As per CBCS Syllabus

INTRODUCING

COMPANY LAW

Basics–Concepts–Texts

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Peface to the First Edition

It our pleasure to present to the readers the first edition of the book , 'Introduction to Company Law'. In this aspect, we would like to thank our esteemed colleagues and students as well as our parents and dear ones for the inspiration behind our effort that made us possible to write this book. Your feedback and suggestions have gone a long way in making this edition more reader friendly by putting the convoluted legal provisions in a more simplified and concise manner. Case laws and illustrations have been given at appropriate places to enable an easy comprehension for the readers. We wish to dedicate our efforts to our esteemed readers, well-wishers and friends in this regard. This book is designed primarily to serve as a text book on 'Introduction to Company Law' for the undergraduate students of B. Com. (Hons.), B. Com. (Programme) BBA, B.Com LL.B, BBA LL.B. and LL.B students of Gauhati University. The book contains 5 Units in all covering all aspects of the syllabus provided. The book is an attempt to provide the basic and preliminary aspects of Company Law in a very simple and lucid language intelligible to all. Feedback from readers is solicited and would be thankfully acknowledged.

September, 2018

Mr. Anurag Hazarika

&

CS Riju Pathak

CASE LAW

1. Ashbury Railway Carriage and Iron Co Ltd

The objects of Ashbury Railway Carriage and Iron Co Ltd were 'to make or sell, or lend on hire, railway-carriages and waggons, and all kinds of railway plant, fittings, machinery and rolling-stock; to carry on the business of mechanical engineers and general contractors; to purchase and sell, as merchants, timber, coal, metals, or other materials; and to buy and sell any such materials on commission, or as agents'.[5] The House of Lords considered the contract to be beyond, or outside of, the powers of the company because it was not included in the objects clause in its memorandum. It was held that by entering into the transaction the company was in breach of its constitution, for it had no 'competence' or 'power' to make the contract and therefore, the transaction had no legal effect. This meant that Richie's claim against the company for breach of contract failed, as there was no contract to be enforced.

This case established the ultra vires rules, which meant that a company only had legal capacity to do what its objects clauses enabled it to do. In the case of Ashbury, had the transaction been included in its object's clause, the company would have had the capacity, making it valid. Another point to distinguish is that the memorandum in Ashbury talks about the object's clauses restricting powers of the company. The difference between these are that objects are those parts of the constitution which describe the activity a company is set up to carry on. Powers of a company are the things it needs to be able to do to carry on the activity.

The difficulty with the ultra vires rules was that those dealing with a company would have to check that it had capacity to enter into the contract by looking at its memorandum in the Register of Companies, otherwise they risked finding themselves unable to enforce a contract that the law would consider void unless the contract entered into was within its object clause. This was quite impractical.

2. Royal British Bank vs. Turquand

The doctrine of indoor management emerges from this case. Unlike the Doctrine of constructive notice, the doctrine of Indoor Management protects the outsiders against the company.

An outsider dealing with the company is not expected that he will know every detail of what is happening in the company. Neither companies internal affairs are of public matter and aren't open for all people unlike Article of Association and memorandum of association.

Thus, it can be said that the Doctrine of indoor management is the opposite of the doctrine of constructive notice.

Background: The Doctrine of Constructive notice says that as the memorandum of association and article of association are public documents, they are available to the public and the registrar of the company. All the people dealing with the company are bound to know what they are dealing with and what the company's power is.

Facts: The director of the defendant company borrowed a sum of money from the plaintiff bank on a bond bearing a company seal. The company's deed of the settlement said that company might borrow money from time to time as the general resolution of the company authorized. There was no resolution passed by the company, but wealth was acquired from the bank. The board borrowed money, and the bond was bearing the company's seal.

In action by the plaintiff against the defendant company on non-payment of money, the defendant company put forward the plea that there has been no such resolution authorizing the making of the bond, and that the same was given and made without authority.

Issue: Whether the company is liable for the loan

Held: Lord Hatherly observed, "Outsiders are bound to know the external position of the company, but are not bound to know it's indoor management."

The dealings with companies are not like dealings with other partnerships. The person dealing with them is just bound to read AOA and MOA, but they are not liable to do more. The court rejected the plea of the defendant and said that a person is bound just to read the statute and deed of settlement and do no more. It appeared on the face of it that the company hence company had followed all the procedures is liable.

The bank was held not to bound to ensure that the necessary resolution in term of the deed of settlement of the company had been passed, and the company was held liable for the loan taken by its discretion on bond bearing company seal.

3. Lakshmanaswami Mudaliar Vs LIC

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 ` 2 lacs to a trust formed for the purpose of promoting technical and business knowledge. The company's business having been taken over by L.I.C., it had no business left of its own. The Supreme Court held that the payment was ultra vires the company. Directors could not spend company's money on any charitable or general objects. They could spend for the promotion of only such charitable objects as would be useful for the attainment of the company's own objects. It is pertinent to add that the powers vested in the Board of directors, e.g., power to borrow money, is not an object of the company. The powers must be exercised to promote the company's objects. Charity is allowed only to the extent to which it is necessary in the reasonable management of the affairs of the company. Justice Shah held: "There must be proximate connection between the gift and the company's business interest". Thus "gifts to foster research relevant to the company's activities" and "payments to widows of ex-employees on the footing that such payments encourage persons to enter the employment of the company" have been upheld as valid and intra vires.

4. Seth Mohan Lal V Grain Chamber Ltd.

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.

Facts: The respondent company was formed for carrying out definite business that communicates with the give-and-take of commodities that included 'gur'. The Articles of Association of the company made it obligatory for all the members in the company to partake in the company's business transactions. The company's transactions were carried out constructed on the Companies Act, 1913 which didn't contain any prohibition against in going of a director into transactions with company. The Act was amended in 1936 which prohibited directors from entering into transactions with the company, this didn't alter the Company's mode of operation. The appellant company had entered into a transaction with the respondent and had made massive deposits in financial terms to the account of the respondent in reverence to the transaction. The Indian government had on February 15, 1950 issued an order that forbids any person from entering into transactions on 'future' in gur or make or receive payments relating to any futures after the held date. The appellant filed a petition against winding of the company following their resolution to resolve all outstanding transactions before the closing day at the principal rate.

Contentions Raised by Petitioner

By virtue of the notification dated February 15, 1950, all outstanding transactions in 'futures' in gur became void.

The resolution dated March 14, 1949, which permitted the company to enter into transactions in 'futures' in gur was invalid since the directors who took part in the meeting were disqualified under 861(1) (h) and 91-B of the Indian Companies Act, 1913, as amended by Act 22 of 1936 and the company had not incorporated in its Articles Regulation 94 of Table A, which validated acts done by directors when disqualifications attaching to them were subsequently discovered.

The resolution dated February 15, 1950 was not passed in the interests of the company and the resolution amounted to repudiation of the contracts by the company.

By reason of the notification by the Government the substratum of the company was destroyed and no business could be carried on by the company thereafter.

Final Judgment

The High Court held that by the notification dated February 15, 1950, the outstanding transactions of "futures" in gur did not become void; that in fixing the rate of settlement by resolution dated February 15, 1950, and settling the transactions with the other contracting parties at that rate the directors acted prudently and in the interests of the Company and of the shareholders, and in making payments to the parties on the basis of a settlement at that rate the directors did not commit any fraudulent act or misapply the funds of the Company; that the case of the appellants that apart from the transactions entered into by them in their firm name, they had entered into other transactions benami in the names of other firms, and that the Company had mala fide settled those transactions with those other firms was not proved; and that the Board of Directors was and remained properly constituted at all material times and no provision of the Companies Act was violated by the directors trading with the Company.

The plea made by the petitioner that there was frustration of the contracts, and on that account the Company was liable to refund all the amounts which it had received, had no substance. The Court held that the outstanding contracts were not at all mattered by the Government Order. Obligation by the Central Government of a prohibition by its notification dated March 1, 1950 restraining persons from offering and the Railway Administration from accepting for transportation by rail any goods, except with the permit of the Central Government from any station outside the State of Uttar Pradesh which was

situated within a radius of thirty miles from the border of Uttar Pradesh didn't lead to frustration of the contracts. Newly made contracts were forbidden but settlement of the outstanding contracts by disbursement of differences was not prohibited, nor was delivery of gur in fulfilment of the contract and receipt thereof at the due date by the Company forbidden. The difficulty which was arisen by the Government orders in transporting the goods needed to meet the contract was not an impossibility contemplated by section 56 of the Contract Act leading to frustration of the contracts.

The Court further held that Company was running an extensive business in "futures" in gur, but the Company was formed not with the only objective of carrying on business in "futures' in gur alone, but in numerous other commodities and supplies as well. The Company had an immovable property and liquid assets of the total worth of Rs.2, 54,000. There was no evidence that the Company was incapable of paying its debts. "As per the Section 162 of the Indian Companies Act, the Court may make an order for winding up a Company if the Court is of the outlook that it is just and equitable that the Company be wound up. In making an order for winding up on the ground that it is just and reasonable that a Company should be wound up, the Court will consider the interests of the shareholders as well as of the creditors. Substratum and objectives of the Company is said to have disappeared when the objective for which it was incorporated has substantively failed, or when it is impossible to carry on the business of the Company except at a loss, or the surviving and possible assets are deficient to meet the existing liabilities." In the case the objective for which the Company was incorporated has not substantively failed, and it cannot be contended that the Company is not in the position to carry on its business except at a loss, nor that its assets were deficient to meet its liabilities. After a thorough investigation and reports made by the Court it said that there were no creditors to whom debts were payable by the Company. The appellants had, it is real and proper that filed suits against the Company in respect of certain gur transactions on the basis that they had entered into transactions as third parties but later those suits were dismissed. The business corporation of the Company was destroyed, merely because the brokers who were acting as mediators in carrying out the business between the members had been discharged and their accounts settled. The services of the brokers could again be secured. The Company could always restart the business with the assets it holds, and put in motion the objectives for which it was incorporated. Further it was held that because of the stretched out litigation held, the Company's business has come to a stand-still but it will not be a valid ground to put issue an order of winding up against the Company. Considering all the circumstances and evidences on the primary level at the existed dates of the petition in the Court it was determined that no such case was made out under which the Company should be wound up and the Supreme Court agreed

with the High Court that no such case is made out.

5. Lee V. Lee's Air Farming Ltd.(1961) A.C.12

The case of Lee v. Lee's Air Farming Ltd. (1961) A.C. 12 (P.C.), The above case illustrates the application of the principles established in Salomon's case (supra). In this case, a company was formed for the purpose of aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company. He voted himself the managing director and got himself appointed by the articles as chief pilot at a salary. He was killed in an air crash while working for the company. His widow claimed compensation for the death of her husband in the course of his employment. The company opposed the claim on the ground that Lee was not a worker as the same person could not be the employer and the employee. The Privy Council held that Lee and his company were distinct legal persons which had entered into contractual relationships under which he became the chief pilot, a servant of the company. In his capacity of managing director he could, on behalf of the company, give himself orders in his other capacity of pilot, and the relationship between himself, as pilot and the company, was that of servant and master. Lee was a separate person from the company he formed and his widow was held entitled to get the compensation. In effect the magic of corporate personality enabled him (Lee) to be the master and servant at the same time and enjoy the advantages of both. The decision of the Calcutta High Court in Re. Kondoli Tea Co. Ltd., (1886) ILR 13 Cal. 43, recognised the principle of separate legal entity even much earlier than the decision in Salomon v. Salomon & Co. Ltd. case. Certain persons transferred a Tea Estate to a company and claimed exemptions from ad valorem duty on the ground that since they themselves were also the shareholders in the company, it was nothing but a transfer from them in one name to themselves under another name. While rejecting this Calcutta High Court observed: "The company was a separate person, a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons.

Unit 1

1.1 Historical Background of the development of Company Law in India:

Company Law in India, is the cherished child of the English parents. Our various Companies Acts have been modelled on the English Acts. Following the enactment of the Joint Stock Companies Act, 1844 in England, the first Companies Act was passed in India in 1850. It provided for the registration of the companies and transferability of shares. The Amending Act of 1857 conferred the right of registration with or without limited liability. Subsequently this right was granted to banking and insurance companies by an Act of 1860 following the similar principle in Britain. The Companies Act of 1856 repealed all the previous Acts. That Act provided inter alia for incorporation, regulation and winding up of companies and other associations. This Act was recast in 1882, embodying the amendments which were made in the Company Law in England up to 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.

1.2 Meaning, definition, features or characteristics of a company:

The word Company has no strictly technical or legal meaning .It may be described to imply an association of persons for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. But, in common parlance, the word company 'is normally reserved for those associated for economic purposes i.e. to carry on a business for gain. Used in the aforesaid sense, the word company', in simple terms, may be described to mean a voluntary associations of persons who have come together for carrying on some business and sharing the profits there from. Indian Law provides two main types of organisations for such associations: partnership' and company'. Although the word company' is colloquially applied to both, the Statute regards companies and company law as distinct from partnerships and partnership law. Partnership law in India is codified in the

Partnership Act, 1932 and is based on the law of agency, each partner becoming an agent of the others and it, therefore, affords a suitable framework for an association of a small body of persons having trust and confidence in each other.

