountants of India. The ICSI-CCGRT (Centre for Corporate Governance Research and Training) provides technical support to SSB.

The adoption of the Secretarial Standards by the corporate sector will have a substantial impact on the quality of secretarial practices being followed by companies, making them comparable with the best practices in the world.

Many companies today are voluntarily adopting the Secretarial Standards in their functioning. The annual reports of several companies released during the last few years include a disclosure with regard to the compliance of the Secretarial Standards.

The Institute has so far issued the following Secretarial Standards:

SS-1: SECRETARIAL STANDARD ON MEETINGS OF THE BOARD OF DIRECTORS

The Board of Directors of a company holds a fiduciary position and hence it is essential that the decisions of the Board are taken conscientiously and that, for this purpose, Meetings of the Board are held frequently, convened and constituted properly and that all important matters are discussed thereat. The Secretarial Standard on Meetings of the Board of Directors lays down a set of principles which companies are expected to adopt in the convening and conduct of meetings of the Board of Directors and committees thereof. These principles relate to frequency of meetings, quorum, attendance, resolutions, recording and preservation of minutes etc. Illustrative lists of items to be considered at different meetings of the Board are enunciated in the Standard. Further, the Standard seeks to enhance stakeholders confidence by focussing on the principles relating to responsibilities of the Chairman of the Board, maintenance of attendance registers, preservation of minutes, disclosures in Annual Report etc.

SS-2 : SECRETARIAL STANDARD ON GENERAL MEETINGS

The members of a company exercise their decision-making powers through the forum of General Meetings and hence it is essential that standard and best practices are followed by companies in this regard which will also strengthen shareholders confidence. The Secretarial Standard on General Meetings prescribes a set of principles which companies are expected to observe in the convening and conduct of General Meetings and matters related thereto. Principles have been laid down with respect to requirements of quorum, voting, proxies, conduct of poll, withdrawal/rescinding/modification of resolutions, adjournment of meetings, recording the minutes , duties of the Chairman and the disclosures to be made in the Annual Reports of companies. Further, explicit principles have been laid down on the related critical aspects such as distribution of gifts, presence and duties of Company Secretary/Auditors in the meetings, preservation of minutes. Besides, it intends to integrate and standardize the diverse secretarial practices prevalent in the corporate sector for conducting General meetings.

SS-3 : SECRETARIAL STANDARD ON DIVIDEND

Declaration and distribution of dividends is a complicated task involving both financial and non-financial considerations.

Recognizing the relevance of the topic, SSB formulated the Secretarial Standard on Dividend. The Secretarial Standard lays down a set of principles in relation to the declaration and payment of dividend, interim dividend, treatment of unpaid Dividend,

revocation of dividend as well as the preservation of dividend warrants, maintenance of dividend registers, disclosure requirements and matters incidental thereto. The Standard, by stipulating requirements in regard to all allied and significant matters such as intimation to members before transferring unpaid dividend to Investor Education and Protection Fund, preservation of dividend Registers, validity of dividend warrants etc. attempts to give the right direction to the corporate sector, promote uniformity of practices and ensure effective corporate governance.

SS-4 : SECRETARIAL STANDARD ON REGISTERS AND RECORDS

A company is required to maintain certain registers and records. There are some registers and records, the maintenance of which is not statutorily required but is essential for the smooth, efficient and systematic functioning of the company. Some of the registers and records are required to be kept open by a company for inspection by directors and members of the company and by other persons, including creditors of the company. The right to inspect such registers and records is an enforceable right. Companies are also required to allow extracts to be made from certain documents, registers and records and to furnish copies thereof.

This Secretarial Standard seeks to prescribe a set of principles in relation to various registers and records including the maintenance and inspection thereof.

The Standards have been laid down in respect of maintenance, authentication, inspection and preservation of registers so as to give a right direction to the companies to establish and maintain systems that comply with all statutory provisions and meet the needs of the stakeholders.

SS-5 : SECRETARIAL STANDARD ON MINUTES

Every company is required to keep minutes of all proceedings of the meetings conducted during its existence. Minutes kept in accordance with the provisions of the Act, evidence that the meeting has been duly convened and held; all proceedings thereat have taken place and all appointments made thereat are valid.

The Minutes should contain a fair and correct summary of the discussions and decisions taken at the meeting so as to enable absentee directors/ committee members/shareholders to form an idea of what transpired at these meetings.

The Standard prescribes a set of principles for maintaining, recording, signing, dating, inspecting and preserving the minutes so as to ensure that the minutes record the true proceedings of the meetings and are accessible for future reference.

SS-6 : SECRETARIAL STANDARD ON TRANSMISSION OF SHARES AND DEBENTURES

Realizing the divergent practices involved in the transmission of shares and the difficulties faced by both the companies and the investors, the Secretarial Standards Board has formulated the Secretarial Standard on Transmission of Shares and Debentures. This Standard intends to lay down principles in relation to the documentation and for verification of legal claimants in case of physically and electronically held shares for smooth functioning of the process. The Standard *inter alia* deals with situations where shares are singly or jointly held, nominee has been appointed, shareholder has died intestate etc.

SS-7: SECRETARIAL STANDARD ON PASSING OF RESOLUTIONS BY CIRCULATION

Section 289 of the Companies Act, 1956 enables the Board of Directors to pass resolutions by circulation. However, it merely provides that the resolution is to be circulated to all members of the Board or Committee and is to be passed by the requisite majority. As the law is silent on who is to propose the resolution, matters which need to be passed through circulation, the mode of circulation, timing of approval of the resolution etc., a need for the Secretarial Standard was felt.

The standard purports to lay down a set of principles and the best practices to be followed for passing of resolutions by circulation. These principles relate to authority, procedure, approval, recording and validity etc. Illustrative matters to be passed at a duly convened Board Meeting and which cannot be passed by circulation are also enunciated in the Standard. This is to ensure that the important items of business which require deliberations by the Board are passed only after necessary debate and discussion at Board meeting.

