



SYLLABUS

Class - B.Com. III Sem. (Plain)

Subject - Indian Company Act

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| UNIT - I | Company definition, characteristics, types of company, formation of company, promotion, incorporation & commencement of business. |
| UNIT - II | Detailed study of memorandum of association, articles of association & prospectus. |
| UNIT - III | Shares - share capital, types of shares, transfer & transmission of shares, shareholder's rights & members of the company. |
| UNIT - IV | Directors - appointment of directors, whole time director, their qualification, appointment, powers, duties & responsibilities. |
| UNIT - V | Minority powers & minority rights, prevention of oppression & mismanagement, winding up of companies - types of companies. |



UNIT – I

Company

The word 'company' in its literary sense, conveys the idea of togetherness. In the business world, the word 'company' may be found being used loosely for any large business concern. In the legal sense the word 'company' point towards a very specific form of business set-up, floated and run by more than one person. This is the body corporate form of business organization.

Definition of a Company

Company : sec.3 (1)(i)- " Company means a company formed and registered under this Act or an existing company"

clause (ii) of Sec.3 (1) defines an existing company as follows :

"Existing company" means a company formed and registered under any of the previous companies laws..."

Thus, every such organization would be a company which is registered under the relevant law as a company before or after the enactment of the companies Act, 1956.

Lord Justice Lindley: "A company is an association of persons who contribute money to a common stock and employed in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money in money and is the capital of the company".

Haney : "A Company is an artificial person created by law having separate entity with a perpetual succession and common seal."

SPECIAL FEATURES OF A COMPANY

1. Incorporated entity
2. Artificial person
3. Separate legal identity
4. Limited liability
5. Perpetual succession
6. Transferable shares
7. Separate property
8. Common Seal
9. Capacity to sue and be sued
10. Governance by majority

LIFTING OR PIERCING CORPORATE VEIL

Lifting of corporate veil is a fiction of law which means disregarding the separate legal entity of a company and identifying the realities which lay behind the legal façade. In applying this doctrine, the court ignores the company and concerns itself directly with the members or directors.

The various cases in which the corporate veil is lifted may be put under two categories:

I. Statutory Exceptions-

1. When the number of members falls below statutory minimum (Sec. 45)
2. Misdiscription in prospectus (Sec. 62)
3. Failure to refund application money [Sec.69 (5)]
4. Misdiscription representation of name (Sec. 147)
5. Subsidiary company (Sec. 212 & 214)
6. For investigation into affairs of related companies (Sec. 239)
7. for investigation of ownership of a company (Sec. 247)
8. Fraudulent conduct (Sec. 542)
9. Liability for pre-incorporation contracts

II. Judicial Exceptions -

1. Determination of character of company
2. For protection of revenue
3. Prevention of fraud
4. Where the company is acting as the agent of the shareholders
5. Avoidance of welfare laws
6. To punish for contempt of court



KINDS OF COMPANIES

The incorporated bodies or the companies may be put in various classes on the basis of following aspects :

- A. Mode of formation.
- B. Permitted number of members.
- C. Liability of members
- D. Control of management.

A. ON THE BASIS OF MODE OF FORMATION

There are two modes under which a corporate body may be formed; one, through a special Act of parliament, and two, through registration under the Companies Act.

1. **Statutory Companies:** Corporations created under the special legislations of parliament or state legislatures may be called statutory companies; examples: Life Insurance Corporation of India, Food Corporation of India etc. The Acts creating such corporations would include in them all necessary rules and regulations for the corporate bodies so created.
2. **Registered Companies:** A corporate body registered under the Companies Act, 1956 would be called the registered company.

B. ON THE BASIS OF PERMITTED NUMBER OF MEMBERS

1. Private company

Sec. 3 (iii) has defined a private company as follows :

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 50 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.

2. Public company

Sec. 3 (1) (iv) has defined a public company as follows :

Public Company ; 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.

(C) ON THE BASIS OF LIABILITY OF MEMBERS

- (a) Limited liability companies
 - (i) Limited by shares
 - (ii) Limited by guarantee
 - (b) Unlimited companies
1. **Company limited by shares.** In the matter of members liability, this is the most common type of company. Such a company must have a share capital. The members liability is limited up to the amount of shares held. Sec. 12(2) (a) states that such a company would be:
 2. **Guarantee company.** This is also called a company limited by guarantee. The guarantee is received from the members. Such a company may or may not have share capital. This is also a limited liability company but the amount of members liability is based not on the shares held but on the guarantee given by the members. Sec. 12(2) (b) states that this is a company having the liability of its members limited by the memorandum to such amount as the



members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

3. **Unlimited company.** The unlimited company may or may not have share capital. The members liability being unlimited, the quantum of share capital is not a very crucial matter. If it has share capital, it can be easily increased or reduced by altering the Articles. The restrictions on changes in capital are not relevant for an unlimited liability company. Such a company may purchase its own shares and is free from the restrictions provided by Sec. 77.

(D) ON THE BASIS OF CONTROL OVER MANAGEMENT

A company is supposed to be autonomous in running its affairs but working under the supervision of law. Sometimes, however, a company may exercise control over another company. The former would be called a holding company and the latter its subsidiary company.