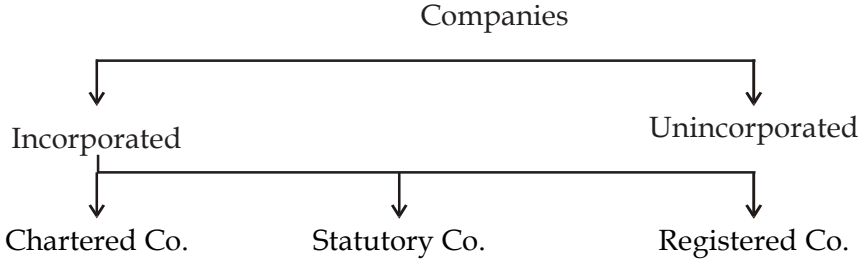
1.2.1 Definition of a Company :

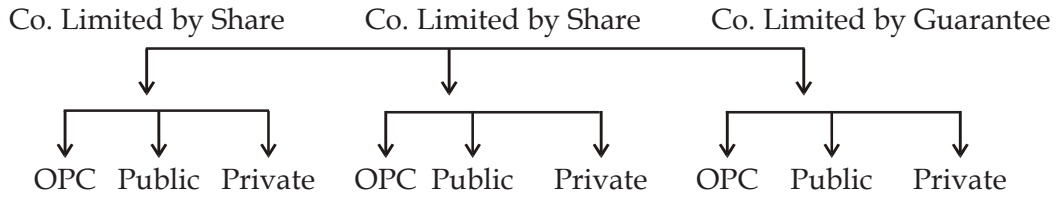
The Companies Act, 1956, does not define a company in terms of its features. Section 3 (1) (i) of the Act merely states that ¯a company means a company formed and registered under this Act or an existing company as defined in Section 3(1)(ii). Section 3(1) (ii) lays down that ¯an existing company means a company formed and registered under any of the previous Company Law. Some of the definitions of Company are:-

Lord Justice Lindley- ¯A company is an association of many persons who contribute money or monies worth 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 and is the capital of the company. The persons who contribute to it or to whom it pertains are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted. Chief Justice Marshall- ¯A corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the Charter of its creation confers upon it, either expressly or as incidental to its very existence. Prof. Haney – a company is an artificial person created by law, having separate entity, with a perpetual succession and common seal.

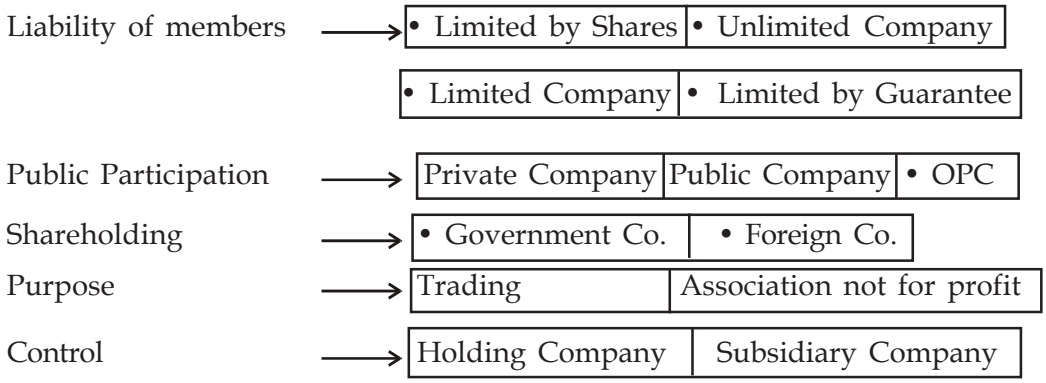
The above definitions clearly bring out the meaning of a company in terms of its features. A company to which the Companies Act applies comes into existence only when it is registered under the Act. On registration, a company becomes a body corporate i.e. it acquires a legal personality of its own, separate and distinct from its members. A registered company is there created by law and law alone can regulate, modify or dissolve it.

1.3 Different types of companies:





REGISTERED COMPANIES



Chartered Companies:

1. Chartered Companies. The 'crown' in the exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as charterd companies. Examples of this type of companies are Bank of England (1694), East India Company (1600). The Powers and the nature of business of a chartered company are defined by the charter which incorporates it.

- Created by **Special Act** of Parliament or State Legislature.
- The Objectives, powers, liabilities, responsibilities are laid in that Special Act
- Mostly concerned with public utilities (e.g Railways, Gas, Electricity) and enterprises of National Importance.
- Examples: Reserve bank of India, State bank of Inida, RBI, LIC, IFC, UTI, etc.
- The Company Act applies only when Special Act is silent on any issue.

3. Registered Companies:

- The companies formed and registered under the Companies Act 2013 or earlier Companies Acts.

- Most commonly found companies.

Types of registered Companies :

On the Basis of Liability:

- Limited Liability Companies: Limited by Shares or Gaurantee
- Unlimited Liability Companies

a) Companies Limited by Shares:

- Sec-2(22) "company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.
- **Company Allots shares to the members.**
- **Liability of members is limited to the amount unpaid on shares held.**
- **The Liability can be enforced at any time during the existence of the company and also at the time of winding up.**
- **b) Companies Limited by Guarantee (and not having share capital): Sec2(21)** "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being woundup;
- **The members undertake to contribute a fixed amount to the assets of the company, called Guarantee, at the time of joining the company.**
- **Company does not allot shares to the members.**
- **Liability of members is limited to the amount of Guarantee.**
- **The Amount of guarantee may differ from member to member**
- **The Liability can be enforced only at the time of winding up.**
- **Also referred as Non-Trading companies.**
- **Mostly such companies are incorporated not for the purpose of profit but to promote Art, Science, Charity, Sports, Commerce ,etc.**

c) Companies Limited by Guarantee and having share capital:

- **The members undertake to contribute a fixed amount to the assets of the company, called Guarantee, at the time of joining the company**
- **Company also allot shares to the members.**
- **Liability of members is two fold –**

i) **limited to the amount of Guarantee and**

ii) **limited to the amount unpaid on shares held.**

- **The Liability towards amount of Gaurantee can be enforced only at the time of winding up.**
- **The Liability towards shares can be enforced at any time during the existence of the company and also at the time of winding up.**

Unlimited Companies:

- Sec2(92) "unlimited company" means a company not having any limit on the liability of its members.
- The members will be liable for all the debts of the company like partners in a Partnership firm.
- The Articles must state the number of members with which the company is to be registered.
- It is a contingent liability of the members which will fall due only on the winding up of the company.
- The Unlimited Company can be re-registered as Limited Company through appropriate alterations in Liability Clause of MOA and alterations in AOA.
- The re-registrations will not affect any debt, liabilities, obligations or contracts of the company before the re- registration.

Private Company

- According to **Section 2(68),** "private company" means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed,and which by its articles,—

  (i) restricts the right to transfer its shares;

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

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

- Provided further that—

  (A) persons who are in the employment of the company; and

  (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have

continued to be members after the employment ceased, shall not be included in the number of members; and prohibits any invitation to the public to subscribe for any securities of the company.

Public Company:

- According to **Section 2(71)** "public company" means a company which—
- (a) is not a private company;
- (b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed:
- Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles ;
- A PUBLIC Company should have minimum of 7 members

Distinction between Private Company & Public Company

	Public	**Private**
1. Minimum Number of Members	7	2
2. Maximum Number of members	No limit	200
3. Minimum Paid up capital	5 Lakh	1 Lakh
4. Number of Directors	Minimum 3	Minimum 2
5. Restriction on appointment of directors	Consent required	Not required
6. Invitation to Public to subscribe for shares	No Restriction	Restricted
7. Transferability of shares	Fully Transferable	Restriction
8. Issue of Prospectus	Required	Not reqd.

Conversion of a Private Company into a Public Company

1. **Conversion by Default: (Section-14):**
   - A private company can enjoy certain privileges as long as it complies with the requirements of Sec-2(68).

- If any default is made in complying with the provisions of the Act, the company will be regarded as a Public Company.
- However, the company may be relieved of the consequences on an application to the Central Govt., and Central Govt. on being satisfied that the default was not willful and it is just and equitable.

2. Conversion by Choice: (Sec-14)

- A private company may deliberately chose to become a public company if it deletes from its Articles the requirements/restrictions of Sec 2(68)by passing Special Resolution.
- The company will cease to be a private company from the date of the alteration of articles.
- It has to file with the registrar a prospectus or a statement in lieu of prospectus and a copy of special resolution, within 30 days of its becoming the public company.
- If the number of members are less than seven then it must be raised to seven.
- If the number of directors are less than three then it must be raised to three.
- The word Pvt. Should be deleted from its name.
- Conversion doesn't affect the legal personality of the company.

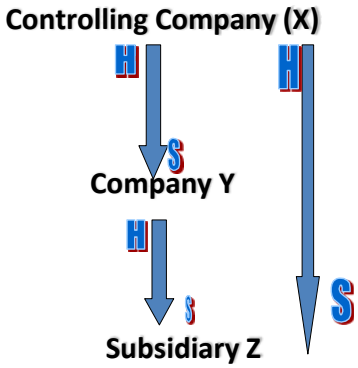
Holding Company and Subsidiary Comapny:

According to Section 2(87) of Companies Act, a holding company is one which;

i) Controls the composition of board of directors of another company (Subsidiary) i.e. no director can be appointed or removed without its consent; or

ii) Holds more than 50% of the nominal value of equity share capital of another company (Subsidiary); or

iii) Where a company (Z) is a subsidiary of another company (Y) which is itself subsidiary of controlling company (X), the former company (Z) becomes subsidiary of the controlling company (X)



Government Company

As per Section 2(45) of Companies Act, a Government company means any company in which not less than 51% of the share capital is held by;

i) The Central Government; or

ii) Any State Government or Governments; or

iii) Partly by Central Govt. and partly by one or more State Governments

- Shares held by Municipal and other Local authorities are not to be taken into consideration.
- A subsidiary of a Govt. Company is also a Govt. Company.

Special Provisions Applicable to Govt. Company

1. Appointment of Auditors:

- Auditors shall be appointed or re-appointed by the Comptroller and Auditor General of India (CAG).
- CAG will direct the manner in which account to be audited.
- CAG have power to conduct supplementary/ test audit.

2. Audit Report: Section :

- Auditor shall submit Audit Report to CAG
- CAG may supplement or Comment upon Audit Report.
- The Audit Report along with CAG Comments/Supplements shall be placed before the AGM.

3. Annual Reports:

- In case Central Govt. is a member of a Govt. Company, an Annual Report on the working and affairs of the Govt. Company shall be laid before both Houses of Parliament (Lok Sabha and Rajya Sabha) along with Audit Report and comments/Supplements of CAG.
- In case only State Government/Governments is/are member/s of a Govt. Company, an Annual Report on the working and affairs of the Govt. Company shall be laid before the State Legislature of respective State Govts., along with Audit Report and comments/Supplements of CAG.

NOTE:

- The Central Govt. may by Notification in the Official Gazette, direct that any of the provisions of the Act, shall not apply or apply with such

exceptions, modifications and adaptations as may be specified to the Govt. Companies.

- Govt. company is permitted to delete word 'Private' from its name.
- Government Companies are non-statutory companies like any other company registered under the Companies Act.
- Employees of Govt. Companies are not employees of the Union or State Government. (Praga Tools Corporation Vs C.V. Imanual AIR 1969) not even when all the share capital is subscribed by the Government (Ranjit Kumar Vs Union of India AIR 1969).
- Government Companies are not agents of Central Government or State Governments. (State Trading Corp. of India Ltd. Vs Commercial Tax Officer AIR 1963)
- A Govt. Company, like any other company may be wound up under the Companies Act

Foreign Company: Sec-2(42)

"**Company or Body Corporate incorporated** outside India having

a. a place of business in India whether by itself or through an agent, physically or through **electronic mode** and

b. conducts any business activity in India in any other manner.

- *However, where not less than 50% of the paid up share capital of a company incorporated outside India having an established place of business in India, is held by none or more Indian citizens or by one or more companies incorporated in India, it shall comply with such provisions of the Act as may be prescribed as if it were a company incorporated in India*
- Companies (Registration of Foreign Companies) Rules, 2014 defines '**electronic mode**' as carrying out electronically based, whether main server is installed in India or not, including but not limited to-
- Business to business and business to consumer transactions, data interchange and other digital supply transactions;
- offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities in India or from citizens of India;
- financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;
- online services such as telemarketing, telecommuting, telemedicine, education and information research; and

- all related data communication services.
- These transactions may be conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

A Company has an established place of business in India if it has a specific or identifiable place at which it carries on business such as an office, store, house, godown, or other such premises with some visible sign or physical indications that the company has a concrete connection with the particular premises (Deverall Vs. Grant Advertising Inc. (1954)

Difference between Partnership and Company

COMPARISON TABLE

PARTNERSHIP	**COMPANY**
The members of the Partnership firm are called as Partners.	The members of the company are called as shareholders of a company.
Enacted by	
Partnership Form of business is governed by "The Indian Partnership Act, 1932."	Company Form of business is governed by "The Indian Companies Act, 2013".
Number of Members	
Partnership firm must have Minimum of 2 partners and maximum of 20 partners.	A Company must have Minimum of 2 and maximum of 200 in the case of private company. Minimum 7 and maximum is unlimited number of members in case of public company
Created by	
Partnership Firm is Created by Contract between two or more people.	Company Firm is Created by Law i.e created by incorporation of a company under company law.
Regulation Authority	
It is regulated by the Registrar of Firms which comes under State Government.	It is regulated by the Registrar of Companies which comes under Central Government.
Registration procedure	
The registration of a Partnership firm is Not Mandatory.	The registration of Company with Registrar of Companies is Mandatory.