SS-8: SECRETARIAL STANDARD ON AFFIXING OF COMMON SEAL

The Companies Act, 1956 provides for a Company to have a common seal from the date of incorporation of a company. Since substantive law is mainly silent on fixation of common seal, the standard aims at clarifying documents which need to be common sealed and procedure thereof. The unique feature of the standard is that it also proposes to introduce the concept of Official Seal. This would substitute the common seal in case affixation of common seal is not possible physically.

Further the standard provides for adoption of common seal, its form and content, mode of affixation, register of documents executed under it, official seal and its custody. This standard seeks to strengthen the process and compliances of the law in respect of affixation of Common Seal.

SS-9: SECRETARIAL STANDARD ON FORFEITURE OF SHARES

There is no section in the Companies Act, 1956 regarding forfeiture of shares. Regulations 29 to 35 of Table A of Schedule I contain regulations regarding forfeiture of shares. The Act being silent on forfeiture gave rise to the need for issuing the secretarial standard. SS-9 proposes to ensure that the forfeiture is carried out bona fide and in the interests of the shareholders. It shall act as a safeguard against collusive forfeiture, made by the directors for the purpose of enabling a favoured member to escape from his liability. It shall also protect against abuse of power and fraud on some of the shareholders.

This standard seeks to lay down a set of principals for forfeiture both for equity and preference shares arising from non-payment of calls. Initiation of forfeiture process, effect of forfeiture, re-issue of forfeited shares, pricing of reissue of forfeited shares, annulment of forfeiture of shares are the major aspects which are being dealt under SS-9.

SS-10: SECRETARIAL STANDARD ON BOARD'S REPORT

It was felt that the Board's Report is an important means of communication by the

Board of Directors of a company with its stakeholders and it should disseminate all material information relating to state of company's affairs as well as any changes which occur during the year and also during the period between closing of financial year and the reporting date. It covers wide spectrum of information that stakeholders need to understand about the prospectus of a company, its business and quality of its management. Moreover, in case of listed companies, it includes a Report on corporate governance and also a report covering Management Discussion and Analysis (MDAR).

The SS-10 seeks to lay down best practices in respect of preparation and presentation of the Board's Report.

Considering the importance of Board's Report, the Standard expects that the Board's Report should be considered and approved at a duly convened meeting of the Board and not by circulation. As a good board level practice, report shall be the collective responsibility of the directors and any dissent of any director on any point, shall be reflected in the minutes of the meeting and not in the Report. The Standard expects the Board's Report to be consistent and self-explanatory.

GUIDANCE NOTES

To facilitate the corporate sector to comply with the Secretarial Standards, the SSB also formulates Guidance Notes. SSB of the Institute has issued various guidance notes *inter alia* including Guidance Notes on

- Meetings of the Board of Directors
- General Meetings
- Passing of the Resolutions by Postal Ballot
- Dividend
- Buy-Back of Securities
- Board's Report
- Corporate Governance Certificate
- Board Processes
- Related Party Transactions
- Listing of Corporate Debt
- Non-Financial Disclosures

REFERENCER ON SECRETARIAL AUDIT

The Institute of Company Secretaries of India (ICSI) has brought out a referencer on Secretarial Audit in August, 2010 to guide its members with the process of Secretarial Audit.

PROCEDURE FOR ISSUING SECRETARIAL STANDARDS

The procedure being adopted by SSB for formulating and issuing Secretarial Standards is briefly explained below:

SSB, in consultation with the Council of the Institute, determines the areas in which Secretarial Standards need to be formulated. The SSB then either constitutes

Working Groups or requests the Secretariat of the Institute to formulate a preliminary draft of the proposed Standard. The preliminary draft is discussed by SSB and then circulated to various persons/authorities such as members of the Council, Chairmen of Regional Councils / Chapters of ICSI; various professional bodies; Chambers of Commerce; Regulatory authorities such as MCA, DEA, SEBI, RBI, DPE and such other bodies/organizations as may be decided by SSB for ascertaining their views, specifying a time-frame within which such views, comments and suggestions are to be received. Based on the suggestions received, an Exposure Draft is prepared by SSB and published in the "Chartered Secretary", the monthly journal of ICSI, and also put on the website of ICSI to elicit comments from members and the public at large. After taking into consideration the comments received, the draft of the proposed Secretarial Standard is finalised by SSB and submitted to the Council which finalises the same in consultation with SSB. The Secretarial Standard on the relevant subject is then issued under the authority of the Council.

By following the Secretarial Standards in true letter and spirit, companies will be able to ensure adoption of uniform, consistent and best secretarial practices in the corporate sector. Such uniformity of best practices, consistently applied, will result in furthering the shareholders democracy by laying down principles for better corporate disclosures thus adding value to the general endeavour to strive for good governance.

EXECUTIVE PROGRAMME

COMPANY LAW

EP-CL/2011

TEST PAPERS

This Test Paper set contains five test papers. Test Paper 1/2011, 2/2011, 3/2011, 4/2011 and 5/2011. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt at least **one Test Paper from Test Papers 3/2011, 4/2011 and 5/2011 i.e. either Test Paper 3/2011 or Test Paper 4/2011 or Test Paper 5/2011** and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate. However, students may, if they so desire, are encouraged to send more response sheets including Test Paper 1/2011 and 2/2011 for evaluation.

While writing answers, students should take care not to copy from the study material, text books or other publications. Instances of deliberate copying from any source, will be viewed very seriously.

WHILE WRITING THE RESPONSE SHEETS TO THE TEST PAPERS GIVEN AT THE END OF THIS STUDY MATERIAL, THE STUDENTS SHOULD KEEP IN VIEW THE FOLLOWING WARNING AND DESIST FROM COPYING.