1. **Holding company.** A company would be a holding company in relation to another company if it possesses control over the other company. Sec 4(4) states that a company shall be deemed to be the holding company of another if, but only if, that other is its subsidiary.

2. **Subsidiary company.** Sec. 4(1) describes a subsidiary company as follows:

Subsidiary company: A company shall be deemed to be a subsidiary of another if, but 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 the commencement of this Act have the same voting rights 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 nominal value of its equity share capital; or

(c) the first mentioned company is a subsidiary of any company which is that other's subsidiary.

Company M holds share capital of Rs. 5,00,000 out of Rs. 18,00,000 share capital in company R. Its subsidiary company N holds Rs. 4,50,000 capital in company R. Company R would be the subsidiary of company M since company M and its subsidiary company N together hold a majority share capital in company R.

CERTAIN OTHER KINDS OF COMPANIES

1. Non profit companies or Section 25 companies

It is not uncommon for people to form organizations or associations to pursue non business objectives, such as promotion of art, culture, science and commerce etc. Such associations may or may not be registered. If members do desire registration, then one of the options would be to get the registration under the Companies Act, 1956. Sec. 25 of the Act facilitates the registration of such non business associations as a company under the Act. For this reason, these associations are called Section 25 companies.

2. Government companies

A Government company is such a company registered under the Act in which not less than 50% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company as thus defined (Sec. 617).

3. Foreign companies

Foreign companies are defined in Sec. 59(1) as follows:

Foreign company: Foreign companies are the companies falling under the following two categories:



- (a) Companies incorporated outside India which, after the commencement of this Act, establish a place of business within India; and
- (b) Companies incorporated outside India which have, before the commencement of this Act, established a place of business within India and continue to have an established place of business within India at the commencement of this Act.

4. One-man company

Where almost the entire shareholding in a company is under the ownership of a single person, while a few more members, usually the family members, are there in the company to comply with the requirements of minimum number of members, such a company is commonly called a one-man company or a family company.

PRIVILEGES AND EXEMPTIONS AVAILABLE TO PRIVATE COMPANIES

The following privileges and exemptions are available to a private company:

1. The provisions of Sec. 81 dealing with the further issue of shares do not apply to a private company. So, the shares of a private company, in the event of further issue of capital, need not first be offered to the existing shareholders.
2. A certificate for commencement of business is not necessary for a private company (Sec. 149). It can commence its business as soon as the certificate of incorporation is obtained.
3. A private company need not hold a statutory meeting and file a statutory report [Sec. 165(10)].
4. In case of a private company, under Sec. 179, in a general meeting of the company, a demand for poll on a resolution, may be made by only one member.
5. At the time of getting the company incorporated with the Registrar of companies, the directors of a private company are not required to file with the Registrar their consent in writing to act in that capacity and the undertaking to take up qualification shares.
6. It can proceed to allot shares without having to wait for any such thing as minimum subscription.
7. A life director appointed by a private company on or before April 1, 1952, cannot be removed by the company in general meeting.
8. A private company need not keep an index of members (Sec. 151).
9. Financial assistance to acquire own shares. A private company is not prohibited from giving financial assistance to any one for purchasing or subscribing for its own shares (Sec. 77).
10. Share capital and voting rights. The provisions that there should be only two kinds of share capital i.e. equity share capital and preference share capital, and that voting rights should be proportionate to the capital paid-up, are not applicable to a private company.
11. Provisions as to general meetings. The provisions of sections 171 to 186 relating to the holding of general meetings do not apply on a private company.
12. Managerial remuneration. A private company is exempted from the provisions of Sec. 198 which fixes the overall limit to the managerial remuneration at 11% of net profits.
13. Appointment of firm or body corporate. A private company may appoint a firm or body corporate to any office or place of profit under it for any period.
14. Restriction on disclosure of profit and loss. No person other than a member of the company is entitled to inspect the profit and loss account of a private company in the office of the Registrar (Sec. 220).

Distinction between Private and Public Company

1. **Paid-up capital.** A private company must have a minimum paid-up capital of Rs. 1 lakh whereas the public company should have at least Rs. 5 lakhs.
2. **Minimum number of members.** In the case of a private company, minimum number of persons to form a company is two while it is seven in the case of a public company (Sec. 12).



3. **Maximum number of members.** In case of private company the membership must not exceed 50 whereas there is no such restriction on the maximum number of members for a public company (Sec. 3).
4. **Transferability of shares.** In a private company, the right to transfer shares is restricted, whereas in the case of public company the shares are freely transferable (Secs. 3 and 82).
5. **Prospectus.** A private company cannot issue a prospectus; while a public company may issue a prospectus to invite the general public to subscribe for its shares or debentures.
6. **Statement in lieu of prospectus.** A public company, if it does not issue a prospectus, is required to file a Statement in lieu of prospectus with the Registrar of Companies at least 3 days before allotment. A private company is not required to do this.
7. **Minimum number of directors.** A private company must have at least two directors, whereas a public company must have at least three directors (Sec. 252).
8. **Increase in number of directors.** The number of directors in a private company may be increased to any extent but in case of a public company if the maximum number of directors is more than twelve, then the approval of the Central Government is necessary for any increase in the number of directors (Secs 258 and 259).
9. **Appointment of directors.** Directors of a private company may be appointed by a single resolution, but it is not so in case of a public company where each director is to be appointed by a separate resolution (Sec. 255).
10. **Retirement of directors.** Directors of a private company are not required to retire by rotation, but in case of a public company at least 2/3rds of the directors must retire by rotation at each annual general meeting (Sec. 256).
11. **Quorum for general meetings.** Two members personally present form the quorum in a private company but in a public company the number is five members (Sec. 174).