Documents Required	
Partnership Deed(Agreement Document) is the mandatory document for creation of a Partnership Firm.	Memorandum of Association(MoA) and Articles of Association(AoA) are the main documents to the incorporation of the company.
Separate Legal Entity	
Partnership firm is not a separate legal entity from partners. The Partners of the firm are collectively referred as a Partnership firm.	A company is a separate legal entity, It is a separate entity from its members, directors, promoters, etc.
Liability of Members	
The partners have Unlimited Liability in all the matters relating to Partnership Firm.	The Shareholders and promoters have Limited liability to Capital of the company.
Accounts and Audit	
Partnership Firm has to maintain accounts as per the conditions stated in partnership deed.	A Company should maintain accounts and auditing of accounts by certified Chartered Accountant are Compulsory.
Common Seal	
A Common Seal is not required for Partnership Firm.	A Common Seal in the form of a stamp is required for the company for legal and functional purposes.
Management	
Management of the activities of a Partnership Firm is usually done by the working partners.	Management of the activities of a Company is done by Board of Directors.
Change of Name	
The name of the Partnership Firm can be changed easily by having a discussion between partners.	The name of the company cannot be changed easily and a prior approval of

Referred Case:

1. Salmon Vs. Salmon and Company Ltd.(1897)AC 22

The case of Salomon v. Salomon and Co. Ltd., (1897) A.C. 22 The above case has clearly established the principle that once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and

for this purpose it is immaterial whether any member holds a large or small proportion of the shares, and whether he holds those shares as beneficially or as a mere trustee. In the case, Salomon had, for some years, carried on a prosperous business as a leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed to 1 share each so that the actual cash paid as capital was £7. Salomon sold his business (which was perfectly solvent at that time), to the Company formed by him for the sum of £38,782. The company's nominal capital was £40,000 in £1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors. The company soon ran into difficulties and the debenture holders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company's assets, viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as a principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf. Their Lordships of the House of Lords observed: "…the company is a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not, in law, their agent or trustee. The statute enacts nothing as to the extent or degree of interest, which may, be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them 4 EP-CL 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."

Unit 2

Formation and Promotion of a Company:

1. Promotion of a Company
2. Registration of a Company
3. Certificate of Incorporation; and
4. Commencement of the Business.

1. Promotion of a Company:

A business enterprise does not come into existence on its own. It comes into existence as a result of the efforts of an individual or group of people or an institution. That is, it has to be promoted by some person or persons. The process of business promotion begins with the conceiving of an idea and ends when that idea is translated into action i.e., the establishment of the business enterprise and commencement of its business.

Who is a Promoter in a Company?

A successful promoter is a creator of wealth and an economic prophet. The person who is concerned with the promotion of business enterprise is known as the Promoter. He conceives the idea of starting a business and takes all the measures required for bringing the enterprise into existence.

For example, Dhirubhai Ambani is the promoter of Reliance Industries.

The promoters find out the ways to collect money, investigate business ideas arranges for finance, assembles resources and establishes a going concern.

The company law has not given any legal status to promoters. He stands in a fiduciary position.

Types of Promoters

Promoters are different types such as professional promoters, occasional promoters, promoter companies, financial promoters, entrepreneurs, lawyers and engineers.

2. Registration of a Company

It is registration that brings a company into existence. A company is properly formed only when it is duly registered under the Companies Act.

Procedure of Registration

In order to get the company registered, the important documents required to be filed with the Registrar of Companies are as follows.

1. **Memorandum of Association**: It is to be signed by a minimum of 7 persons for a public company and by 2 in case of a pvt company. It must be properly stamped.
2. **Articles of Association**: This document is signed by all those persons who have signed the Memorandum of Association.
3. **List of Directors**: A list of directors with their names, address and occupation is to be prepared and filed with the Registrar of Companies.
4. **Written consent of the Directors**: A written consent of the directors that they have agreed to act as directors has to be filed with the Registrar along with a written undertaking to the effect that they will take qualification shares and will pay for them.
5. **Notice of the Address of the Registered Office**: It is also customary to file the notice of the address of the company's registered office at the time of incorporation. It is to be given within 30 days after the date of incorporation.
6. **Statutory Declaration**: A statutory declaration by
    a. any advocate of the Supreme Court or
    b. of a High Court, or
    c. an attorney or pleader entitled to appear before a High Court or
    d. a practicing chartered accountant in India, who engages in the Company formation or
    e. by a person indicated in the articles as director, managing director, Secretary or manager of the company, mentioning that the requisites of the Act and the rules there under have been complied with. It is to be filed with the Registrar of Companies.

When the required documents have been filed with the Registrar along with the prescribed fee, the Registrar scrutinizes the documents. If the Registrar is satisfied, the name of the company is entered in the register. Then the Registrar issues a certificate known as Certificate of Incorporation.

3. Certificate of Incorporation

On the registration of Memorandum of Association, Articles of Association

and other documents, the Registrar will issue a certificate known as the '**Certificate of Incorporation**'. The issue of certificate is the evidence of the fact that the company is incorporated and the requirements of the Companies Act have been complied with.

4. Certificate of Commencement of Business

As soon as a private company gets the certification of incorporation, it can can commence its business. A public company can commence its business only after getting the '**certificate of commencement of business**'. After the company gets the certificate of incorporation, a public company issues a prospectus for inviting the public to subscribe to its share capital. It fixes the minimum subscription. Then it is required to sell the minimum number of shares mentioned in the prospectus.

After completing the sale of the required number of shares, a certificate is sent to the Registrar along with a letter from the bank stating that all the money is received.

The Registrar then scrutinizes the documents. If he is satisfied he issues a certificate known as 'Certificate of Commencement of Business'. This is the conclusive evidence for the Commencement of Business.

Registration and incorporation:

A company is a voluntary association of persons formed for the purpose of business activities. A company has distinct name and limited liability, it is a juristic person having a separate legal entity different from its members who constitute it, capable of rights and duties of its own and endowed with a potential or perpetual succession. The Companies Act, 1956 prescribes specific procedures for incorporation and registration of companies. A company can be formed either by:— (i) incorporation of a new company; or (ii) conversion of existing business (sole proprietorship concern or partnership firm or co-operative societies) into company under the provisions of Chapter IX and Chapter IXA of the Companies Act, 1956; or (iii) companies incorporated under section 25 of the Companies Act, 1956. The incorporation (birth) and winding up and dissolution (death) of a company are governed by the provisions of the Companies Act, 1956. Therefore each company is subject to the provisions of the Companies Act, 1956, as may be amended from time to time. The following procedure involves for incorporation of a company.

After Promotion, the second stage in the formation of a company is the registration or incorporation. The promoter of a company should perform the following functions for getting the company registered under the Companies Act.

1. Approval of the Proposed Name of the Company

Before the company is registered, it is essential to obtain the approval of the

Registrar to its proposed name. There is a specific application form for this purpose. The promoter generally selects a few suitable names in order of preference and apply to the National Company Law Tribunal through the Registrar of the State in which the company is to be registered in Form No. 1A along with a fee of Rs.100. On hearing about the available name, the promoter has to decide the name for the company.

2. Documents to be Filed with the Registrar during registration

The promoter should then prepare and file the following documents with the Registrar of Joint Stock Companies. He should also pay the necessary filing and registration fees.

1. Memorandum of Association

The Memorandum should be printed and at least seven persons each agreeing to take at least one share must subscribe their names to Memorandum.

2. The Articles of Association

The Articles must also be signed by at least seven members. If a public company doesn't prepare and file Articles, then it is deemed to have adopted Table A in Schedule I of the Indian Companies Act.

3. List of Directors

A complete list of directors, their addresses and occupations and age. If not separate list is filed, the subscribers to the Memorandum are deemed to be the first directors.

4. Consent of the Directors

When Directors of a Company are appointed by the Articles of Association or named in the prospectus, a written consent to act as directors and also a written undertaking to take up and pay for the qualification shares if any are mandatory in Incorporation of a Company.

5. Statutory Declaration

A statutory declaration by any one of the following persons stating that all the requirements of the Act regarding Registration have been duly complied with:

1. An Advocate of the Supreme Court or High Court.
2. An Attorney or Pleader who is entitled to appear before a High Court.
3. A Chartered Accountant who is engaged in formation of the company and also practicing in India.
4. Any individual who is named in the Articles of Association as the Company's Director, Manager or Secretary.

6. Notices of the Address of the Registered Office

The notice for the address of the registered office of the company should be given within 30 days after its incorporation or on the date from which the company commences its business whichever is earlier.

7. A Letter of Authority for Making Necessary Corrections in Memorandum and Articles

A letter of authority on a non-judicial stamp paper of the requisite value signed by all the subscribers in favour of one of them or any other person for making necessary corrections, on their behalf, in the Memorandum and Articles and other papers is to be filed with the Registrar of Companies.

8. Letter of Registrar of Companies about the Availability of Name

Notarized original copy of Registrar of Companies stating the availability of the proposed name is mandatory while registering a company name. It should be filed with the Registrar of Companies. However, the requirements as given in points 3 and 4 above shall not apply to private companies.

3. Payment of Necessary Fees

Along with the above-detailed documents, the registration and filing fee as per the rates prescribed in Schedule X to the Companies Act, 1956 are to be paid.

4. Registration of the Company

The Registrar of Companies will then verify the documents submitted for registration. If there are any discrepancies found, concerned person was called to visit the Registrar's office to rectify the errors in the documents. If the documents for registrations are found in order, the Registrar will register the company and a Registration number is allotted.

The Registrar under his hand and Seal of his office will issue a Certificate of Incorporation. The date given by the Registrar in the certificate will be the date of incorporation of the company. The company will be considered to be a legal entity from this date.

Certificate of Incorporation of the Company

After the above documents are filed with the Registrar and the prescribed fees are paid and the Registrar is satisfied that all the requirements of the Act regarding the registration have been complied with, he will register the documents and retain them.

The Registrar will then issue a certificate known as **Certificate of Incorporation** and enter the name of the company in the Register kept in his office. This Certificate of Incorporation entitles the company as a legal person. In other

words, the company is born upon the issue of Certificate of Incorporation.

Advantages of Incorporation of a Company

1. **Creates a Separate Legal Entity:** This states that a company is independent and separate from its members, and the members cannot be held liable for the acts of the company, even when a particular member owns majority of shares. This was held in the case of ***Salomon v Salomon & Co. Ltd. (1897) AC 22.*** Salomon transferred his business of boot making, initially run as a sole proprietorship, to a company (Salomon Ltd.), incorporated with members comprising of himself and his family. The price for such transfer was paid to Salomon by way of shares, and debentures having a floating charge (security against debt) on the assets of the company. Later, when the company's business failed and it went into liquidation, Salomon's right of recovery (secured through floating charge) against the debentures stood prior to the claims of unsecured creditors, who would, thus, have recovered nothing from the liquidation proceeds. The claims of certain unsecured creditors in the liquidation process of Salomon Ltd., where Salomon was the majority shareholder, was sought to be made personally liable for the company's debt. Hence, the issue was whether, regardless of the separate legal identity of a company, a shareholder/controller could be held liable for its debt, over and above the capital contribution, so as to expose such member to unlimited personal liability. The House of Lords held that, as the company was duly incorporated, it is an independent person with its rights and liabilities appropriate to itself, thus, making Salomon & Co. Ltd liable, and not Salomon.
2. **Company has Perpetual Succession:** The term perpetual succession means continuous existence, which means that a company never dies, even if the members cease to exist. The membership of a company changes from time to time, but that has no effect on the existence of the company. The company only comes to an end, when it is wound up according to law, as per the provisions of the Companies Act, 2013. ***Re Noel Tedman Holdings Pty Ltd (1967) Qd R 56*** stated that a companies members may come and go but this does not affect the legal personality of the company
3. **Can own Separate Property**: Since a company is termed as a separate legal entity in the eyes of law, it can hold property in its own name and the members cannot claim to be the owner of the companies property(s). The Supreme Court, in the case of ***Bacha F. Guzdar v CIT Bombay*** stated that a company being a legal person, in which all its property is vested and by which it is controlled, managed and disposed of a member cannot, ensure the companies property on its own name. In ***Macaura v. Northern Assurance Co. Ltd.,*** a shareholder of a timber company, held all shares of the company but one. He also insured the timber (asset of the company) on his own name, which was destroyed in fire.

When he sought compensation, it was held that they were not liable to pay any money to the shareholder, in lieu of the timber since he did not own the timber and that timber, which the company owned was not insured.

4. **Capacity to sue and be sued:** The company has the capacity of suing a person or being sued by another person in its own name. A company, though can be sued or sue in its own name, it has to be represented by a natural person and any complaint which is not represented by a natural person is liable to be dismissed in the same way in which an individual complaint is liable to be dismissed in the absence of the complainant.
5. **Easier access to Capital:** Raising capital is easier for a corporation, since a corporation can issue shares of stock. This may make it easier for your business to grow and develop. If the in the market for a bank loan, that's another reason to incorporate, since n most cases, banks prefer and easily lend money to incorporated business ventures.

Disadvantages of Incorporation of a Company

1. **Cost –** The initial cost of incorporation includes the fee required to file your articles of incorporation, potential attorney or accountant fees, or the cost of using an incorporation service to assist you with completion and filing of the paperwork. There are also ongoing fees for maintaining a corporation.
2. **Double Taxation –** Some types of corporations such as a C Corporation, have the potential to result in "double taxation." Double taxation occurs when a company is taxed once on profits, and again on the dividends paid to shareholders.
3. **Loss of Personal "Ownership" –**If a corporation is a stock corporation, one person doesn't retain complete control of the entity. The corporation is governed by a board of directors who are elected by shareholders.
4. **Required Structure –**When you form a corporation, you are required to follow all of the rules outlined by the state in which you filed. This includes the management of the corporation, operational requirements and the corporation's accounting practices.
5. **Ongoing Paperwork –** Most corporations are required to file annual reports on the financial status of the company. The ongoing paperwork also includes tax returns, accounting records, meeting minutes and any required licenses and permits for conducting business.
6. **Difficulty Dissolving –** While perpetual existence is a benefit of incorporating, it can also be a disadvantage because it can require significant time and money to complete the necessary procedures for dissolution.