W A R N I N G

Time and again, it is brought to our notice by the examiners evaluating response sheets that some students use unfair means in completing postal coaching by way of copying the answers of students who have successfully completed the postal coaching or from the suggested answers/study material supplied by the Institute. A few cases of impersonation by handwriting while answering the response sheets have also been brought to the Institute's notice. The Training and Educational Facilities Committee has viewed seriously such instances of using unfair means to complete postal coaching. The students are, therefore, strongly advised to write response sheets personally in their own hand-writing without copying from any original source. It is also brought to the notice of all students that use of any malpractice in undergoing postal or oral coaching is a misconduct as provided in the explanation to Regulation 27 and accordingly the studentship registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information :

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may *suo motu* or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

EXECUTIVE PROGRAMME

COMPANY LAW

TEST PAPER 1/2011
(OPTIONAL)

(Based on study lessons 1 to 18)

Time allowed: 3 hours

Maximum marks: 100

NOTE: Answer All Questions.

1. Comment on **any four** of the following:
 - (i) A company cannot ratify a pre-incorporation contract though it is open to it to enter into fresh contract.
 - (ii) The power to borrow implies a power to secure the borrowings by mortgage or a charge on the company's assets.
 - (iii) The alteration of articles of association must not constitute a fraud on the minority by a majority.
 - (iv) Company Secretaries in Practice can sign Compliance Certificate of eighty companies in a year.
 - (v) Foreign Companies having a place of business in India are also governed by the Companies Act, 1956. *(5 marks each)*
2. (a) Can contracts before incorporation be enforced against the company? *(5 marks)*
 - (b) A shareholder having given proxy, personally attends and votes at the meeting. Comment, illustrating a case law. *(5 marks)*
 - (c) Is it compulsory to maintain a Debenture Redemption Reserve? If yes, how? *(6 marks)*
3. (a) State the provisions of the Companies Act, 1956, relating to remuneration of Managerial Personnel. *(8 marks)*
 - (b) State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980. *(8 marks)*
4. Write short notes on the following:
 - (i) Schedule 1A read with Section 6(c) of the Companies Act, 1956.
 - (ii) Pre-incorporation contracts
 - (iii) Satisfaction of Charges
 - (iv) Irregular allotment
 - (v) Flowchart of process of e-filing of an e-form. *(5 marks each)*
5. (i) Distinguish between transfer and transmission of shares. *(5 marks)*
 - (ii) Write a short note on surrender of shares. *(5 marks)*
 - (iii) Discuss the duty of a director to disclose his interest in contracts to be entered into by the company. What are the consequences of non-disclosure? *(6 marks)*

6. (i) What particulars are required to be entered in the Register of Loans and Investments? *(5 marks)*
- (ii) A valid demand of a poll was received at a general meeting. Thereafter, those who made it, withdraw it. Examine the same in the light of the provisions of the Companies Act. *(5 marks)*
- (iii) At a general meeting, two joint holders voted on a resolution. Will the votes of both the joint holders be accepted? *(6 marks)*
-

TEST PAPER 2/2011
(OPTIONAL)

(Based on study lessons 19 to 37)

Time allowed: 3 hours

Maximum marks: 100

NOTE: Answer All Questions.

1. Comment on **any four** of the following:
 - (i) The power to invest funds of the company is the prerogative of the Board of Directors
 - (ii) The provisions of the Companies Act relating to prospectus shall apply to the advertisement inviting public deposits also.
 - (iii) The winding up of a company by the Court is deemed to commence at the time of the presentation of the petition for winding up.
 - (iv) A compromise means settlement or adjustment of claims in dispute by mutual concessions.
 - (v) The minority shareholders may bring an action against the company, where although there is not fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.
(5 marks each)
2. (a) ABC Ltd. is a listed company having a paid-up share capital of Rs. 36 crore and general reserves of Rs. 24 crore. It desires to make a loan of Rs. 10 crore to XYZ Ltd. ABC Ltd. holds 60% of the equity shares in XYZ Ltd. ABC Ltd. has already made investment in and given loans to other companies aggregating to Rs. 30 crore. ABC Ltd. has not committed any default in respect of institutional loans or in repayment of fixed deposits. State whether the company is eligible to give loan of Rs. 10 crore to XYZ Ltd. Would your answer be different if XYZ Ltd. is ABC Ltd.'s wholly-owned subsidiary?
(5 marks)
- (b) Write a short note on appointment of cost auditor.
(5 marks)
- (c) Discuss the limits of accepting 'deposits' as prescribed under the Companies (Acceptance of Deposits) Rules, 1975.
(6 marks)
3. (a) An auditor appointed at the Annual General Meeting of XYZ Ltd. resigned within 2 months of appointment. State the legal position.
(5 marks)
- (b) An equity dividend of 12% was declared at the annual general meeting of Z Ltd. The directors convened an extra-ordinary general meeting of the company to consider and approve a further 3% equity dividend for the same year, on the plea that the earlier profit were not correctly computed. Some of the shareholders of the company raised objection to this additional dividend. Examine the legality of the directors' proposal.
(5 marks)
- (c) What is the procedure for keeping the Register and Returns at a place other than the Registered office?
(6 marks)
4. (a) Analyse in detail the provisions relating to appointment of sole selling agents.
(8 marks)
- (b) Discuss the role of Company Secretary as a statutory officer of the

- company? (8 marks)
5. (a) Write short notes on:
- (i) Revocation of a trust (5 marks)
 - (ii) Dissolution of a society. (5 marks)
- (b) What is the difference between striking off a company by the Registrar on its own motion and striking off a company by the Registrar on the application of a company? (6 marks)
6. (a) Define an unregistered company and point out how and when such a company can be wound up? (8 marks)
- (b) What are the key benefits of MCA-21 project? (8 marks)
-

TEST PAPER 3/2011
(COMPULSORY)

(Based on all the study lessons)

Time allowed: 3 hours

Maximum marks: 100

NOTE: Answer All Questions.