When does a private company become a public company?

1. **Conversion by default (Sec. 43).** Where a default is made by a private company in complying with the essential requirements of a private company (viz., restriction on transfer of shares, limitation of the number of members to 50 and prohibition of invitation to the public to buy shares or debentures), the company ceases to enjoy the privileges and exemptions conferred on a private company. In such a case, the provisions of the Companies Act apply to it as if it were not a private company.
2. **Conversion by operation of law (deemed public company)** The Companies (Amendment) Act, 1960 introduced a new Sec. 43-A with a view to deal with those private companies which employed public money to a large extent but escaped the restrictions and limitations as to disclosure as apply to public companies]
The Companies (Amendment) Act, 2000 abolished Sec. 43-A with effect from 13th December, 2000.
3. **Conversion by choice or volition (Sec. 44).** If a private company so alters its Articles that they do not contain the provisions which make it a private company, it shall cease to be a private company as on the date of the alteration. It shall then file with the Registrar, within 30 days, either a prospectus or a statement in lieu of prospectus..

A private company which becomes a public company shall also

1. File a copy of the resolution altering the Articles
2. Take steps to raise its membership to at least 7 if it is below that number
3. Alter the regulations contained in the Articles which are inconsistent with those of a public company



Conversion of a public company into a private company

A public company may be converted into a private company by passing a special resolution. The special resolution should be to change the Articles of the company so as to include the conditions as prescribed in Sec. 3 (!) (iii) Which make a company a private company? An alteration made in the Articles which has the effect of converting a public company into a private company shall have effect only when such alteration has been approved by the Central Government. Where the alteration has been approved by the Central Government a printed copy of the Articles as altered shall be filed by the company with the Registrar within 1 month of the date of receipt of approval.

FORMATION OF A COMPANY

The process of formation of a company can be divided and discuss under the following four stages:

1. Promotion;
2. Incorporation or Registration;
3. Capital Subscription;
4. Commencement of Business

Of these stages only the first two are necessary for the formation of a private company, and of a public company not having any share capital. A public company having a share capital has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers. (Sec. 149)

PROMOTION

Before a company can be formed, there must be some persons who intended to form a company and who take the necessary steps to carry that intention into operation. Such persons are called promoters. The promotion of a company is a comprehensive terms denoting that process by which a company is incorporated and floated, or established financially as a joint concern, by the issue of a prospectus.

The 'promotion' is the first stage in the formation of a company. Promotion may be defined as "the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profit there from."

The Promoter

"A person who originates a scheme for the formation of the company, has the memorandum and articles prepared, executed and registered and finds the first directors and settles the terms of the preliminary contracts and prospectus (if any) and making arrangement for advertising and circulating the prospectus and placing the capital is a promoter."

A person may be a promoter even if the undertakes a lesser active role in the formation of a company. Section 62(6) makes it clear that person who acts in a professional capacity is not a promoter, like an advocate, solicitor and auditor.

Who can be a promoter:- A promoter may be a natural person or a company, firm or association of persons, whether a person is or is not a promoter depends upon the nature of the role played by him in the promotion of business.

Functions/Role of a Promoter

1. **To originate the scheme for formation of the company:** Promoter conceives the idea of forming a company after a through study of the business world and identify the business fields which are unexplored or may be explored further.
2. **To secure the cooperation of the required number of persons willing to associate themselves with the project:** In fact, the minimum number of members required to join a private company is two and in case of a public company seven.
3. **Nomenclature:** The promoters have to verify from Registrar of Companies whether the proposed name is available. Promoters usually give three names in order of preference.
4. **To get the documents of the proposed company prepared:** No company can be incorporated unless the M.O.A. and A.O.A. and other documents are not field with the Registrar. Since the company takes birth from the date when certificate of incorporation is issued.



5. To appoint bankers, legal advisors of the company:

6. Arrangement of capital: If a company is to be incorporated as a private company, it has to make arrangement of its capital through private sources as a private cannot invite public to subscribe for its shares.

However, if the company is to be incorporated as a public company and it intends to invite public for subscribing its shares, then the promoters have to prepare the prospectus.

Consent of Directors: Since the first directors are to be appointed by the promoters so they must get the consent of such persons who are to be so appointed.

7. To enter into preliminary Contracts with the Vendors:

8. To arrange for filing of the necessary documents with the Registrar:

Legal Position of Promoters

While the accurate description of a promoter may be difficult, his legal position is quite clear.

A Promoter is neither a trustee nor an agent:- The reason is that a person cannot act as an agent or trustee for a person who is non-existent and the company is non-existent at the time when the promoters act for it.

Fiduciary relations with the company: - It does not mean that the promoters do not have any legal relationship with the proposed company. The legal position of a promoter can be correctly described by saying that he stands in a fiduciary position (relationship of trust and confidence) in relation to the company to be promoted.