2.2 Promoter:

A promoter conceives an idea for setting-up a particular business at a given place and performs various formalities required for starting a company. A promoter may be a individual, firm, association of persons or a company. The persons who assist the promoter in completing various legal formalities are professional people like Counsels, Solicitors, Accountants etc. and not promoters.

Definitions:

"A promoter is the one, who undertakes to form a company with reference to a given object and sets it going and takes the necessary steps to accomplish that purpose." —Justice C.J. Cokburn

"A promoter is the person conscious of the possibility of transforming an idea into a business capable of yielding a profit; who brings together various persons concerned and who finally, superintendents the various steps necessary to bring the new business into existence." —Arthur Dewing

Characteristics of a Promoter:

The above given definitions bring out the following characteristics or features of a promoter:

1. A promoter conceives an idea for the setting-up a business.
2. He makes preliminary investigations and ensures about the future prospects of the business.
3. He brings together various persons who agree to associate with him and share the business responsibilities.
4. He prepares various documents and gets the company incorporated.
5. He raises the required finances and gets the company going.

Kinds of Promoters:

The promoters may be of the following types:

1. Professional Promoters:

These are the persons who specialise in promotion of companies. They hand over the companies to shareholders when the business starts. In India, there is lack of professional promoters. In many other countries, professional promoters have played an important role and helped the business community to a great extent. In England, Issue Houses; In U.S.A., Investment Banks and in Germany, Joint Stock Banks have played the role of promoters very appreciably.

2. Occasional Promoters:

These promoters take interest in floating some companies. They are not in promotion work on a regular basis but take up the promotion of some company

and then go to their earlier profession. For instance, engineers, lawyers, etc. may float some companies.

3. Financial Promoters:

Some financial institutions of financiers may take up the promotion of a company. They generally take up this work when financial environment is favourable at the time.

4. Managing Agents as Promoters:

In India, Managing Agents played an important role in promoting new companies. These persons used to float new companies and then got their Managing Agency rights. Managing Agency system has since long been abolished in India.

Legal Position of Promoter:

The company law has not given any legal status to promoters. A promoter is neither an agent nor a trustee of the company because it is a non entity before incorporation. Some legal cases have tried to specify the status of a promoter. He stands in a fiduciary position.

The promoter moulds and creates the company and under his supervision it comes into existence. It is the duty of the promoter to get maximum benefits for the company. He should not get secret profits from the company. If he sells his property to company, then he should explain his interest in such property.

Liabilities of a Promoter:

Following are the liabilities of a promoter:

(i) A promoter should not make secret profits out of the dealings of the company.
(ii) He must deposit with the company all money received on its behalf.
(iii) He must exercise due diligence and care while performing the work of a promoter.
(iv) He will be personally responsible for all the preliminary contracts till all these are approved by the company.
(v) He will compensate any person who made investments in the company on the basis of untrue statements made by the promoter.

2.3.1 Memorandum of Association:

Definition:

A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders. The Memorandum of Association or MOA of a

company defines the constitution and the scope of powers of the company. In simple words, the MOA is the foundation on which the company is built

The MOA is accessible to the public and describes the company's name, physical address of registered office, names of shareholders and the distribution of shares. The MOA and the Articles of Association serve as the constitution of the company.

2.3.2. Articles of Association:

Definition:

The **Articles of Association or AOA** are the legal document that along with the memorandum of association serves as the constitution of the company. It is comprised of rules and regulations that govern the company's internal affairs. The articles of association are concerned with the internal management of the company and aims at carrying out the objectives as mentioned in the memorandum. These define the company's purpose and lay out the guidelines of how the task is to be carried out within the organization. The articles of association cover the information related to the board of directors, general meetings, voting rights, board proceedings, etc.

The articles of association is comprised of following provisions:

- Share capital, call of share, forfeiture of share, conversion of share into stock, transfer of shares, share warrant, surrender of shares, etc.
- Directors, their qualifications, appointment, remuneration, powers, and proceedings of the board of directors meetings.
- Voting rights of shareholders, by poll or proxies and proceeding of shareholders general meetings.
- Dividends and reserves, accounts and audits, borrowing powers and winding up.

2.3.3. Differences between Articles of Association and Memorandum of Association:

BASIS FOR COMPARISON	MEMORANDUM OF ASSOCIATION	ARTICLES OF ASSOCIATION
Meaning	Memorandum of Association is a document that contains all the fundamental information which are required for the incorporation of the company.	Articles of Association is a document containing all the rules and regulations that governs the company.

BASIS FOR COMPARISON	MEMORANDUM OF ASSOCIATION	ARTICLES OF ASSOCIATION
Defined in	Section 2 (56)	Section 2 (5)
Type of Information contained	Powers and objects of the company.	Rules of the company.
Status	It is subordinate to the Companies Act.	It is subordinate to the memorandum.
Retrospective Effect	The memorandum of association of the company cannot be amended retrospectively.	The articles of association can be amended retrospectively.
Major contents	A memorandum must contain six clauses.	The articles can be drafted as per the choice of the company.
Obligatory	Yes, for all companies.	A public company limited by shares can adopt Table A in place of articles.
Compulsory filing at the time of Registration	Required	Not required at all.
Alteration	Alteration can be done, after passing Special Resolution (SR) in Annual General Meeting (AGM) and previous approval of Central Government (CG) or Company Law Board (CLB) is required.	Alteration can be done in the Articles by passing Special Resolution (SR) at Annual General Meeting (AGM)
Relation	Defines the relation between company and outsider.	Regulates the relationship between company and its members and also between the members inter se.
Acts done beyond the scope	Absolutely void	Can be ratified by shareholders

2.3.4. **STEPS FOR ALTERATION IN ARTICLE OF ASSOCIATION:**

STEP – I: Convey Board Meeting of Directors: (As per section 173 and SS-1) to alter the Article of association of Company By giving Notice of at least 7 days.

STEP –II: Held Board Meeting: (As per section 173 and SS-1) ƒ

- At the Board meeting, the given resolutions in respect of alteration in AOA must be passed. ƒ
- *Get Approval to Alteration in Article of Association and recommending the proposal for members' consideration by way of special resolution. ƒ
- Fixing the date, time, and venue of the general meeting and authorizing a director or any other person to send the notice for the same to the members.

STEP- III: Issue Notice of General Meeting: (Section 101) Notice of EGM shall be given at least 21 days before the actual date of EGM. EGM can be called on Shorter Notice with the consent of atleast majority in number and ninety five percent of such part of the paid up share capital of the company giving a right to vote at such a meeting: ƒ

- All the Directors. ƒ
- Members ƒ
- Auditors of Company

STEP- IV: Hold General Meeting: (Section 101) ƒ

* Check the Quorum.
* ƒ Check whether auditor is present, if not. Then Leave of absence is Granted or Not. (As per Section- 146). ƒ
* Pass Special Resolution.[Section-114(2)] ƒ
* Approval of Alteration in AOA.

STEP- V: Filing of form with ROC: (Section 117) File Form MGT-14 (Filing of Resolutions and agreements to the Registrar under section117) with the Registrar along with the requisite filing within 30 days of passing the special resolution, along with given documents:- ƒ

- Certified True Copies of the Special Resolutions along with explanatory statement; ƒ
- Copy of the Notice of meeting send to members along with all the annexure; ƒ
- A printed copy of the Altered Article of Associations

2.3.5. Alteration of the Memorandum of Association:

Memorandum of association is one of the documents which have to file with the registrar of companies at the time of incorporation of a company. Memorandum of Association of a Company sets down the constitution of a company including the permitted range of activities of the company. Section 2(56) defines a memorandum to mean "the memorandum 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."

Changes to the Memorandum of Association of a company would require the passing of a special resolution and shareholders consent. The procedure of alteration of MOA under Companies Act are as follows:

- Alteration in the Memorandum of Association can be made by following the procedure under section 13 of the Companies Act'2013.
- Hold board meeting to recommend the proposal for members' consideration by passing special resolution.
- Since alteration of the memorandum is a special business therefore an explanatory statement u/s 102 of the Companies Act'2013 shall be accompanied with the notice of the meeting in which special resolution is to be passed.
- Special resolution: For alteration of any of the clauses of memorandum of association, except the capital clause, consent of members by way of special resolution is required.
- The company is required to file special resolution passed by shareholders for alteration of memorandum of association with the Registrar of Companies. Form MGT-14 has to be filed for registration of special resolution within 30 days of passing of resolution.
- A certified copy of the special resolution along with notice and explanatory statement of the general meeting in which resolution is passed and the altered memorandum and articles are to be attached as attachments to the form MGT-14. Copy of approval from the central govt. filed with the registrar in case of change in name and registered office clauses of the memorandum.

Doctrine of Ultra Vires, Constructive notice, Doctrine of indoor management.

3.1 DOCTRINE OFCONSTRUCTIVE NOTICE

The law recognizes a company as an artificial person, which means it has been

given some status of a legal person. It is governed by its own constitution and framework which lays down the powers, objectives, and functions of the company along with the nature of its business. The set of these documents is called the Memorandum and Articles of association. Since a company needs to get these documents registered to gets its incorporation certificate, they are public documents which are accessible to the people either without any costs or on payment of a nominal amount. A person dealing with the company is duty-bound to read, understand and inspect these documents to ensure that its contract is in congruence with the provisions of the company. The person is deemed to have understood the documents as per the meaning in the manner they are to be interpreted. This includes an understanding of the powers of the company, its directors, officers and the extent of those powers. This assumption that the person dealing with the company has the notice of the contents of the Memorandum and Articles, is known as the doctrine of constructive notice.

Consequently, if a person enters into a contract which was against the Memorandum, or beyond the powers which have been conferred on the directors in the Articles of Association, then the contract is void and cannot be enforced by the person even if he/she had acted in good faith and the money was utilized to achieve the objective of the company, as given in its Memorandum.

Effect of the Doctrine of Constructive Liability

The courts see it as the responsibility of the party entering into the contract to inspect the legal documents before agreeing to the contract terms. It is also expected that the person fully understands each of the terms of the contract before agreeing to it. This doctrine prevents legal lawsuits from being filed.

Case Laws

The leading case on this is that of KotlaVenkata Swamy v. China Ramamurthy.

In this, the Articles of Association of the company made it mandatory for all the deeds to be signed by the managing director, the secretary, and a working director on behalf of the company. The secretary and the working directory of the company signed a mortgage deed which was executed in the favour of the plaintiff. At a later date, the company opted for voluntary liquidation and sold the mortgaged property to the defendant. The plaintiff then approached the court.

The court in its decision upheld the sale of the mortgaged property. The reason given by the court was that the Articles of Association of the company specifically asked for the signature of four officers of the company, and this was public knowledge. But since the plaintiff didn't act prudently and dodged its duty to read the documents, the doctrine of constructive notice will apply and the mortgage deed will be considered as an incomplete document.

Rama Corporation v. Proved Tin and General Investment Co. (1952)

The Director of the plaintiff Company formed an agreement with the Director of the defendant company which would enable them to subscribe to funds which they can use to finance the sale of goods produced by a third company. The director of the plaintiff company gave a cheque to the defendant company. But as per the articles of association of the defendant company only a director to whom the power of the board has been delegated, can collect a cheque on the behalf of the company. The plaintiff hadn't read the defendant's articles and was unaware of this clause.

In the decision of the court applied the doctrine of constructive notice and the defendant company was held not bound by the agreement.

3.2 DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management was evolved 150 years ago. It is also known as Turquand's rule. The role of the doctrine of indoor management is opposed to the role of the doctrine of constructive notice. The doctrine of constructive notice protects the company against outsiders whereas the doctrine of indoor management protects outsiders against the actions of the company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice.

The person entering into a transaction with the company only needed to satisfy that his proposed transaction is not inconsistent with the articles and memorandum of the company. He is not bound to see the internal irregularities of the company and if there are any internal irregularities than the company will be liable as the person has acted in the good faith and he did not know about the internal arrangement of the company.

The rule is based upon the obvious reason of convenience in business relations. Firstly, the articles of association and memorandum are public documents and they are open to the public for inspection. Hence an outsider "is presumed to know the constitution of a company, but what may or may not have taken place within the doors that are closed to him."

ORIGIN OF THE DOCTRINE

This doctrine was laid down in the case of **Royal British Bank V. Turquand**:

The Directors of the Company borrowed some money from the plaintiff. The article of the company provides for the borrowing of money on bonds but there was a necessary condition that a resolution should be passed in general meeting. Now in this case shareholders claims that as there was no such resolution passed in general meeting so the company is not bound to pay the money. It was held that the company is bound to pay back the loan. As directors could borrow but subjected to the resolution, so the plaintiff had the right to infer that the necessary resolution

must have been passed.

It was held that Turquand can 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."

Sections 290 provides for the validity of acts of directors- acts done by a person as a director shall be valid, notwithstanding that it may afterward 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 afterward be discovered that his appointment was invalid or that it had terminated under any provision of this act or the articles of the company."

ESTABLISHMENT OF THE DOCTRINE

The rule was not accepted as being firmly well established in law until it was approved by the House of Lords in Mahoney v East Holyford Mining Co.. In this case, It was contained in the Company's Article that a cheque should be signed by 2 of the 3 directors and also by the secretary. But in this case, the director who signed the cheque was not properly appointed. The court said that whether the director was properly appointed or not it comes under the internal management of the company and the third party who receives cheque were entitled to presume that the directors had been properly appointed, and cash cheques.