1. Comment on **any four** of the following:
 - (a) Surrender of shares means the surrender to the company on the part of the registered holder of shares already issued.
 - (b) The Company Law Board is empowered under section 621A of the Companies Act, 1956 to compound the offence wherein the default is punishable with fine.
 - (c) The Management Discussion and Analysis Report (MDAR) should either form a part of the Board's Report or be given as an addition thereto in the annual report to the shareholders.
 - (d) If a dividend is declared and paid to shareholders, the character of the payment cannot be altered by a subsequent resolution.
 - (e) If no auditors are appointed or re-appointed at the annual general meeting, the Central Government may appoint a person to fill the vacancy. *(5 marks each)*
2. (a) Choose the most appropriate answer from the given options in respect of the following :
 - (i) Which type of company should have no profit motive?
 - (a) limited company
 - (b) unlimited company
 - (c) Section 25 company
 - (d) guarantee company
 - (ii) A floating charge crystallizes and the security becomes fixed in the following cases:
 - (a) When the company shift its business.
 - (b) When the company ceased to carry on the business.
 - (c) When the company is bankrupt.
 - (d) All of the above.
 - (iii) Section 433 lays down the grounds on which a company may be wound up _____.
 - (a) compulsory winding up
 - (b) members voluntary winding up
 - (c) creditors voluntary winding up
 - (d) by the court
 - (iv) What is the penalty for improper use, circulation or publication of balance sheet or profit and loss account?
 - (a) fine upto Rs. 10,000.
 - (b) fine upto Rs. 5,000.
 - (c) fine upto Rs. 5,000 and imprisonment of 6 months.

- (d) None of the above.
- (v) The Central Government has been empowered to conduct investigation into the affairs of the company in the following circumstances:
- (a) On the Report of Registrar
(b) On the application of Members
(c) On the passing of special resolution or Order of the Court
(d) All of the above. *(1 mark each)*
- (b) Re-write the following sentences after filling in the blanks spaces with appropriate word(s)/figures(s):
- (i) SEBI (Issue of Capital & Disclosure) Regulations notified in the year_____.
- (ii) In case of a company limited by guarantee, a member cannot be called upon to pay anything before the company goes into _____.
- (iii) Preliminary contracts are contracts purported to be made on behalf of a company before its _____.
- (iv) Sweat equity shares issued to employees or directors shall be locked in for a period of _____ from the date of allotment.
- (v) A poll is complete on the day when ____ and not when the voting is completed. *(1 mark each)*
- (c) X, a duly qualified cost auditor, consented to the company for his appointment as cost auditor, and accordingly, government approval for his appointment was obtained. The cost auditor, later on, did not accept the offer. Advise the company how to proceed in the matter. *(6 marks each)*
3. Attempt the following:
- (i) The Articles of a company provided that the shares of a member who became bankrupt would be offered for sale to other shareholders at a certain price. Is the provision binding on the shareholders?
- (ii) The capital of ABC Ltd. is Rs. 50 lakhs, consisting of Equity Share Capital of Rs. 40 lakhs and Redeemable Preference Share Capital of Rs. 10 lakhs. The preference share capital is to be redeemed before 31st December, 2011. The company wants to borrow Rs. 20 lakhs from Financial Institutions to improve its working and also to redeem the preference share capital. Advise.
- (iii) Total strength of the Board of directors of XYZ Ltd. is twelve. How many directors are liable to retire by rotation at the next annual general meeting?
- (iv) The required quorum is not present within thirty minutes of the scheduled time for holding of annual general meeting. Advise with help of relevant provisions of the Companies Act, 1956. *(4 marks each)*
4. (a) What is a charge? Enumerate the statutory provisions for their registration. Also state the consequences of non-registration. *(8 marks)*

- (b) A buys 200 shares in a company from B on the faith of a share certificate issued by the company. A tenders to the company a transfer deed duly executed in his favour by B together with B's share certificate. The company discovers that the certificate in the name of B has been fraudulently obtained and refuses to register the transfer. Is A entitled to get the registration of the transfer? *(4 marks)*
- (c) What are the remedies for misrepresentation of prospectus? *(4 marks)*
5. (a) Write short note on:
- (i) Diversity in Board Room.
 - (ii) Designated Partners. *(4 marks each)*
- (b) A valid demand of a poll was received at a general meeting. Thereafter, those who made it, withdraw it. Examine the same in the light of the provisions of the Companies Act. *(8 marks)*
6. (a) What are the conditions required to be satisfied by a company issuing equity shares with differential rights as to dividend, voting or otherwise? *(5 marks)*
- (b) Once a duplicate certificate is issued, the original certificate becomes extinct. Comment *(5 marks)*
- (c) "A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed." Discuss this statement. *(6 marks)*
-

TEST PAPER 4/2011
(COMPULSORY)

(Based on all the study lessons)

Time allowed: 3 hours

Maximum marks: 100

NOTE: Answer All Questions.