Duties of Promoters

Since the promoter occupies a position of total trust and confidence in relation to the company promoted by him. The promoters in their fiduciary capacity have the following duties:

1. Duty not to make any secret profit: A promoter cannot make either directly or indirectly any profits at the expenses 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 case, a promoter makes a secret profit, the company has the following remedies against him:

(a) **Rescission of the contract:-** The Company may rescind the contract, in which the promoter has made secret profits.

(b) Order for repayment of secret profits.

2. Duty to make full disclosure to the company of all relevant facts: It is the duty of the promoter to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with the company.

Erlanger vs. New Sombbrero Phosphate Co. (1878) 3 A.C. 1218.

3. Duty towards future allottees: It is a duty of the promoters to ensure that the real truth is disclosed to those who are induced by the promoters to join the company and the future allottees of the shares.

Liability of Promoters:-

(1) Section 56 lays down matters to be stated and reports to be set out in the prospectus. Promoter 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.

(3) Section 63 specifies the criminal liabilities for issuing a prospectus which contains untrue statement. 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.

(4) A promoter can be held liable if he had mis-applied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

Remuneration to Promoters:-

The promoters cannot claim as a matter of right any remuneration from the company for the service rendered for a company that is yet in existence. Even where the articles of a company



specifically provide that a specified sum may be paid to the promoters for their services, it does not give the promoters a right to claim remuneration or to sue the company for the same.

However, the normal ways of rewarding the promoters for their valuable services are as follows:

- (i) They may be paid a lump sum either in cash or in the form of shares or debentures of the company.
- (ii) They may be given commission on the purchase price of the business taken over by the company.
- (iii) They may be inducted into the Board of Directors.
- (iv) He may be allowed to sell his own property to the company for cash at an inflated price, after he has made a full disclosure about the valuation and the profit earned to an independent Board of Directors.
- (v) The company may give him an option to subscribe for a certain number of the company's unissued shares at par when their market price is higher.

Preliminary Contracts and Pre-incorporation Contracts

The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called pre-incorporation or preliminary contracts.

Provisional Contracts

The provisional contracts are those contracts which are entered by a public company after incorporation but before the company becomes entitled to commence business.

INCORPORATION OF A COMPANY

"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 name to a memorandum of associations and otherwise complying with the requirement of this Act in respect of registration, form an incorporated company, with or without limited liability." [Sec. 12]

Disqualifications of subscribers of MOA: The 'person' who subscribes to the memorandum of association of the company should not be an infant, an undischarged insolvent, an alien enemy, a lunatic and a person disqualified by law from entering into a contract.

Procedure of Incorporation of a Company

Before proceeding to register a company, the promoters have to decide the following aspects:

(a) Type of company: the promoters must decide whether they want to incorporate a private company or a public company.

(b) Availability of Name: A company is identified by the name with which it is registered.

As per section 13, the memorandum of association of a company should state the name of the company.

Promoters of a company under a proposed name may make an application to Registrar of Companies in e-Form No. 1A, accompanied with a fee of Rs. 500.

Corporate Identity Number: Registrar of Companies is to allot a Corporate Identity Number (CIN) to each company registered on or after Nov. 1, 2000.

Documents to be filed with the Registrar:-

1. Memorandum of Association
2. Articles of Association
3. Copy of Proposed Agreement
4. Power of Attorney
5. Consent of the Directors
6. Particulars of Directors
7. Notice of Registered Address
8. Statutory Declaration
9. Filing of Document with the Registrar for Registration

On registration, the Registrar will issue a certificate of incorporation whereby he certifies that the company is incorporated and in the case of a limited company, that the company is limited. **(Sec. 39)**



(1)

This certificate contains the name of the company, the date of its issue, and the signature of the Registrar with his seal.

Effect of Certificate of Incorporation

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.

Conclusiveness of the Certificate of Incorporation:-

The certificate of incorporation shall be conclusive evidence that:

- (i) all the requirements of the Act have been complied with in respect of registration.
- (ii) The company is duly registered, and
- (iii) that the company has come into existence on the date of the certificate.
- (iv)

CAPITAL SUBSCRIPTION

After being registered and receiving the Certificate of Incorporation, Company is ready for flotation. It can go ahead with raising capital from the public to commence its operation satisfactorily.

Since private company is prohibited from inviting public to subscribe, it can raise the necessary capital from friends and relatives.

Section 70 of the Companies Act requires every public company to take either of the following two steps:

- (i) Issue a Prospectus if public is to be invited to subscribe to its share capital, or
- (ii) File 'A Statute In Lieu of Prospectus', in case capital has been arranged privately.

COMMENCEMENT OF BUSINESS

A private company can commence business immediately after incorporation. However, in the case of companies other than the private company and a company having no share capital, further requirement is to be complied with, namely, obtaining 'a certificate of commencement of businesses before it commence its business.

No public company can commence any business on exercise any borrowing power unless the Certificate to Commence Business is obtained.