Exceptions to the doctrine of indoor management

In the following circumstances, relief of indoor management cannot be claimed by an outsider who is dealing with the company.

Where the outsider had knowledge of irregularity – The rule will not apply if the person dealing with the company has a slight knowledge about the lack of authority of the person who is acting on behalf of the company in this situation the doctrine will not apply.

In the case of Howard v. Patent Ivory Co., the Directors cannot borrow more than 1000 pound without the consent of the company's annual general meeting. Directors borrowed 3500 pounds without the consent of Annual General Meeting from another director who took debentures. Now as the plaintiff is a director that

he has the knowledge about the internal irregularity. Held- the debentures are good only for the 1000 pounds only because the plaintiff (director) has the knowledge of the internal irregularity

No knowledge of memorandum and articles- again, the rule cannot be invoked by a person on the ground that he doesn't have the knowledge of memorandum and articles and thus he did rely on them.

In the case of Rama Corporation v. Proved Tin & General Investment Co., the X who was the director in the company entered into a contract with Rama Corporation while purporting to act on behalf of the company and he also took a cheque from them. The articles of the company did provide that the director may delegate their power but Rama Corporation did not have knowledge of this as they did not read the articles and memorandum of the company. Now, later on, it was found that the company had never delegated its power to X.

Held– the plaintiff cannot take the remedy of the indoor management as they even don't that power could be delegated.

Forgery- The rule does not apply to the transaction involving forgery or illegal or transactions which are void ab initio. In the case of the forged transaction, there is a lack of consent. Here the question of consent cannot arise as the person whose signature is forged he is not even aware of the transaction.

In the case of **Rouben v. Great Fingal Consolidated**:

Here the secretary of the company forged the signature of two of the directors and issued the certificate without the authority. The issue of the certificate requires the signatures of two directors as given in the article. Held- here the holder of the certificate cannot take the advantage of the doctrine as it was forged transaction which is void ab initio.

In the case of **Kreditbank Cassel v. SchenkersLtd**,:

A bill of exchange signed by the manager of a company with his own signature under the words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favor of a payee to whom the manager was personally indebted. 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.

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 authority, the person dealing with him must make proper inquiries and satisfy him as to the officer's authority. If he fails to make an inquiry, he is estopped from relying on the rule.

In the case of **B. Anand Behari Lal v. Dinshaw& Co. (Bankers) Ltd**.,:

An accountant of a company in favor of Anand Behari. On an action brought by him for breach of contract, the court held the transferto 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.

The doctrine will not apply where the question is in regard to the very existence of an agency.

In the case of **VarkeySouriar v. Leralеeya Banking Co. Ltd**,:

The Kerala High Court held that the doctrine of Indoor management cannot apply where the question is not one as to the scope of the power exercised by an apparent agent of a company but is in regard to the very existence of the agency.

This doctrine is also not applicable where a pre-condition is required to be fulfilled before the 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.

3.3 DOCTRINE OF ULTRA VIRES

A company being an artificial person, its powers are defined in its memorandum. The Memorandum of Association (MOA) is the constitution of the company. Under section 4[1] of the companies act, 2013 it contains the name, address, objects, and scope of the company and sets out the power for the directors of the company. The Object Clause in the memorandum of the company contains the object for which the company is formed. If the company or the directors and members of the company act beyond their authority enumerated in the object clause then that will amount to ultra vires. The Latin term 'ultra vires' means beyond power. An ultra vires act is null and void and cannot be ratified by the directors even if they wish to later on. Under section 4(1)(c)[2] of the companies act states that any matter which is considered to be necessary must be mentioned in the object clause of the memorandum because if at a later stage the directors or the company presumes that such an act/transaction comes under their power and act and commit breach of the contract then section 245 (1)(b) comes into play which prevents the company from doing so.

The main aim of the doctrine of ultra vires is to protect the investors and the creditors of the company from suffering any kind of loss for which the company is responsible to pay. This doctrine prevents the company from employing the money of the investors and creditors elsewhere which is outside the scope of the object clause of the memorandum of the company. It allows them to know the objects of the company by keeping a check on their money and the transaction of the directors on behalf of the company.

In the company law, the ultra vires mean "to go beyond the object clause of a memorandum of association of a company". The company, being an artificial person, its objects and powers are specified in the memorandum of association (MoA) of the company. The Memorandum is the most crucial document for a company. It contains the object clause which enables the company in achieving its purpose for which it was formed.

In India, the doctrine of ultra vires holds a very important role in the legal framework in order to restrain the companies from surpassing its power as mentioned in the object clause of the memorandum. The doctrine, in India, was first accepted in the case of Jahangir R. Modi vs Shamji Ladha in 1866. In this case, the court held that the directors of the company had acted beyond their scope as specified in its memorandum. Further, the new companies act, 2013, section 245(1)(a)[4] aims "to restrain the company from committing an act which is ultra vires the articles or memorandum of the company". And under section 245(1)(b)[5] "to restrain the company from committing the breach of any provision of company's memorandum or articles".

The doctrine of ultra vires is applicable to all companies which are incorporated under companies act and have separate legal existence in the eyes of law. The companies that are not registered such as partnership and sole proprietorship will not have the applicability of the ultra vires, however, the doctrine is applicable to Limited Liability Partnership (LLP) as it is an artificial being, having separate legal existence and it is governed by LLP agreement which prevents them from doing unauthorized act to protect the interests of the partners and creditors and even if such an act is committed by the partners, LLP will not be liable, the partners are personally held liable. Thus, the doctrine is applicable to only those companies that are incorporated and have an independent existence in the law.

Moreover, every illegal act or transaction or abuse of power done by the director or member or the company cannot be said ultra vires. It will apply to only those acts or transaction which were specified in the object clause of memorandum of the company, the breach of which is committed or when the company surpasses its object clause – this will be declared null and void and cannot be ratified later by the company or its members because it lacks the legal capacity to incur liability for its action. The company or the directors on behalf of it cannot amend/alter or by passing a special resolution in its general meeting change any of its object clauses to give effect to the ultra vires act already done. Section 6 under the companies act, 2013 provides for any provision contained in the memorandum and articles overriding this act or any statute enacted by the parliament will be void and invalid.

This doctrine got its roots firm in 1875 in case of **Ashbury Railway Carriage and Iron company ltd. v. Riche.:**

Facts:

The Company's object was to make, sell and hire railway carriages. The Company entered into a contract to build a railway in Belgium. The contract was approved by the shareholders at its general meeting.

Held:

- The contract is ultra vires since the object's clause does not empower the Company to build a railway in Belgium.
- The contract is void in its inception because the Company did not have the capacity to make such on contract.
- Furthermore, since it lacked the capacity to make the contract, how can it have capacity to ratify it.
- Hence, the contract cannot be ratified even if it is approved by all the shareholders of the company.

Unit 2

METHODS TO INITIATE NEW VENTURES

Learning Objectives-

After completion of the unit, students will be able to explain the following aspects regarding **Methods to initiate new ventures** -

- Pathway of being an entrepreneur
- Steps or process of creating own venture
- Advantages and disadvantages of buying an existing business
- Concept of franchising business
- Details regarding franchising law in India

Contents of the unit-

2.1 Introduction
2.2 The pathway to new venture for entrepreneurs
2.3 Creating new venture (Steps, advantages and disadvantages)
2.4 Buying an existing business (Advantages and disadvantages)
2.5 Franchising
2.6 How Franchising works
2.7 Franchising law in India
2.8 Evaluating franchising opportunities

2.1 Introduction

"To win big, you sometimes have to take big risks." – Bill Gates, Co founder, Microsoft Corporation; "**Uncommon thinkers reuse what common thinkers refuse"** JRD Tata etc are some quotes by some great entrepreneurs defining the quality of an entrepreneur.

The task of being an entrepreneur is challenging and risky, but it is also true

that higher the risk means higher the gain. An entrepreneur is one of the essential part of the economy, who introduces new product or service or a new business idea, capitalise the same, create employment opportunities, create a business framework and accordingly contribute to the growth and development of the economies.

2.2 The pathway to new venture for entrepreneurs

The pathway of being an entrepreneur or the pathway to new venture for entrepreneurs includes the various ways and means through which a creative or innovative person can become a successful entrepreneur. Pathway to new venture for entrepreneurs are discussed below-

1. Bootstrapping

Bootstrapping is building a company from the ground up with nothing but personal savings. Any person having a new business idea can start his business through his own personal savings or limited resources without the use of any loan fund or debt fund initially and thereby to become an entrepreneur. The term is also used as a noun: A bootstrap is a business an entrepreneur with little or no outside cash or other support launches. The bootstrap entrepreneur retains total control of the business and makes all of the decisions.

Bootstrapping allows business owners to experiment more with their business ideas or brand, as there is no pressure from investors to get the product right the first time. The owner can independently manage his business by investing is own assets and resources and enter in any product or service market easily. Once the business growth achieves, the entrepreneur can expand his business by collecting or investing more debt and equity fund.

2. Business assistance funding

The Indian startup industry is getting a remarkable growth with startup business grants, from the Government and private sector. Numerous reports have viewed to a promising future for the Indian startup sector.

According to Nasscom's Indian Startup Ecosystem Report, India has the 3rd largest startup ecosystem in the world, with a 108% growth in funding. Despite a vibrant startup ecosystem in the country, finding funds and investors for early-stage, and growth-stage startups for the entrepreneurs is a challenge. Ideas and businesses are driven by passion or creativity, but they require money to sustain and expand it.

There are some popular start up business grants which help the entrepreneurs to capitalise their business ideas-

i) PRISM's Technopreneur Promotion Program (TePP)is an initiative of the Department of Science and Technology, Govt. of India. The program aims to support entrepreneur individual innovations to transform them into successful enterprises with the help of promotion and funding.

ii) Multiplier Grants Scheme (MGS) offered by the Department of Electronics and Information Technology assists entrepreneurs with the support and fund for industries such as IT, analytics, enterprise software, artificial intelligence and technology hardware.

iii) Startup India Hub is a one-stop platform for all stakeholders ie entrepreneurs, investors, business analyst, financial experts, market experts, successful businessmen etc in the Startup ecosystem to interact amongst each other, exchange knowledge and form succesful partnerships in a highly dynamic environment.

iv. The Amity Innovation Incubator fund is a set up of different investment stakeholders through which businesses of new entrepreneurs can generate financial support. The Amity Innovation Funds helps entrepreneurs and startups with direct investments into ventures via Amity Capital Ventures, raising debt/equity via financial institution schemes, venture capital funds etc

3. Classic start up

Classic start up refers to creating a start up through a unique product or service or adapt or extension of an existing product or service available in the market by the entrepreneurs. It is based on new-new approach and new-old approach.

New-new approach means a start up through identifying trends that could make new products or services. For example, with the development of information and communication technology, by observing new educational trend; Unacademy, Byjus etc educational application have been successfully operating in India.

New old approach means bring an existing idea to a new place. Food delivery services like Zomato, Uber eats, Swiggy etc are now operating in India successfully.

5. Buying existing business

Entrepreneurs can start their business easily by way of buying an existing business or already established business in the market. Sometimes, improper management, less efficiency, poor marketing, financial burden, shift to other profession etc may compel an existing business man to sell his business. In such case, entrepreneurs with new ideas, confidence and enthusiasm can buy those businesses by investing their own funds or borrowings from financial market. While buying an existing business typically involves more upfront cost, it also presents

less risk than starting from scratch. The entrepreneur or buyer may also acquire valuable patents or copyrights, or have the opportunity to drive a stagnant business in an exciting direction with his expertise.

6. Franchising is a well-known business strategy. Franchising is a form of contractual agreement in which a franchisee (a retailer) enters into an agreement with a franchisor (a producer) to sell the goods and services for a specified fee or commission. The retailer through his outlet distributes the goods or services on behalf of the franchisor. Entrepreneurs seeking for starting their business can enter into the contract of franchising where they can add their marketing skills and creativity for manufacturing or selling the products of the franchisor under the brand name of the franchisor.

7) Social venturing

A Social Venture or a social enterprise is an undertaking or organization established by social entrepreneurs, which seeks to provide systemic solutions to achieve a sustainable social objective. Social ventures may be structured in many forms, like sole proprietors, non-governmental organizations, youth groups, community organizations, and more. Social ventures are established to cover the range of social issues, including poverty, inequality, education, the environment, and economic development. The context in which social ventures operate is very complex as they are trying to bring about solutions where markets or governments may have failed or actually impede solutions.

Elkington and Hartigan define three models for social ventures or social enterprise,namely leveraged nonprofit, hybrid nonprofit, and social business. In the leveraged nonprofit venture, the entrepreneur uses external partners for financial support in providing a public good. On the other hand, the hybrid nonprofit venture recovers a portion of its costs through sales of its goods or services. The social business venture generates profits, it reinvests those profits to further the social venture rather than return those profits to shareholders, and the resulting social benefits.

2.3 Creating new venture (Steps, advantages and disadvantages)

Creating a new venture or starting own business is complex. It needs creativity, market knowledge, financial capacity, technical knowledge, legal knowledge and it moves through number of processes. The key of creating and starting the new business venture successfully need to look at the various market opportunities, creation and capitalisation of new business strategy, and then measuring the appropriate risk, considering whether or not the opportunity fits personal goals and needs.