1. Comment on **any four** of the following:
 - (i) Red-herring prospectus means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.
 - (ii) The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India.
 - (iii) Share certificate is a declaration by the company that the person in whose name the certificate is issued is a shareholder in the company.
 - (iv) A minor is wholly incompetent to enter into a contract and as such cannot become a member of a company.
 - (v) Section 383A (1) of the Companies Act, 1956 makes it obligatory for every company having a prescribed capital, to have a whole time company secretary. *(5 marks each)*

2. (a) Re-write the following sentences after filling in the blanks spaces with appropriate word(s)/figures(s):
 - (i) A prospectus is not required to be issued where a person is a bona fide invitee to enter into _____ agreement with regard to shares or debentures.
 - (ii) Every Limited Liability Partnership shall have at least _____ designated partner.
 - (iii) Section 149(1) of the Companies Act provides that in case of a public company, _____ are not exercisable until the company is entitled to commence business.
 - (iv) Mortgage is created by the act of parties whereas a _____ may be created either through the act of parties or by operation of law.
 - (v) Section 75 of the Companies Act, 1956 provides that a _____ in the prescribed e-form 2 must be filed with the Registrar of Companies within 30 days of the allotment of shares. *(1 mark each)*

- (b) Choose the most appropriate answer from the given options in respect of the following:
 - (i) The chairman can exercise a casting vote if so empowered by the _____
 - (a) board meeting
 - (b) general meeting
 - (c) articles of a company

- (d) none of the above
- (ii) The Registrar of Companies can extend the time for holding an Annual General Meeting by not more than _____
- (a) one month
(b) three months
(c) six months
(d) None of the above
- (iii) As per section 230 of the Companies Act, 1956, auditors's report should be read at the _____
- (a) Annual General Meeting
(b) Extraordinary General Meeting
(c) General Meeting
(d) Board Meeting
- (iv) In the case of a company in which not less than twenty-five percent of the subscribed share capital is held, whether singly or in any combination, by a public financial institution or a Government company or Central Government or any State Government, the appointment shall be made by
- (a) Special Resolution
(b) Ordinary Resolution
(c) Postal Ballot
(d) Board Resolution
- (v) Who among the following may be considered as "officer who is in default"?
- (a) the independent director
(b) the whole time director
(c) the nominee director
(d) all of the above (1 mark each)
- (c) Write a short note on Secretarial Standard on Board's Report. (5 marks)
3. (a) The main object of a company is to manufacture cement. Now, the board of directors decides to go in for manufacture of steel and steel related products. These are included in the 'objects clause' under the heading 'Other Objects' of the company. Can the company undertake the aforesaid new business? Discuss. (5 marks)
- (b) Vinayak, an employee of Sadbhawna Ltd. was appointed as an alternate director. In the meantime, the original director returned and wanted to attend the Board meeting. Advice. (5 marks)
- (c) How a trust is created and by whom it is created? (6 marks)
4. (a) "Section 397 and 398 are intended to avoid winding up, if possible, and keep the company going while at the same time saving the minority shareholders from oppression and mismanagement." Explain. (8 marks)

- (b) Briefly explain the general structure of an e-form and the e-filing process.
(8 marks)
5. (a) A general meeting was properly convened and was subsequently adjourned by the chairman for want of quorum. No fresh notice is given for the adjourned meeting which is held subsequently. State whether the adjourned meeting is valid?
(5 marks)
- (b) PQR Ltd. has only eight shareholders. Can a shareholder of the company apply to the Company Law Board for relief against oppression and mismanagement?
(5 marks)
- (c) Distinguish between Limited Liability Partnership (LLP) and Partnership.
(6 marks)
6. (a) At an annual general meeting held on 15th September, 2009, an auditor was appointed. The next annual general meeting was convened on 10th September, 2010 but stood adjourned. However, the retiring auditor continues to hold the office till the conclusion of the meeting. Advice with regard to the provisions of the Companies Act, 1956.
(5 marks)
- (b) In a private limited company, there are 54 members. Out of these members, six members are former employees of the company. Now, is it necessary to convert it into a public limited company?
(5 marks)
- (c) Briefly describe the following terms used while e-filing of forms –
- (i) Corporate Identity Number
 - (ii) Digital Signature Certificate. (3 marks each)
-

TEST PAPER 5/2011
(COMPULSORY)

(Based on all the study lessons)

Time allowed: 3 hours

Maximum marks: 100

NOTE: Answer All Questions.

1. Comment on **any four** of the following:
 - (i) Class meetings are those meetings which are held by holders of a particular class of shares.
 - (ii) Every profit and loss account and balance sheet shall comply with the accounting standards.
 - (iii) In case of absence or inadequacy of profits, dividend can be declared out of the accumulated profits earned by the company in the previous years.
 - (iv) Inspection of books of account and other books and papers of every company may be conducted by the Registrar or by such officers of Central Government or SEBI as may be authorized in this behalf.
 - (v) Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder. *(5 marks each)*

2. (a) Re-write the following sentences after filling in the blanks spaces with appropriate word(s)/figures(s):
 - (i) A company can keep its books of accounts at a place other than the registered office of the company by giving a notice in writing to the ROC within ____ days of the decision.
 - (ii) A notice of change of registered office is required to be given to the Registrar in e-form _____.
 - (iv) Secretarial Standard-4 issued by ICSI deals with _____.
 - (iv) While the doctrine of constructive notice seeks to protect the company against the outsiders, the principle of _____ operates to protect the outsiders against the company.
 - (v) Pursuant to the provisions of Section 78 of the Companies Act, 1956, _____ can be used in utilizing unissued shares of the company to be issued to its members as fully-paid bonus shares. *(1 mark each)*

- (b) Choose the most appropriate answer from the given options in respect of the following:
 - (i) Revised Schedule VI to Companies Act, 1956 provides-
 - (a) Format of cash flow statement
 - (b) Format of Balance Sheet
 - (c) Format of Statement of Profit and Loss
 - (d) Both 'b' & 'c' above.
 - (ii) Sanction of which of the following authorities is required in compulsory winding up:

- (a) Company Law Board
 - (b) Court
 - (c) Central Government
 - (d) None of the above
- (iii) Which among the following powers of the Board must be exercised by resolutions passed at meeting with the consent of all the directors present at the meeting:
- (a) the power to fill up casual vacancies in the office of directors.
 - (b) the power to issue debentures.
 - (c) the power to make donation to political parties.
 - (d) the power to invest in shares or debentures of any other body corporate.
- (iv) A public company can borrow money--
- (a) Before incorporation
 - (b) Soon after incorporation
 - (c) After one year of incorporation
 - (d) After obtaining Certificate to commence business.
- (v) The particulars of investment, loan, guarantee or security referred to above shall be entered chronologically in the register of loans made, guarantees given, securities provided and investment made within
- (a) five days
 - (b) seven days
 - (c) fifteen days
 - (d) thirty days. *(1 mark each)*
- (c) "Interim dividend once declared becomes debt." Comment on this statement. *(6 marks)*
3. (a) A company declared dividend in the annual general meeting held on 31st August, 2010. However, it could not pay the dividend within stipulated time. Explain the consequences that follow. *(5 marks)*
- (b) Distinguish Nominee Vs. Legal heirs. *(5 marks)*
- (c) Write a short note on director's liability for the acts of co-directors. *(6 marks)*
4. (a) In XYZ Ltd., the directors are found guilty of delay, bungling and faulty planning, which have resulted in losses and fall in prices of the shares of the company. Members holding 1/10th of the voting power in the company apply to the Central Government for investigation on the ground that the circumstances establish fraud on the part of the directors. Is the appointment of an inspector justified under the circumstances? *(5 marks)*
- (b) "A private company can accept deposits only from its members, directors and their relatives." Comment. *(5 marks)*
- (c) Ram, Shyam and Laxman hold jointly 100 shares in a company. They

want the order of names changed in the share certificate as Shyam, Ram and Laxman and make an application for change and lodge the original share certificate. The company directed them to execute a proper instrument of transfer to effect the change. Is the company justified?

(6 marks)

5. (a) Discuss. Committees required to be constituted under the Companies Act, 1956 and Companies Bill, 2011. *(5 marks)*
- (b) A house is allotted to the whole time director of the company. After the death of the whole time director, the house was occupied by his legal heirs. The company demanded the house from the legal heirs of whole time director. Whether the company will be successful? *(5 marks)*
- (c) Discuss the provisions of the Companies Act, 1956 with reference to variation of member's rights. *(6 marks)*
6. (a) Write a short note on mode of payment under the MCA-21 system.
- (b) Pawan Ltd. committed default by failing to file Balance Sheet and Profit and Loss Account. Proceedings have been initiated against a non-executive director. However, he contended that he has resigned before the date of default. Whether the contention of the ex-director be taken into account?
- (c) A director of the company along with another director were prosecuted under section 220 for their failure to file return, annual accounts and audited balance sheet required to be laid before the annual general meeting. The question is whether any failure to file such documents would constitute a continuing offence. Whether the period of limitation applicable in this case?
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EXECUTIVE PROGRAMME
COMPANY LAW

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Company Law paper are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

JUNE 2011

Time allowed : 3 hours

Maximum marks : 100

NOTE: 1. Answer **SIX** questions including Question No.1 which is **COMPULSORY**.
2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

1. Comment on **any four** of the following:
 - (i) The liability of member to pay their guaranteed amount arises only when the company has gone into liquidation and not when it is a going concern.
 - (ii) The managing director and other directors of a company are not liable to be sued for dues against a company.
 - (iii) The competent court of law can entertain a petition for winding-up of an illegal association under company law.
 - (iv) A company can be regarded as having enemy character under certain circumstances.
 - (v) Preference shares are non-cumulative unless expressly stated to be cumulative. *(5 marks each)*
2. (a) Write the most appropriate answer from the given options in respect of the following :
 - (i) Which of the following is not a 'public corporation' within the meaning of company law—
 - (a) Life Insurance Corporation of India
 - (b) Damodar Valley Corporation

- (c) State Trading Corporation of India Ltd.
 - (d) None of the above.
- (ii) All contracts which are purported to be made on behalf of a company before its incorporation are known as—
- (a) Preliminary contracts
 - (b) Provisional contracts
 - (c) Commercial contracts
 - (d) None of the above.
- (iii) Which of the following financial institution shall not be regarded for the purposes of the Companies Act, 1956 as 'public financial institution' (PFI)—
- (a) Life Insurance Corporation of India
 - (b) Infrastructure Development Finance Company Ltd.
 - (c) Unit Trust of India
 - (d) Sundaram Finance Ltd.
- (iv) Which of the following is incorrect as regards creditors of a partnership firm—
- (a) Creditors of a partnership firm are creditors of individual partners
 - (b) A decree against the firm can be executed against the partners jointly and severally
 - (c) Both (a) and (b) above
 - (d) None of the above.
- (v) Under section 252, every public company shall have at least—
- (a) Three directors
 - (b) Two directors
 - (c) Five directors
 - (d) Seven directors.
- (vi) Under section 285, in the case of every company, a meeting of the Board of directors shall be held—
- (a) At least once in every three months
 - (b) At least once in every six months
 - (c) At least once in every four months
 - (d) At least once in every two months.
- (vii) Appointment of a whole-time Company Secretary is mandatory for every producer company in case where average annual turnover exceeds—

- (a) Rs.5 crore in each of three financial years
 (b) Rs.2 crore in each of three financial years
 (c) Rs.10 crore in each of three financial years
 (d) Rs.20 crore in each of three financial years.
- (viii) Any political contribution made in contravention of section 293A(5)(a) shall be punishable with fine upto—
 (a) Three times of the contribution
 (b) Two times of the contribution
 (c) Four times of the contribution
 (d) One time of the contribution. *(1 mark each)*
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
- (i) The words _____ must be added at the end of its name by a private limited company.
- (ii) A company formed under an Act of Parliament or State Legislature is called a _____ company.
- (iii) A subsidiary of a government company is treated as a _____ company.
- (iv) The quantum of fee prescribed for registration of a company having share capital depends on the _____ of the company to be incorporated.
- (v) The application for registration of multi-State co-operative society should be addressed to _____.
- (vi) Every producer company shall hold its first annual general meeting (AGM) within a period of _____ from the date of its incorporation.
- (vii) A foreign company is a company which is incorporated in a country outside India under the law of that other country and has a place of business in _____.
- (viii) Register and index of debentureholders should be preserved for _____ after the redemption of the debentures. *(1 mark each)*
3. Distinguish between **any four** of the following :
- (i) 'Company' and 'corporation'.
 (ii) 'Doctrine of indoor management' and 'doctrine of constructive notice'.
 (iii) 'Rights issue' and 'bonus issue'.
 (iv) 'Motion' and 'resolution'.
 (v) 'Whole-time Company Secretary' and 'Company Secretary in whole-time practice'. *(4 marks each)*