Penalty: If any public company having share capital commences business or exercises borrowing power without obtaining the certificate to commence business, then every person at fault shall be liable to fine which may extend to Rs. 5,000 for every day of default. **(Sec. 149 (b))**

It should be noted that the company commences business within one year of its incorporation or otherwise it is liable to be wound up by the Tribunal. **(Sec. 433 (c))**

Procedure for the Incorporation of a Private Company: The procedure for the incorporation of a private company is the same as that of a public limited company with the following charges:

- (a) There should be at least two subscribers in place of seven.
- (b) e-Form No. 29 (relating to consent of directors) need not be prepared and filed.
- (c) Registration of articles of association in compulsory.



UNIT-II

Definition

Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies' law or of this Act. {Sec. 2 (56)} Palmer... It contains the objects for which the company is formed and therefore, identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company.

Significance

1. It determines some basic features of the company being formed, such as its name, registered office, capital etc.
2. It determines the area of activity for the company.
3. It lays down the basic parameters to guide the relationship between the company and the outsiders who deal with the company.

Contents of the Memorandum:-

Contents of a memorandum depend on the kind of company. The contents of memorandum of a company limited by shares shall contain the following clauses as per Table A of the Schedule I to the Act:

1. Name clause :

Every company has to adopt its corporate name carefully. This name has to be stated in the Memorandum. The name of the company as approved by the Registrar would need to be given sufficient display as per the rules, such as outside every office, on the letters, notices etc. In the case of a limited liability company, the word Limited Private limited must be there as the last words of the name.

In case of a **OPC**, words 'One Person Company' shall be mentioned in brackets below the name of such company, wherever its name is printed affixed or engraved. {Sec. 12(3)}

2. Registered office clause :

This clause requires the mention of the state in which the registered office of the company is to be statute. A company must have a registered office as a stable place for its location and as its domicile.

3. Object clause :

The memorandum must state the objects for which the company is being formed. This clause defines the area of activities for which the company is being formed. Any activity outside the limits defined by this clause would be ultra vires (beyond the powers) for the company and the company can neither do it nor ratify it if it is done by any agent without its sanction.

4. Liability clause :

The nature of liability of the members of the company being formed must be indicated by the memorandum. The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.

5. Capital clause :

The capital clause lays down the maximum limit of the capital beyond which the company cannot issue shares. This amount is described as registered capital or authorized capital or nominal capital.

6. Subscription or association clause

This clause contains the declaration by the signatories to the Memorandum about their desire to be formed into a company, about their commitment to acquire the qualification shares, if any, and the personal details about the subscribers with their signatures attested by a witness.

In case of a OPC, this clause contains the name of the only subscriber and his other particulars and his undertaking to take all the shares of the company.



7. Nomination clause:

This clause is application only in case of OPC. This clause contains the name of a some other person with his written consent. He shall become member of the company in the event of subscriber's/member's death or incapacity to contact. { Sec. 4 and refer Table A of the Schedule I }

ALTERATION OF MEMORANDUM

(A) Alteration of name clause

A company may, be special resolution and with the approval of the Central Government signified in writing change its name: If a company makes default in complying with any direction given by the government.

(B) Alteration of registered office clause

- (i) Change of office within the same city. A company can make a change in the registered office within the local limits of the same city, town or village through a resolution of the Board of directors. Such a change must be brought to the notice of the Registrar within 30 days of the change.
- (ii) Change from one city to another within the same state. A change in the registered office from one city to another within the same state would require the passing of a special resolution in the general meeting of the company and filing its copy with the Registrar within 30 days. [Sec. 13 (4) (5) (6) (7)]
- (iii) Change of registered office from one state to another. [Sec. 18 (2)]
The office is shifted to the new state and the address notified to the new Registrar within 30 days of shifting to the new office.

(C) Alteration of object clause

A company can alter its objects clause also, but, since it is a very vital clause in the Memorandum.

- a) passing a special resolution in the general meeting [Sec. 13(8)]
- b) Filing the resolution with the Registrar with 1 month together with the printed copy of the altered Memorandum.

(D) Alternation of liability clause

Liability of members of a company can be altered (increased or decreased) only if the company is converted form one class of company to another class. A company of any class registered under this Act by alteration of memorandum and articles of the company.

If a company intends to convert itself from one class of company to another class of company to another class it shall pass a special resolution and make an application to the Registrar. The company shall be required to comply with all the provision application for registration of companies. The Registrar after satisfying himself shall close the former registration of the company. Then the Registrar shall register all the documents filed for re-registration and issue a certificate of incorporation in the same manner as its first registration. [sec.18]

(E) Alteration of capital clause

If the articles authorize, a company limited by shares can alter capital clause of its memorandum. An alteration may result in increase, reduction or reorganization of the capital. Sometimes it involves the conversion of shares into stock or vice-versa. [Sec. 61] For details on alteration of capital clause, refer Chapter entitled 'Share Capital'.

DOCTRINE OF ULTRA VIRES

The doctrine of ultra vires is one of the most important principles of company law.

The word ultra means beyond, and the word vires means powers. So, the doctrine of ultra vires means that it is beyond a company's powers to do those activities which have been kept outside the scope of the objects clause in the Memorandum. If any such act is undertaken by the



company or any of its agents on its behalf, the act shall not be deemed to be done by the company. Even the entire Board or the body of the shareholders cannot approve or ratify it.