Creating new ventures typically involves the following steps-

Step 1. Discovery of business idea –

It is the first step of starting a new business. Changing business environment in the form of technological change, change of consumer preferences, economic upliftment, changing demographic profile of customers, legal changes, globalisation, liberalisation etc pave the way of vast business opportunities in the local, national or international market. Entrepreneurs by analysing the market opportunities and by using their creativity can discover new business ideas. Such new business ideas may be in the form of a new or unique product or service or modified version of an existing product or service which are produced and sold to customers. Moreover, a new production strategy, a new marketing or distribution strategy, a new promotion strategy can also bring out a new business idea.

Step 2. Feasibility analysis and assessment

Once the new business idea is discovered, in the second stage, the entrepreneur has to study the feasibility of the business idea. The new business idea is analysed on its technical viability, economic viability, resources viability, market viability etc. Availability of the factors of production like land, labour, capital etc affect the establishment of the business. The new business idea would be capitalised only if required skilled labours, required land or building, required power source, required technology, required finance, required permission from various commerce related legal authorities, required market, required distribution network, required infrastructure etc are available significantly in the area where the new business idea is incepted. For example, establishing a business by introducing a new tech product needs huge funds, skilled labours, sophisticated technology, availability of basic infrastructure, legal permission, access to market etc. If any one of such important input is absent, it will not be feasible to start the business. Therefore the entrepreneur need to study properly the feasibility of his discovered business idea before it is actually capitalised.

Step 3 Making business plan

Once feasibility study is made and once the entrepreneur found his business idea feasible in the market, then the next step is to make the detailed business plan.

At this stage, the entrepreneur needs to set out the primary and secondary goals of his business, make business policies, make business strategies, frame out the rules for the business etc. It is better to set out some primary business plan which is followed by some sub plans which determine the future courses of action of the business.

The entrepreneur makes plan for establishment of the factory/production system, resource arrangement, fund acquisition and investment, marketing, HR activities, accounting etc.

Step 4 - Launching the business

Once various business plans are formulated, at this stage, the entrepreneur launches his business. The entrepreneur makes necessary arrangements for organising his business activities, departmentation if required, staffing function like recruitment, selection, placement, compensation of the staff and workers, directing the activities of the business concern, controlling various activities.

Entrepreneurs make contracts with raw material suppliers, use technologies and machineries in the production, make contracts with marketing and distribution partners, promote the products or services and accordingly the actual operation of the business starts.

Step 5 Growing the business

Once the business successfully operates in the market, at this stage the entrepreneur makes the necessary arrangements for growing his business. The entrepreneur may expand the market, expand the product line, diversify the market, acquire or make joint ventures with other business etc in order to make growth of his business.

Advantages and disadvantages of stating a new venture

Advantages of starting or own small or medium business can include:

Being the own boss –

The entrepreneur can make his own decisions, keep his own time and not have to answer to "The Boss" just like the employees do.

Use of creativity in productive purpose –

The entrepreneur will be able to utilise his creativity in productive purpose by starting his own business.

Financial independence –

The entrepreneur will enjoy financial independence.

Creative freedom –

The entrepreneur will have the freedom to work, design, create, build what he think is best in his own business venture

Employment potentiality -

Starting of own business by the entrepreneur makes the entrepreneur bread giver, where entrepreneur will be able to earn for himself as well as giving employment to the required staff for operating his business.

Business image –

By producing and delivering quality products, entrepreneur will be able to build brand image or goodwill for his business which in turn will provide the entrepreneur extended market opportunities.

Disadvantages of starting own business can include:

Cash flow –

At the initial stage, there may be insufficient cash flow towards the business as the business or the products or services are new. Customers in the market may not be aware about the business or such new products or services, and customers will show reluctant to purchase such new products at the beginning stage

Competitors –

Once the entrepreneur practically enters in the market by stating his own venture, there is strong possibility that the entrepreneur need to face severe competition from the existing market players. If the entrepreneur becomes unable to face such competition, his business may collapse.

Huge initial investment-

Before starting the business, the entrepreneur need to make huge financial investment on product, design, technology, factory establishment, promotion etc. However there is no certainty of getting income from the market even after such huge investment.

Problem of finding exact financial source-

In the initial stage of starting a new business, entrepreneurs face the problem of finance. The entrepreneurs need proper guidance and assistance regarding finding out the exact source of finance, making proper investment, making optimum debt-equity ratio; but in practical, such financial assistance are not easily available.

Legal aspects-

In India, business and commerce is regulated by many legal and licensing

requirements. While starting a new business, the entrepreneur needs to fulfil all the legal and licensing formalities which is a lengthy procedure.

No guarantee of market and sale-

There is always a difference between theoretical and practical aspects of business idea inception and capitalisation. Even after starting a new business based on throughout feasible study, there is no guarantee of market and sale of the new product or service discovered by the entrepreneur. The changing business environment may make the business idea out of date, improper promotion and awareness also cause poor market and sale.

Having these various disadvantages or challenges for starting a new business, an entrepreneur with courage, dynamic outlook, confidence, market knowledge, proactive philosophy etc would be able to convert the challenges into opportunities for his business. This is the power of successful entrepreneurs.

2.4 Buying an existing business (Advantages and disadvantages)

Entrepreneurs can start their business easily by way of buying an existing business or already established business in the market. Sometimes, improper management, less efficiency, poor marketing, financial burden, shift to other profession etc may compel an existing business man to sell his business. In such case, entrepreneurs with new ideas, confidence and enthusiasm can buy those businesses by investing their own funds or borrowings from financial market. While buying an existing business typically involves more upfront cost, it also presents less risk than starting from scratch. The entrepreneur or buyer may also acquire valuable patents or copyrights, or have the opportunity to drive a stagnant business in an exciting direction with his expertise.

Advantages of buying an existing business

Groundwork –

The setting up of the business has already been done. The entrepreneur need not to invest time on site selection, setting up factory , making contracts with stakeholders, employ staff, purchase machineries and building office. With little or no modification of the ground work, the entrepreneur can start the operation of the business.

Finance –

It is easier to get finance for an established business as the business has established financial contacts, access to funds etc

Market place –

A need for the product or service has already been established through an

established market. The entrepreneur, who acquires an existing firm simply can make little modification of the market of the business by way of adding some new products in the existing product line or diversify the product line.

Goodwill –

An established customer base, an established brand name, a patent or trademark of the existing business in the market makes it easy for the entrepreneur to gain revenue from the business so acquired.

Stock and Equipment –

An existing business will have sufficient stock for the short term and long term purposes and it generally have all the equipment required to run the business.

Employees –

Retaining existing staff not only saves time and money on recruitment, but it is also benefited by the experience the existing staff can share. It becomes an added advantage to the entrepreneur who has acquired the business.

Disadvantages of buying an existing business

The reasons why the current owner is selling –

What impact does this have on the business, it is a crucial. There may be some reasons like the business is in the stage of severe market weakness, inefficiency, poor technology and market etc. In such case, the entrepreneur must be very cautious while buying an existing business.

Finance –

A large amount of capital will be needed for cash flow and for professional fees for solicitors, surveyors, accountants etc of the existing business. The entrepreneur needs to make payments to all these parties. Moreover, the existing business may have some financial burden, which burden comes on the head of the entrepreneur who has purchased the existing business.

Investment –

If the business was inefficient during the time of acquisition, the entrepreneur needs to make more investment to make the business profitable and successful

Stock and Equipment-

Some stock may be damaged or obsolete, old equipment may need to be replaced, in such case, the entrepreneur needs tomakehuge investments.

Employees –

Staff morale maybe low if the business has been badly run or they are not happy with the news boss. Moreover, the existing staff may resist towork with the

new technology or method of production so introduced by their new boss. In such case, bringing back the confidence and zeal among the existing staff, developing their morale will become challenging for the entrepreneur who acquire such business.

External Factors –

Future growth may be affected by increased competition, or a decline in the industry. The entrepreneur has to build definite strategies in order to solve such market and competition challenges.

2.5 Franchising

Franchising is a form of contractual agreement in which a franchisee (a retailer) enters into an agreement with a franchisor (a producer) to sell the goods and services for a specified fee or commission. The retailer through his outlet distributes the goods or services.

A contractual agreement takes place between Franchisor and Franchisee. Franchisor authorizes franchisee to sell their products, goods, services and give rights to use their trademark and brand name. And these franchisee acts like a dealer.

The franchisee they have to pay a proportion of their profits to the franchiser on a regular basis. Depending on the business involved, the franchiser may provide training, management expertise and national marketing campaigns. They may also supply the raw materials and equipment to the franchisee.

Buying a franchise a good way for an entrepreneur setting up a business because:

They do not have to establish themselves in the same as a sole trader or other business might have to.

They will have the support of a tried and tested business model, having a good customer or market base.

Advantages of buying a franchise

The following are some of the advantages of buying franchise.

1. Higher success Rate:

When entrepreneurs buy a franchise, they buy an established business concept that has been successful. Franchisees stand a much better chance of success than people who start independent businesses because there is an established market and a customer base of the franchisor.

2. Assistance:

When entrepreneurs buy a franchise; they get all the equipment, supplies and instruction or training, market assistance needed to start the business.

3. Easier access to capital

Franchisors typically have a number of tie-ups with banks to provide loans for setting up a franchise business. Therefore, franchise owners can have easier access to bank loan through the franchisor.

4. Cost reduction:

Being a franchisee is cost saving technique as compared to starting own company. The franchisee need not make huge investment for establishment of the business, introducing techniques of production, promotion of the business etc unlike starting a new business or company. For example, running a courier company on own could be a difficult task. But by being a franchisee of Overnite Express, the franchisee can save money.

5. Brand value advantage:

Many well-known franchises have national brand-name recognition. Buying a franchise can be like buying a business with built-in customers.

6. Profits:

A franchise business can be immensely profitable. The probability for a small business to succeed is high as they have the backup and support of well established big business enterprises.

7. Staff training:

The franchisor provides all the necessary training to the franchisee and his business staff and provides additional resources and decision-making capabilities to a small business.

Disadvantages of buying a franchise

The following are some of the disadvantages of buying franchise.

1. Control:

Franchisors exert a high degree of control over the activities of the franchisee. No decision can be taken by the franchisees without consulting the franchisor.

2. Ongoing Costs:

Besides the original franchise fee and royalties, a percentage of franchisee's business revenue, will have to be paid to the franchisor on a periodicalbasis.

3. Lack of Support:

All franchisors do not offer the same degree of assistance in starting a business and during operation to the franchisee. Assistance is provided only at the time of starting the business.

4. Expensive:

Buying a well-known franchise is very expensive. Entrepreneurs must have the ability to arrange the necessary finance in order to purchase franchise.

5. Time consuming:

Lot of time is required while selecting a franchise. A complete and thorough research is required to select the right franchise and to determine whether it would work for the business or not.

6. Misunderstanding:

Franchise is a complex procedure and disputes may arise between the franchisee and franchisor over various terms of business.

2.6 How Franchising works?

The concept of franchising has evolved wherein a business (Franchisor) allows grants another business (Franchisee) the license to operate under the same name and use the expertise of the parent company for establishing a successful business. Some of the most well-known franchise business in the world is Domino's Pizza and McDonald's restaurants, Pepsico, Coca Cola, KFC restaurant etc. Here, we look at how to franchise business works in India.

Franchisor – Franchisee Relationship

The franchisor is the parent business that allows franchisees to operate using the same products or services, trademarks, techniques, etc., in return for an agreed-upon fee. A franchisor usually has a number of franchisees. A franchisee can have only one franchisor. The relationship between the franchisor and franchisee is governed by the franchise agreement.

Franchise Agreement

The franchise agreement is a written legal document between the franchisor and franchisee. The franchise agreement is the basic document upon which the franchisor-franchisee relationship is based on. The franchisor and franchisee must both sign the agreement agreeing the terms and conditions of the agreement. . A typical frnchise agreement includes the following major aspects-

1. Details about the franchisor and franchisee
2. Appointment of franchisee and grant of a license
3. Location of the franchisee
4. Development of the franchisee location
5. Maintenance of the franchisee location

6. Proprietary marks or trademarks the franchisee can use
7. Licenses or permissions the franchisee must obtain or can use from the franchisor
8. Operation standards
9. Quality standards
10. Details of royalty, profit sharing and commission
11. Training and assistance from the franchisor, if any
12. Franchisee license fee, if any
13. Marketing assistance from Franchisor, if any
14. Products or Services that can be offered by the Franchisee
15. Obligations of the Franchisee
16. Obligation of the franchisor
17. Terms of the franchise agreement
18. Tenure of the franchise agreement
19. Renewal of the franchise agreement
20. Termination of the franchise agreement

2.7 Franchising law in India

Legal Definition and Scope

The Indian legal framework hasn't defined the term franchise. However, its meaning can be inferred from the Finance Act of 1999, which provides that a 'franchise' is an agreement that authorizes the 'franchisee' (the term is explained below) to sell or manufacture goods, provide services or pursue businesses identified with the franchisor.

A typical franchise agreement involves a franchisor and a franchisee. The franchisor is an entity which lends its trademark, trade name or any other form of intellectual property rights along with the business system to thefranchisee the franchisee refers to an entrepreneur who undertakes the former's business under the mark or name of the franchisor by paying a royalty and an initial fee.

Regulatory Framework

Franchise agreements in India aren't governed by any franchise-specific legislation but by various applicable statutory enactments of the country. A few of them includes the Indian Contract Act 1872; the Consumer Protection Act, 1986; the Trade Marks Act, 1999; the Copyright Act, 1957; the Patents Act, 1970; the Design Act, 2000; the Specific Relief Act, 1963; the Foreign Exchange Management Act, 1999; the Transfer of Property Act, 1882; the Indian Stamp Act, 1899; the Income

Tax Act, 1961; the Arbitration and Conciliation Act, 1996; and the Information Technology Act, 2000.