4. (a) As on 31st March, 2010, the balance sheet of ABC Ltd. shows the following :

	<i>Rs. in Crores</i>
Paid-up share capital	30
Reserves and surplus	40
Reserve for redemption of debenture	20
Capital reserve	10

The company made loan/stood guarantee for loans to other companies as below :

Loan to DEF Ltd.	Rs.15 crore
Guarantee given on behalf of GHK Ltd.	Rs.15 crore

LKP Ltd. approached ABC Ltd. for loan of an amount of Rs.20 crore.

Advise the management of ABC Ltd. as to whether the company can give loan of Rs.20 crore to LKP Ltd. *(4 marks)*

- (b) State the procedure for granting loan by one company to another company. *(6 marks)*
- (c) What is meant by the term 'disqualifying company' under the Companies (Disqualification of Directors under Section 274(1)(g) of Companies Act, 1956) Rules, 2003 ? State the grounds under which the directors are disqualified under the said rules. *(6 marks)*
5. (a) What is meant by the term 'striking-off' of the name of a company ? Can any aggrieved creditor apply for restoration of the name of the company after 10 years of its striking-off ? If so, how ? *(4 marks)*
- (b) What is the general structure of e-filing process under MCA-21 ? *(4 marks)*
- (c) List out the kind of investigations carried out under the Companies Act, 1956. *(4 marks)*
- (d) Enumerate the circumstances under which the Central Government can order special audit. *(4 marks)*
6. (a) "Approval of the government is not always required under section 269 for appointment of a whole-time director by a company having a paid-up capital of Rs.5 crore." Discuss. *(4 marks)*
- (b) "A new business cannot be dealt with in an adjourned meeting without permission of the chair." Do you agree with the statement ? Give reasons. *(4 marks)*
- (c) A single fixed depositor, after marriage, applied for adding the name of his wife as joint-holder. The company refused to do so. What are the remedies available to the depositor ? *(4 marks)*
- (d) What do you mean by 'abridged letter of offer' ? What should it contain ? *(4 marks)*

7. (a) The promoters of a new company have decided to start their company with the name 'i2 Technologies Ltd.'. However, the jurisdictional Registrar of Companies (ROC) has declined to allow the name starting with small alphabets. Is the ROC's contention valid under company law as prevalent in India ? *(4 marks)*
- (b) John, who is a member of Alex Ltd., is of unsound mind. Can the shareholder of unsound mind exercise his voting rights in respect of his membership in the said company ? Give your advice. *(4 marks)*
- (c) Thrive Ltd. is a public limited company, incorporated under the Companies Act, 1956. The Board of directors of the said company has recently decided to insert an article in its articles of association relating to expulsion of a member by the Board of directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company. Is the Board's decision valid in the eye of law? *(4 marks)*
- (d) Chatur is a director of Hopes Ltd., a public limited company, registered under the Companies Act, 1956. He wants to inspect the books of account and other books and papers of the company. Can he do so ? Will your answer be different, if the director wants to inspect the books of account through an agent? *(4 marks)*
8. (a) Shine Well Ltd. has accepted deposits from the public under the Companies (Acceptance of Deposits) Rules, 1975. The company has now decided to repay some of its deposits before maturity. Can the company do so? If yes, what are the conditions attached thereto? *(4 marks)*
- (b) Grow More Ltd. is a government company in which the Central Government and many State Governments in India are members. The company has recently convened its annual general meeting at its registered office. Does the legislature have any access to the annual reports of such a company? Give your advice. *(4 marks)*
- (c) Daisy Ltd., a company registered under the Companies Act, 1956, has failed to register a charge which requires registration under section 125 and the charge is not registered as per sub-section (1) of section 125. What will be the consequences of such non-registration? *(4 marks)*
- (d) Rahees, who is a member of Vivek Ltd., a public company, has very recently become an insolvent. Can the insolvent Rahees continue as a member of the company? *(4 marks)*
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DECEMBER 2011

Time allowed : 3 hours

Maximum marks : 100

- NOTE:** 1. Answer **SIX** questions including Question No.1 which is **COMPULSORY**.
2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

1. Comment on **any four** of the following:
 - (i) Every company intending to invite deposits from public under section 58A must issue an advertisement which shall be signed by all the directors of the company.
 - (ii) Doctrine of constructive notice seeks to protect the company against the outsiders.
 - (iii) Board meetings of the company to be held at the registered office of the company during the working hours on a day that is not a public holiday.
 - (iv) Dividend can be paid out of capital if the articles of association authorise such payment.
 - (v) Director Identification Number (DIN) is not mandatory for directors of foreign company having branch offices in India. *(5 marks each)*

2. (a) Write the most appropriate answer from the given options in respect of the following:
 - (i) The privilege of doing business under the corporate form of organisation is —
 - (a) Limited liability for business debt
 - (b) Unlimited liability for business debt
 - (c) No liability for business debt
 - (d) None of the above.
 - (ii) The question of provisional contract does not arise as the company commences business immediately on its incorporation in case of —
 - (a) A public company
 - (b) A private company
 - (c) Both (a) and (b)
 - (d) None of the above.
 - (iii) The money paid by the subscribers must be returned forthwith, if the minimum subscription is not raised within —
 - (a) 30 Days after the issue of the prospectus
 - (b) 60 Days after the issue of the prospectus