Effects of ultra vires Transactions

- (i) Contracts are void ab initio. A contract which is ultra vires the company is void ab initio. Under such a contract, the company cannot sue or be sued upon.
- (ii) Personal liability of directors to the company. If the directors of the company utilize funds of the company in ultra vires transactions, they would be personally liable to compensate the company for any loss suffered by the company.
- (iii) Personal liability of directors to third parties. As the agent of the company, the directors are expected to act within the authority available to them. If they act outside the scope of this authority by presenting themselves to be possessing the authority, this will be a breach of warranty of their authority.
- (iv) Property acquired ultra vires. The funds of the company may be spent in acquiring a property ultra vires. The company's right over the acquired property shall be secure and intact.
- (v) Injunction. In case a company has done or is about to do an act ultra vires its Memorandum, any shareholder may seek an order of injunction from the court restraining the company from doing so.

Where the Doctrine does not Apply under some circumstances as mentioned below:

- (i) Where the act is ultra vires only the directors, it may be ratified by the company.
- (ii) Where the act is ultra vires only the Articles of Association, the Articles may be altered to make the action intra vires the articles.
- (iii) Where the act is intra vires but has been done in violation of some bye-laws of the company, the Board or the general meeting may condone it.

ARTICLES OF ASSOCIATION

The Articles of Association is the second important document to be prepared by the promoter and then submitted at the time of registration. The Articles contain the rules and regulations and the bye-laws of the company to govern its internal affairs and functioning.

Definition: According Sec. 2(5) of the Act

"Articles means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act, including, so far as they apply the company the regulations contained in Table A in Schedule I annexed to this Act".

A public company limited by shares may either frame its own Articles and get them registered or may adopt Table A of Schedule I as its Articles.

Form

Articles shall be printed, be divided into paragraphs numbered consecutively, and be signed by each subscriber of the memorandum of association.

Contents

- 1) Various classes of shares the company shall issue and their rights.
- 2) Procedure for issue of shares and their allotment.
- 3) Procedure for issuing share certificates and share warrants.
- 4) Forfeiture of shares and the procedure for their re-issue.
- 5) Procedure for transfer and transmission of shares.
- 6) Calls on shares.
- 7) Conversion of shares into stock.
- 8) Payment of commission on shares and debentures to underwriters.
- 9) Borrowing powers of directors.



- 10) Rules for adoption for preliminary contracts, if any,
- 11) Re-organization and consolidation of share capital.
- 12) Alteration of shares capital.
- 13) Payment of dividends and creation of reserves.
- 14) General meetings, proxies and polls.
- 15) Voting rights of members.
- 16) Keeping of books of account and their audit.
- 17) Rules regarding use of the Common Seal of the company.
- 18) Appointment, powers, duties, qualifications and remuneration of directors.
- 19) Appointment, powers, duties remuneration, etc of auditors.
- 20) Appointment, powers, duties, qualifications, remuneration etc of the managing director, manager and secretary, if any.
- 21) Lien on shares.
- 22) Capitalization of profits.
- 23) Board meeting and their proceedings
- 24) Rules as t resolutions.
- 25) Winding up of the company.

ALTERATION OF ARTICLES

The expression 'alter' or 'alteration' shall include the making of additions, omissions and substitutions. [Sec. 2(3)]

Every company has a statutory power to alter its articles by a special resolution. But this power is subject to the provision of the companies Act and conditions of the memorandum of the company. [Sec 14]

It is pertinent to note that no provision in the articles can prevent a company from including any additional matter in its articles that the company considers necessary for its management. [Proviso to Sec. 5]

The power of alteration of articles is almost absolute and irrevocable. Any clause of the articles or any contract which takes away the company's power to alter its articles is void as being contrary to the provisions of the Companies Act. [State of Karnataka v. Mysore Coffee Curing Works. Ltd. (1984) 55 Comp Cases 70 Karnataka] However, a company's power to alter its articles is subject to certain statutory and judicial restrictions.

Procedure of Alteration

The procedure of alteration of articles may be discussed under the following three heads:

- I. Where the nature of company remains unchanged.
 - II. Where a public company is converted into a private company.
- I. Where the nature of company remains unchanged:**
1. Approval of the Board of directors.
 2. Special resolution.
 3. Complying with entrenchment provisions.
 4. Filling resolution with the Registrar.
- II. Where a public company is converted into a private company:**
1. Board shall approve the draft resolution.
 2. Special resolution.
 3. Approval of the tribunal.

Limitations of freedom to alter the Articles

- (i) Alteration must not exceed the scope of or conflict with the Memorandum.
- (ii) The alteration must not be inconsistent with the provisions of the Companies Act or any other law.



- (iii) The Articles cannot be made to include anything which is in itself unlawful or opposed to public policy.
- (iv) The alteration must not seek to undo the alteration made by the CLB or Tribunal in the documents of the company.
- (v) The alteration must be bona fide and for the benefit of the company as a whole.
- (vi) The alteration must not amount to a fraud by majority on the minority.
- (vii) The alteration cannot be done to break a contract with a third party.
- (viii) An alteration would not be complete unless it is followed by the approval of the Central Government wherever necessary.