Need for Franchisor Registration

Indian laws do not make it mandatory that the franchisor to be registered with any professional or regulatory body before entering into an agreement for this purpose.

Membership with Associations

It is not mandatory for a franchise to hold membership with any national franchise association, but doing so could protect the interest of the franchise owners in an improved manner.

Royalty Remittance

The FEMA and RBI regulate the terms of payment under Franchise Agreements such as franchise fees, management fees, development fees, administrative fees, royalty fees and technical fees in cases where one party is a non-Indian entity including the amount to be paid and procedure for remittance of these payments outside India. The RBI prescribes legal requirements such as furnishing of tax clearances and chartered accountant certificate at the time of remittance of royalty payments by the franchisee to franchisor outside India.

The Indian government permits the foreign franchisors to charge royalties up to 1% for domestic sales and 2% on exports for use of the foreign franchisor's brand name or trademark, without transfer of technology. The laws in India also permit lump sum and royalty payments up to US$ 2 million are permitted and royalties of 5% on domestic sales and 8% on exports can be paid to the foreign franchisor to be made by Indian franchisees to their foreign counterparts for use of foreign technology. The Government has specified formula for calculation of royalties which must be adhered to before the foreign company can remit funds out of India. If the franchise agreement proposes royalties or lump sum fees beyond the specified limits, the approval of the Foreign Investment Promotion Board(FIPB) is required.

Taxation

Taxation is another issue which deserves due consideration in franchise agreement. It is important to know the local sales tax, property tax, and withholdings tax applicable in certain areas. Where the franchisor receives royalties, service or franchise fees etc from the franchisee, tax has to be paid under the income tax Act (as income arising and accruing in India) irrespective of the franchisor is an Indian or foreign. In case where the foreign franchisor sends training personnel and supervisors to the Indian Franchisee, the salaries payable to these persons may be subject to personal income tax, whether an arrangement is made to deduct the tax

at source or they are taxed as self-employed persons (professionals).

In calculating the amount of tax payable by the franchisor or the franchisee company, the deduction available in tax laws of India can be important for tax planning purposes. The availability of tax advantages depends on the type of franchise, the product of the franchise and unit locations

Restrictions Imposable

The franchisor may impose reasonable restrictions on the franchisee concerning the sale, transfer, assignment or disposal of the franchised business In such cases provisions are needed to be included in the agreement. On the same note, these restrictions shouldn't restrain either of the parties in the performance of trade.

Cause for Termination

A franchise could only be terminated for reasonable causes. Defaults such as criminal conviction, abandonment and insolvency of either of the parties, causes termination of franchise agreement.

If the franchise agreement is terminated, an international franchisor's ability to take over the franchisee's business is predicated on applicable foreign investment guidelines. If the Indian company operating the business is a joint venture between the international franchisor and the Indian franchisee, in the single-brand retail sector, the franchisor could acquire the franchisee's interest in the joint venture such that the Indian company becomes a wholly owned subsidiary of the international franchisor

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2.8 Evaluating franchising opportunities-

A franchise is an established business system that has been market tested. The franchise has systems in place that allow its franchisees to own and operate under that established business system and brand. Let us examine some other considerations when first evaluating a franchise opportunity:

1. The Market.

Before entering into franchise agreement it is necessary to identify that market is in growth mode or is it in decline mode. Understanding the target market helps to determine the viability, and ultimately the profitability, of the franchise.

2. Company History.

Researching the officers and management of the franchise along with those who will be supporting the franchisee provide with some insight on the franchise's culture. Before entering into the agreement with the franchisor, the franchisee must analyse the financial history, market history, HR practice history, legal history,

financial statements etc of the franchisor.

3. Level of Investment.

The franchisee's investment capacity is a matter of concern before entering into franchising contract. All franchise companies will look at the liquid capital, assets-to-liabilities, and net worth of the franchisee. If the franchisee is in undercapitalized, the franchisee is more likely to fail and drain the resources of the franchise company. Therefore before entering into franchising contract, the franchisee must be sure about its financial capacity.

4. Training and Support.

The franchisors or the owners are a valuable resource and can provide the franchisee with concrete solutions to real challenges. Therefore before entering into franchising contract, the franchisee need to ensure the level of training and support to be provided by the franchisor.

5. Royalties.

Royalty payments are paid for the continuous use of a piece of work. In addition to initial fees, franchisees have to regularly pay an agreed share of the percentage of its sales to the franchisor. A franchisee's main source of revenue is its daily sales. However, the regular monthly income of the franchisor is based on the royalty payments from each franchisee. Such royalties to be paid to the franchisor is fixed as a fixed monthly rate, or as a increasing or decreasing percentage over sale. The franchisee should be cautious and carefully analyse such royalty amount.

6. Restrictions.

There have to be some restrictions in order to protect brand identity and consistency across the franchise system. Franchisee should understand such restrictions with surety.

7. Suitability.

A franchise agreement lasts generally anywhere from 5 to 15 years. It's very expensive to back out once the agreement has been signed. Therefore, before entering to a franchising agreement, franchisee should make a SWOT analysis of his own capacities so as to make the business suitable for fulfilling the business goals.

Questions-

A. Very short answer type questions

1. What is franchising?
2. What do you mean by bootstrapping?

B. Short/Medium answer type questions

1. How franchising works?
2. Discuss the advantages of starting own business.
3. Discuss the process of starting own business
4. How to evaluate franchising opportunities?

C. Long answer type questions

1. Write a note on franchising law in India
2. Discuss about the various pathways to new venture for entrepreneurs
3. Discuss the advantages and disadvantages of buying an existing business

Unit-3

PROSPECTUS, SHARES AND MEMBERSHIP

3.1 Prospectus

Meaning

Prospectus is an invitation issued to the publicto subscribe to the shares or debentures of aCompany. It is a document containing detailed information about the Company. In other words, any advertisement offering shares or debentures of the Company for sale to the public is a prospectus. The features and characteristics of the prospectus are:

- It is a document issued as a prospectus by a Company;
- It is an invitation to the member of the public;
- The public is invited to subscribe to the shares or debentures of the Company;
- It includes Red herring Prospectus, Shelf Prospectus or any notice, circular, advertisement inviting deposits from the public;
- It is a document by which the Company procures its share capital needed to carry on its activities.

Private limited companies are strictly prohibited from issuing prospectus and they cannot invite public to subscribe to their shares. Only public limited companies can issue prospectus. Thus, it is an open invitation extended to the public at large.

Definition

It has been defined under section 2(70) so as tomean any document described or issued as a prospectus and includes a red herring prospectus referred toin section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or otherdocument inviting offers from the public for the subscription or purchase of any securities of a bodycorporate.

Significance

i. Prospectus contains the summary of the Company's past history and present operation.

ii. It reflects the future programs and prospects of the Company.

iii. It serves as an invitation to the public to subscribe to the shares and debentures of the Company.

iv. It provides a legal document of the terms and conditions on which shares and debentures have been issued.

v. It identifies the persons who can be held responsible for any untrue statements made in it.

Contents of a prospectus:

- Address of the registered office of the Company.
- Name and address of Company secretary, auditors, bankers, underwriters etc.
- Dates of the opening and closing of the issue.
- Declaration about the issue of allotment letters and refunds within the prescribed time.
- A statement by the board of directors about the separate bank account where all monies received out of shares issued are to be transferred.
- Details about underwriting of the issue.
- Consent of directors, auditors, bankers to the issue, expert's opinion if any.
- The authority for the issue and the details of the resolution passed therefore.
- Procedure and time schedule for allotment and issue of securities.
- Capital structure of the Company.
- Main objects and present business of the Company and its location.
- Main object of public offer and terms of the present issue.
- Minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash.
- Details of directors including their appointment and remuneration.
- Disclosure about sources of promoter's contribution.
- Particulars relation to management perception of risk factors specific to the project, gestation period of the project, extent of progress made in the project and deadlines for completion of the project under this head information is

provided regarding.

Registration of Prospectus

On or before the date of its publication, a copy of the prospectus, which has been signed by every person who is named therein as a director or proposed director of the Company or by his agent authorized in writing, and having endorsed thereon or attached thereto as may be required, shall be delivered to the Registrar of Companies for its registration.

In other words, no prospectus shall be issued by or on behalf of a Company or in relation to an intended Company unless, on or before the date of its publication, there has been delivered to the Registrar for registration a copy thereof.

Statements of lieu of Prospectus

- Statement in lieu of prospectus is a document issued by the Company when it does not offer its securities for public subscription.
- This document is required to be filed with the Registrar.
- This Document is used when a Company wishes to raise capital from known sources.
- It contains information similar to a prospectus but in brief.
- Minimum subscription is not required to be stated unlike a Prospectus.

Golden Rule of Framing Prospectus

The 'Golden Rule' for framing of a prospectus is:

- 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 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 principles and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the Company's venture should be disclosed.
- Thus, the persons issuing the prospectus must not only include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge with might in any way affect

the decision of the prospective investor to invest in the Company.

Liabilities for mis-statement in Prospectus

A misstatement in the prospectus can invoke criminal (sec. 34) and civil liabilities (sec. 35). Misstatements can lead to punishment for fraud under Sec. 447.

I. Criminal liability

A person who authorizes the issue of a prospectus which has untrue or misleading statements is liable for punishment under Sec. 34. Such a punishment is for fraud as set out in Sec. 447. As set out in Sec 447, the punishment for fraud are:

If the fraud involves an amount of ten lakh rupees or more, or one per cent. of the turnover of the Company (whichever is lower): the person who is found guilty of fraud shall be punishable with imprisonment for a minimum term of six months which may extend to ten years. Such a person shall also be liable to a fine of an amount not less than the amount involved in the fraud and the fine may extend to three times of such amount.

If the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the Company (whichever is lower) and does not involve public interest: the imprisonment may extend to five years or with fine which may extend to fifty lakh rupees or with both.If the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

II. Civil liability

Civil liability for misstatements in prospectus will arise when a person has sustained any loss or damage by subscribing securities of a Company based on a misleading prospectus (sec. 35). In such instances the following persons shall be liable under sec 447 and will have to pay compensation to persons who have sustained such loss or damage:

- Director of the Company at the time of the issue of the prospectus;
- Person who has agreed to be named as a director in the prospectus and is named as a director of the Company, or has agreed to become such director;
- is a promoter of the Company;
- has authorized the issue of the prospectus; and
- is an expert who has been engaged or interested in the formation or promotion or management of the Company.

3.2 Shares

Meaning

The share capital is the most important requirement of a business. It is divided into a 'number of indivisible units of a fixed amount. These units are known as "shares". Whoever subscribes to these shares becomes the Shareholder of the Company. For example, Total capital of a Company is 5, 00,000 divided in to 50,000 shares of Rs. 10 each, each unit of Rs. 10 is called share. In this case there are 50,000 unit i.e. shares of Rs. 10 each and the capital is Rs. 5, 00,000.

Definition

According to Section 2 (84) of the Companies Act, 2013, "share" means a share in the share capital of a Company and includes stock.

Characteristics

1. **Permanent Capital:**Shares bring in permanent capital which financial manager can utilize during the lifetime of the Company. The management need not bother for refunding capital to the owners. There is no contractual agreement between the Company and shareholders with respect to refund of capital.
2. **No Obligation to Pay Dividends:**Another redeeming feature of shares is that it does not involve any fixed charge nor the Company is under obligation to pay dividends. Management may even use the whole of its earnings for reinvestment and shareholders have no right to interfere.
3. **No Security:** For obtaining share capital the issuing Company need not mortgage whole or any part of its assets.
4. **Freedom to Transfer Shares:** Shareholders have right to sell shares to any person they like and invest the proceeds in some other organizations.
5. **Right to Manage the Company:** Holders of shares are the owners of the Company. The ownership confers voting right to shareholders. It is they who appoint directors for administration of the Company. Being owners of the Company, shareholders have to bear all risks of business losses.
6. **Limited Liability:** Liability of shareholders of the Company is limited (in the case of limited companies) to the par value of shares held by them. However, in case of unlimited companies, liability of shareholders is unlimited.