- (c) 120 Days after the issue of the prospectus
 - (d) 180 Days after the issue of the prospectus.
- (iv) In the absence of a valid nomination, on the death of a sole owner of shares, the rights and liabilities go in favour of the —
- (a) Company
 - (b) Government
 - (c) Registrar of Companies
 - (d) Legal heirs.
- (v) Appointment of an alternate director is the prerogative of the —
- (a) Board of directors
 - (b) Shareholders
 - (c) Government
 - (d) None of the above.
- (vi) Section 226 containing provisions about qualifications and disqualifications of auditors is applicable to —
- (a) Public companies
 - (b) Private companies
 - (c) Section 25 companies
 - (d) All companies.
- (vii) According to section 294, no company shall appoint a sole selling agent for any area for a term exceeding —
- (a) 2 Years
 - (b) 3 Years
 - (c) 5 Years
 - (d) None of the above.
- (viii) Which of the following court is empowered to supervise the implementation of the scheme of compromise and arrangement under section 392 —
- (a) Supreme Court
 - (b) High Court
 - (c) Sessions Court
 - (d) None of the above. *(1 mark each)*
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
- (i) A company being a legal entity must have a _____ of its own to establish its separate identity.

- (ii) _____ means a prospectus issued by any financial institution or bank for one or more issues of securities or class of securities specified in the prospectus.
- (iii) Where a company borrows without the authority conferred on it by its articles or beyond the amount set-out in the articles, it is _____ an borrowing.
- (iv) A _____ is a security given for securing loans or debentures by way of a mortgage on the assets of the company.
- (v) The Depositories Act, 1996 specifies that all _____ held in a depository are fungible.
- (vi) A director can act for _____ months without possessing the qualification shares.
- (vii) For any public deposit matured and claimed but remaining unpaid, the company should pay a penal interest of _____ per annum for overdue period.
- (viii) _____ means the profits which the law allows the company to distribute by way of dividend. (1 mark each)

3. Write notes on **any four** of the following :

- (i) Conclusive evidence
- (ii) True and fair view
- (iii) Digital signature
- (iv) Essentials of a mortgage
- (v) Divisible profits
- (vi) Independent director. (4 marks each)

4. (a) Define 'oppression and mismanagement'. What are the powers of the Government of India to prevent oppression and mismanagement? (8 marks)

(b) What are the objects of Multi-State Cooperative Society? (8 marks)

5. (a) The managing director of a public limited company applied for purchasing a company's flat. The price of the flat is ₹40 lakh. The managing director suggested that he may be allowed to pay ₹20 lakh and the balance of ₹20 lakh may be recovered from his salary in 40 installments. Accounts department observed that it will tantamount to providing house building advance to the managing director which is not covered by the rules of the company. Being the Company Secretary of the company, you have been asked by the Board of directors to examine and submit a note stating the rules in this regard and action to be taken for considering the request. (8 marks)

(b) Can an insurance company commence business immediately after getting registered under the Companies Act, 1956 and obtaining

certificate of commencement of business? If not, what are the formalities required to be fulfilled before commencing business? (8 marks)

6. (a) Well-done Ltd. wants to make a first call of ₹30 on equity share of nominal value of ₹100 each on 16th October, 2011. Can it do so? Further, if the company proposes to make second call on 7th November, 2011, will it be permitted to do so? (4 marks)
- (b) The chairman and managing director of Progressive Ltd. resigned on 6th May, 2009 as such, but the company filed Form No.32 with the Registrar of Companies stating the date of resignation as 15th March, 2010. The company issued various cheques to its investors in repayment of their deposits after 6th May, 2009 which were bounced. The investors filed a complaint against the former chairman and managing director. The articles of association of the company provided that the resignation would be effective from the date it was tendered. Will the chairman and managing director be liable in the instant case? (4 marks)
- (c) A registered office was shifted from one State to another. A labour litigation was pending before the court. So, the employees objected to transfer. Whether the objection of the employees is sustainable? (4 marks)
- (d) Accounting year of Devdatta Ltd. ends on 30th June, 2009. It is required to hold an annual general meeting by 31st December, 2009. Due to some reason, the annual general meeting could not be held in December, 2009. On an application, the Registrar of Companies granted permission to hold the meeting in February, 2010. The annual general meeting was duly held in February, 2010.

Has the company complied with the requirements of holding annual general meeting every year? Will it amount to contravention of the provisions of section 166? (4 marks)

7. State, with reasons in brief, whether the following statements are true or false:
- (i) An incorporated company never dies except when it is wound-up as per law.
 - (ii) An auditor of a government company is appointed by the Central Government on the advice of Comptroller and Auditor General of India.
 - (iii) A company has a statutory right to alter its articles of association.
 - (iv) A public company can be converted into a private company without the approval of the Central Government.
 - (v) A company may create a mortgage or a charge, including a floating charge, on any of its book-debts.
 - (vi) The power to make calls is exercised by the shareholders in their meetings by means of a resolution.
 - (vii) Shares of a company can be a subject matter of a valid pledge.

- (viii) The Companies Act, 1956 lays down certain qualifications for a person to be appointed as a director of a company. *(2 marks each)*
8. (a) "The objective of introduction of secretarial standards by the ICSI is to integrate, harmonise and standardise the diverse practices for good governance." Explain. *(6 marks)*
- (b) Who may petition for winding-up of a company? What are the procedures for winding-up of unregistered company? *(6 marks)*
- (c) Discuss the term 'profit and loss account' of a company. What are the matters to be disclosed in the profit and loss account? *(4 marks)*
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