Distinction between Memorandum and Articles

The memorandum and articles are two important documents for incorporation and governance of a company. The two may, however, be distinguished on the basis of the following points :

- (i) The memorandum contains the basic conditions associated with the incorporation of the company. This includes the name, the maximum capital and the total area of activity of the company etc. The articles however, are the rules governing the internal functioning of the company.
- (ii) The memorandum is a supreme document sub-ordinate to the Companies Act only. The articles is the document sub-ordinate to the memorandum and cannot override it.
- (iii) A memorandum has to be compulsorily registered. The articles may not be registered.
- (iv) The memorandum defines the relationship between the company and the outside world. The articles determine the relationship between the company and the members.
- (v) The alteration in memorandum requires a somewhat difficult procedure. The articles will require a simple procedure for alteration.
- (vi) The acts of the company which are ultra vires the memorandum cannot be made valid through their ratification by the company. However, the acts ultra vires the articles can be made valid through their ratification if they are intra vires the memorandum.

Constructive Notice of MOA & AOA-

The term constructive notice means the presumption of notice in certain circumstances. MOA and AOA are public documents. They are open for public inspection in registrar's office. It is duty of every person dealing with the company to inspect these documents and make sure that this cataract with the company is in accordance with the provisions of these documents. He will be presumed to have read the documents and to know their contents. This kind of presumes knowledge of these documents is called 'constructive Notice' of memorandum and articles of association. If any person enters into a contract with the company which is contract to the provisions of memorandum and articles of association, he will not get any right under such contract.

Doctrine of 'Indoor Management'

According to this doctrine, a person dealing with the company is not presumed to have the knowledge of internal proceedings of the company i.e. there is no constructive notice as to how the company's internal machinery is handled by its officers. Thus, every person dealing with the company is entitled to assume that everything has been done regularly so far as the internal proceedings of the company are concerned. This doctrine seeks to protect the outsiders against the company. If the internal formalities have not been complied with the contract will be binding on the company and it will be liable to the outsiders.



PROSPECTUS

Every company require capital for its business activities. Therefore, every company issues its securities. But the public and private companies cannot use almost the same ways or methods for issuing their securities. The ways/modes of issuing securities by both the classes of companies are briefly described in the ensuing paragraphs.

Meaning of Prospectus

Prospectus means any document described or issued as a prospectus and includes a red herring prospectus (referred to in Section 32) or shelf prospectus (referred to in section 31) or any notice, circular, advertisement or other documents inviting offers from the public for the subscription or purchase of any securities of a body corporate. [Sec. 2 (70)]

Contents of the Prospectus

The new companies Act. 2013 does not contain any model prospectus. It only prescribes the contents of a prospectus. It also states that a prospectus shall also contain the matters as may be prescribed. According to the provision of Companies Act and the Rules made there under, a prospectus to be issued shall contain the particulars with respect to the following matters:

1. The date
2. Signature
3. Information
 - a. Names of address
 - b. Dates of opening and closing of the issue
 - c. Declaration about the issue of allotment letters and refunds
 - d. A statement by the Board
 - e. Underwriting
 - f. Consent of the directors
 - g. The authority for the issue
 - h. Procedure and time schedule for allotment
 - i. Capital structure
 - j. Main objects of public offer
 - k. Main objects and present business of the company
 - l. Minimum subscription
 - m. Details of directors
4. Particulars of project
5. Particulars of Litigation
6. Reports
7. Declaration

Who can issue Prospectus?

Prospectus may be issued by any of the following:

1. Public company
2. Any person on behalf
3. Who has been engaged who is or interested
4. On behalf of a person who is or who has been engaged of interested

When issue of Prospectus not Need

1. Not offered to the public
2. Offered to the existing members
3. Offered are uniform in all respects
4. A bona fide invitation is made to a person to enter into an underwriting agreement



Public Offer

Public offer of securities means an offer of securities made to the public through a prospectus. The expression 'public offer' is quite comprehensive and it includes the following kinds of offers:

1. Initial public offer or IPO.
2. Further or follow up public offer or FPO. Both these public offers are made through prospectus
3. Offer for sale of securities to the public by an existing shareholder. Such offer is also made through issue of a prospectus. It may be both the initial public offer or IPO and further or follow up public offer or FPO [Explanation to Sec. 23]

Abridged Prospectus

Abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf. [Sec. 2 (1)]

Deemed Prospectus

It is a common practice that the securities of a company are allotted or agreed to be allotted to some intermediary known as 'Issuing House'. The issuing house in turn, is required to offer all or any of these securities to the public by means of some documents. Such a document issued by an issuing house is known as offer for sale of securities. For all purpose it shall be and deemed to be a prospectus issued by the company. The provision relating to offer for sale of securities by a issuing house are summarized as under.

Shelf Prospectus

Definition:- 'Shelf prospectus' means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. [Explanation to Sec. 31]

Red Herring Prospectus

Definition:- Red herring prospectus means a prospectus which does not have complete particulars on the quantum or price of the securities offered and the quantum of securities included therein. [Explanation to Sec. 32]

Offer to the Public

Section 67(1) of the Act States that public includes "any section of the public whether elected as members or debenture holders, or as clients of the person issuing the prospectus or in any other manner." But an offer is not to be treated as made to the public where the offer can in all the circumstances be properly regarded as a domestic concern of the persons making and receiving it.

Abridged Prospectus

It is no longer necessary to furnish a copy of the prospectus along with every application form which the company may issue while inviting the public to purchase or subscribe for its shares or debentures. In future, application form is to be accompanied only by a gist of material formation. This is referred to as 'abridged prospectuses.

SHELF-PROSPECTUS

Companies (Amendment) Act, 2000, has introduced the concept of 'shelf prospectus'. It was noticed that public financial institutions sometimes access the capital market more than once during a year. Under the Act, a company was required to issue a full-fledged prospectus each time it wanted to access the capital market. To do away with this time consuming process and to reduce the cost burden on the company, the concept of shelf prospectus from the date of opening of the first issue of securities under that prospectus has been introduced. The validity period of self prospectus is one year.



Information Memorandum or Red-herring Prospectus

Companies (Amendment) Act, 2000 has inserted a new section 60B whereby the issue of securities through "book building" concept has been recognized. As per SEBI guidelines, book building is a pre-issue exercise whereby the issuer company collects order from investment bankers and large investors based on an indicative price range. Thus, the issue price and the exact number of securities to be issued is not decided in advance (and is not disclosed in the draft prospectus) but is fixed on the basis of bids received from potential investors.

The term 'Information memorandum' has been defined in section 2(19B) of the Act to mean a process undertaken prior to filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed by means of a notice, circular, advertisement or document. An information memorandum can be issued by a public company which is already listed or which is already listed or which intends to be listed after the issue. Recently, Maruti Udyog Limited has invited applications by issuing information memorandum.

'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 through such document. In other words, a red-herring prospectus lacks price and quantity of the securities offered.

WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED

The issue of a prospectus containing the details as required by section 56(1) is not necessary in the following cases:

1. Where an offer is made in connection with bonafide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures. [Clause (a) of proviso 2 to Sec. 56 (3)]
2. Where the shares or debentures are not offered to the public. [Clause (b) of proviso 2 to Sec. 56(3)]
3. Where the shares or debentures are offered to the existing members or debenture holders of the company. [Sec.56(5)(a)]
4. Where the shares or debentures offered are uniform in all respects with shares or debentures previously issued and dealt in or quoted on a recognized stock exchange. [Sec. 5(b)]
5. Where any prospectus is published as a newspaper advertisement, it is not necessary to specify the contents of the Memorandum or the signatories thereto, or the number of shares subscribed for them. [Sec. 66]

STATEMENT IN LIEU OF PROSPECTUS

All public companies either issue a prospectus or file a statement in lieu of prospectus. A private company is prohibited from inviting monetary participation of the public. But the promoters of a public company need not necessarily go to the public for money. The promoters may be confident of obtaining the required capital, through private sources.

In such a case no prospectus need be issued to the public, but promoters must prepare a document, akin to the prospectus known as 'Statement in lieu of prospectus.' This document must be in the form set out in Schedule III of the Act and must contain practically the same information as is required in the prospectus.

Deemed Prospectus

Provisions relating to the prospectus are most stringent and duty of preparing and filling it in accordance with law is extremely onerous. So, a company may instead of offering its shares or



debentures for sale to the public allot its shares or debentures to an intermediary called 'issuing house'. Thereafter the 'issuing house' offers them for sale to the public by advertisement or circular of its own. The document by which the offer is made to the public by the issuing house is deemed for all purposes to be a 'prospectus' issued by the company.

CONTENTS OF PROSPECTUS

Section 55 provides that a prospectus issued by or on behalf of a company, or in relation to an intended company shall be dated, and that date must, unless contrary is proved, be taken as the date of the publication of the prospectus.

Section 56 provides that a prospectus must (i) contain the matters specified in Part I Schedule II and set out the reports specified in Part II of Schedule II of the Companies Act, 1956. The third part of the schedule is explanatory of Part I and II.

The government has revised the format of prospectus given in Schedule II of the Companies Act, 1956. The revised format will be effective from 1.11.1991.

PROSPECTUS

After having obtained the certificate of incorporation the promoters of a public company will have to take steps to raise the necessary capital for the company. A public company may invite the public to subscribe to its shares or debentures. For this purpose a document known as Prospectus has to be issued.

Meaning of Prospectus

A document containing detailed information about the company and an invitation to the public for subscribing to the share capital and debentures issued is called prospectus.

According to section 2(36) of the Companies Act, "Prospectus means 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". Any document to be called a prospectus must have the following ingredients;

- (a) there must be an invitation offering 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.

[Parmatha Nath Sanyal vs. Kali Kumar Dutt AIR 1925 Calcutta 714]

Meaning of the word 'issued': The rules as to prospectus apply only where a prospectus is 'issued'. 'Issued' here means issued to the public. Whether the prospectus has been issued is a matter of fact.

Nash vs. Lynde (1929)

[South of England Natural Gas & Petroleum Company Ltd. (1900) 1. Ch. 513]

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Section 67(1) of the Act States that public includes "any section of the public whether elected as members or debenture holders, or as clients of the person issuing the prospectus or in any other manner." But an offer is not to be treated as made to the public where the offer can in all the circumstances be properly regarded as a domestic concern of the persons making and receiving it.



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