Classification of Share Capital

S.No.	Type of Capital	Definition
1.	**Nominal, Authorised or Registered Capital**	Such capital as is authorised by the memorandum of a Company to be the maximum amount of share capital of the Company.
2.	**Issued Capital**	It is that part of the authorized ornominal capital which the Company issues for the timebeing for public subscription and allotment.
3.	**Subscribed Capital**	It is thatportion of the issued capital at face value which hasbeen subscribed for or taken up by the subscribers of shares in the Company.
4.	**Called-up Capital**	It is that portion of the subscribed capital which has been called up or demanded on the shares by the Company.
5.	**Paid-up Share Capital**	Such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the Company, but does not include any other amount received in respect of such shares, by whatever name called.
6.	**Equity & Preference Share Capital**	**''equity share capital''**, with reference to any Company limited by shares, means all share capital which is not preference share capital;**''preference share capital''**, with reference to any Company limited by shares, means that part of the issued share capital of the Company which carries or would carry a preferential right with respect to—a) payment of dividend, either as a fixed amountor an amount calculated at a fixed rate, whichmay either be free of or subject to income-tax;andb) repayment, in the case of a winding up orrepayment of capital, of the amount of theshare capital paid-up or

	deemed to have beenpaid-up, whether or not, there is a preferentialright to the payment of any fixed premium orpremium on any fixed scale, specified in thememorandum or articles of the Company;

Allotment of Shares

You know that a public limited Company invites subscriptions from the public and for this purpose a prospectus is issued. In response to this invitation, the prospective investors offer to buy shares by submitting the prescribed application form. If the application is accepted by the Company, it proceeds to allot him the shares. With the issue of the letter of allotment, the offer stands accepted thereby giving riseto a legally binding contract between the Company and the shareholder. Thus, an allotment is the acceptance by the Company of the offer to purchase shares. The term 'Allotment' has nowhere been defined in the Companies Act. It may be said that allotment is an appropriation by the Board of directors of a certain number of shares to a specified person in response to his application. In other words, allotment means the appropriation out of the previously unappropriated capital of a Company, of a certain number of shares to a person.The general rules regarding allotment of shares are as follows:

i. **The allotment must be made by proper authority:** It is the duty of the Board of' directors to allot the shares. However, the Board may delegate this authority to some other person or persons as per the provisions of the articles of association. Allotment of Shares made by an improper authority will make it void.

ii. **The allotment should be made within reasonable time:** The offer to purchase shares of the Company must be accepted within a reasonable time otherwise the applicants may refuse to take shares because after a reasonable time the offer lapses. What is the 'reasonable time' is a question of fact in each case.

iii. **It must be communicated:** The allotment of shares should be communicated to the applicants. Posting of a properly addressed and stamped letter of allotment will be taken as avalid communication.

iv. **It must beabsolute and unconditional:** The allotment of shares must conform to the terms and conditions of the application. If the allotment is not according to the terms and conditions, the applicant may refuse to accept the shares even though allotment has been made to him.

Transfer and Transmission of Shares

Transfer of Share

It is basically handing over the rights and duties of a member of the Company

to any other personwho wishes to become a member of the Company. According to Section 56 of the **Companies Act, 2013**, shares are movable property and are transferred in a manner provides in the Articles of Association of the Company. A Shareholder is free to transfer shares to a person of his own choice. However, in case of Private Company, there are certain restriction on transfer of shares. In case of transfer of shares of a private Company, the provisionsor restrictions contained in the Articles of Association should be duly complied with by the transferorand transferee.

A Company, shall not register a transfer of securities of, the Company, unless a proper instrument of transferduly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered tothe Company by the transferor or transferee within a period of sixty days (irrespective of the nature of theCompany, whether listed or unlisted) from the date of execution along with the certificate relating to thesecurities, or if no such certificate is in existence, then along with the related certificate or letter of allotmentof securities. In case of loss of the instrument, the Company may register the transfer on terms as toindemnity.

Transmission of Shares

Where any person acquires any right to securities by operation of any law, the Company may register thetransmission of shares in favour of such person if the Company receives intimation of transmission from suchperson, and in such a case no transfer deed shall be necessary.According to Section 56(2), a Company shall have power to register on receipt of an intimation oftransmission of any right to securities by operation of law from any person to whom such right has beentransmitted.

Share Certificate

A share Certificate refers to a document which is issued by a Company evidencing that a person named in such certificate is the owner of the shares of Company as stated in the share certificate. The Indian Companies Act mandates companies for issuing share certificates post their incorporation.Every share certificate issued in India should contain the below mentioned:

1. Name of issuing Company
2. CIN no. (Corporate Identification Number) of such Company
3. Address of the Company's registered office
4. Name of owners of such shares
5. Folio number of members;
6. Number of shares which is represented by such share certificate
7. An amount which is paid on such shares
8. Distinct number of the shares

Share Warrant

A Share Warrant is a document issued by the Company under its common seal, stating that its bearer is entitled to the shares or stock specified therein. Share warrants are negotiable instruments. They are transferable by mere delivery without registration of transfer.The following conditions should be satisfied for issuing share warrants.

i. Only a public Company can issue share warrants.
ii. It must be authorized by the Articles of Association.
iii. The shares must be fully paid-up.
iv. The approval of the Central Government is necessary.

On the issue of the share warrant, the Company must strike off the name of the member in its Register of Members and must enter the following particulars:

- The fact of the issue of the share warrant,
- A statement of the shares included in the warrant, distinguishing each share by its number, and;
- The date of issue of the warrant.

Prohibition to issue Shares at a Discount

- Section 53 states that except as provided in section 54 (i.e. issue of sweat equity shares), a Companyshall not issue shares at a discount. Any share issued by a Company at a discount shall be void.
- A Company may issue shares at a discount to its creditors when its debt is converted into shares inpursuance of any statutory resolution plan or debt restructuring scheme in accordance with anyguidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank ofIndia Act, 1934 or the Banking (Regulation) Act, 1949.

Stock v Shares

Basis for Comparison	**Shares**	**Stock**
Meaning	The Capital of a Company is divided into small units, which **are** commonly known as shares	The Conversion of the fully paid up shares of a member into a single fund is known as stock
Is it possible for a Company to make Original issue?	Yes	No

Paid up Value	Shares can partly or fully paid.	Stock can only be fully paid up.
Distinctive Number	A share has a definite number known as distinctive number.	A stock does not have such number.
Fractional transfer	Not possible	Possible
Nominal Value	Yes	No

Calls on Shares

"Call on shares" means the demand made by the Company on its shareholders holding partly paid shares to pay part or full unpaid amount on the shares.The following points should be noted, in this context, so that we can understand what a call really means.

1. **Time for Making the Call:** The call can be made at any time during the life time of the Company or during the course of winding up. During the life time, the call should be made by the Board of Directors and during the course of winding up, it should be made by the liquidator.
2. **Obligatory:** Each shareholder is obliged to pay the amount of call as and when the call is made. But this liability arises only when the call is made and not before.
3. **Debt Due:** As soon as a call is made, the call amount shall become a debt due from the shareholders to the Company.
4. **Consequences of Default:** If a shareholder fails to pay the call amount, the Company can enforce payment of the amount together with interest or can forfeit the shares.
5. **Calls and Other Payments:** A call is different from other payments made by a shareholder. The amounts paid on application and allotment are not calls. Similarly, if a Company requires the shareholders to pay the entire amount either on application or on allotment, it is not a call under this Act.

Forfeiture of Shares

A Company may if authorized by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal. Where power is given in the articles, it must be exercised strictly in accordance with the regulationsregarding notice, procedure and manner stated therein, otherwise the forfeiture will be void.Forfeiture will be affected by means of Board resolution. The power of forfeiture must be exercisedbona fide and in the interest of the Company.

3.3 Members

Member, in relation to a Company, means,

1. The subscribers to the memorandum of a Company who shall be deemed to have agreed to becomemembers of the Company, and on its registration, shall be entered as members in its register ofmembers;
2. Every other person who agrees in writing to become a member of a Company and whose name isentered in its register of members shall, be a member of the Company;
3. Every person holding shares of a Company and whose name is entered as a beneficial owner in therecords of a depository shall be deemed to be a member of the concerned Company.

Modes of acquiring Membership

As per Companies Act, 2013person may acquire the membership of a Company:

a) by subscribing to the Memorandum of Association (deemed agreement); or

b) by agreeing in writing to become a member:

   i. by making an application to the Company for allotment of shares; or

   ii. by executing an instrument of transfer of shares as transferee; or

   iii. by consenting to the transfer of share of a deceased member in his name; or

   iv. by acquiescence or estoppel.

c) by holding shares of a Company and whose name is entered as beneficial owner in the records of adepository (Under the Depositories Act, 1996)

and on his name being entered in the register of members of Company. Also, every such person holding shares of the Company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be the member of the concerned Company.

Shareholders

Rights

A. Appointment of Directors: Shareholders play an important role in the appointment of directors. An ordinary resolution is required to be passed by the shareholders for the appointment.

B. Appointment of Company auditors: Shareholders also have a right to appoint the Company auditors.

C. **Voting rights:**Shareholders also have the right to attend and vote at the annual general body meeting.

D. **Right to call for general meetings:** Shareholders have the right to call a general meeting. They have a right to direct the director of a Company to can all extraordinary general meeting. They also can approach the Company Law Board for the conduction of general body meeting, if it is not done according to the statutory requirements.

E. **Right to inspect registers and books:**As shareholders are the main stakeholders in a Company, they have the right to inspect the accounts register and also the books of the firm and can ask questions about the same if they feel so.

F. **Right to get copies of financial statements:**Shareholders have the right to get copies of financial statements. It is the duty of the Company to send the financial statements of the Company to all its shareholders either in a quarterly or annual statement.

G. **Winding up of the Company:**Before the Company is wound up the Company has to inform all the shareholders about the same and also all the credit has to be given to all the shareholders.

H. **Transferring ownership (often in restricted circumstances):** The shares of Private Company are transferable subject to certain restrictions;

I. **Receiving dividends and other distributions:** The Shareholders have a right to receive dividends

Duties

There are also responsibilities and duties of shareholders which they should perform. Besides several rights which they have, there exists several duties. They are:

- ✓ Shareholders should participate in the general body meetings so that they can see and also can advise on the matters which they feel is not going well;
- ✓ Shareholders should consult on the matters of finance and other topics.
- ✓ Shareholders should be in touch with other members of the Company so that they can see the work progress of the Company.

Liabilities

A shareholder of a Company limited by shares has limited liability. This means that the shareholder is not liable for the acts and omissions of the Company. The liability of the shareholder is limited to the nominal value of its shares.

Unit-4

LAW RELATING TO DEBT, FINANCE AND COMPANY MANAGEMENT

4.1 Debenture

Meaning

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. Debenture is a mode through which a Company can borrow some money to expand themselves. The features of Debentures are:

i. It is issued by a Company;

ii. It is a long-term security;

iii. It yields a fixed rate of interest to the Debenture holder; and

iv. It is secured against assets.

Definition

According to Section 2(30) of Companies Act, 2013, "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Further it is provided that—

a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

Nature and Classification

Debentures are generally classified into different categories on the basis of:

On the basis of Convertibility of Instrument

A. **Non-Convertible Debentures (NCD):** These instruments retain the debt character and cannot be converted into equity shares.

B. **Partly Convertible Debentures (PCD):** A part of these instruments are converted into Equityshares in the future at notice of the issuer. The issuer decides the ratio for conversion. This isnormally 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.

On the basis of Security of Instrument

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 the principal or interest amount, his assets can be sold to repay the liability to the investors. Section 71(3) of the Companies Act, 2013 provides that secured debentures may be issued by a company subject to such terms and conditions as may be prescribed by the Central Government through rules.

B. **Unsecured Debentures:** These instruments 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.

On the basis of Redemption ability

A. **Redeemable Debentures:** It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice, or under a system of periodical drawings. Debentures are generally redeemable and on redemption these can be reissued or cancelled. The person who has been re-issued the debentures shall have the same rights and priorities as if the debentures had never been redeemed.

B. **Perpetual or Irredeemable Debentures:** A Debenture, in which no time is fixed for the company to pay back the money, is an irredeemable debenture.

The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation. However, after the commencement of the Companies Act, 2013, now a company cannot issue perpetual or irredeemable debentures.

On the basis of Registration of Instrument

A. Registered Debentures: Registered debentures are made out in the name of a particular person; whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders. Such debentures are transferable in the same manner as shares by means of a proper instrument of transfer duly stamped and executed and satisfying the other requirements specified in Section 56 of the Companies Act, 2013.

B. Bearer debentures: Bearer debentures on the other hand, are made out to bearer, and arenegotiable instruments, and so transferable by mere delivery like share warrants. The person towhom a bearer debenture is transferred become a "holder in due course" and unless contrary isshown, is entitled to receive and recover the principal and the interest accrued thereon.

Creation of Charge

A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. A company, like a natural person, can offer security for its borrowings. Normally, the debentures and other borrowings of the company are secured by a charge on the assets of the company. Where property, both existing and future, is agreed to be made available as a security for the repayment of debt and creditors have a present right to have it made available, a charge is created. The legal right of the creditor can only be enforced at some future date if certain conditions governing the loan are not met. The creditor gets no legal right either absolute or special to the property charged. He only gets the right to have the security made available/enforced by an order of the Court.

According to Section 2(16) of the Act, "charge" means an interest or lien created on theproperty or assets of a company or any of its undertakings or both as security and includesa mortgage.

Fixed and Floating Charges

On the basis of the nature of charge:

A charge on the property of the company as security for debts may be of the

following kinds, namely:

(i) Fixed or specific charge: A charge is called fixed or specific when it is created to cover assets which are ascertained and definite or are capable of being ascertained and defined, at the time of creating the charge e.g., land, building, or plant and machinery. A fixed charge, therefore, is a security in terms of certain specific property and the company gives up its right to dispose off that property until the charge is satisfied.

(ii) 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.

Conversion of Debenture

In simple words, conversion of debentures into equity shares means to convert loan liability into capital liability. After converting debentures into equity shares, debenture-holder becomes shareholder. He will get right to vote. Without liquidation, their invested money will not be refunded.

Condition for Conversion of Debentures into Equity Shares:

1. When company issues debentures, company has to give the option of conversion debentures into equity shares.
2. Debenture-holders should notify his intention to convert in the written form to company before repayment of debentures in cash.

Distinction between Debenture and Shares

Sl. No.	Debenture	Share
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.	Debenture holder gets fixed interest which carries a priority over dividend.	Shareholder gets dividends with a varying rate.
4.	Debentures generally have a charge on the assets of the company.	Shares do not carry any such charge.

5.	Debentures can be issued at a discount without restrictions.	Shares cannot be issued at a discount
6.	The rate of interest is fixed in the case of debentures	Whereas on equity shares the dividend varies from year to year depending upon the profit of thecompany and the Board of directors decides to declare dividends or not.
7.	Debenture holders do not have any votingrights.	Shareholders enjoy voting rights.
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 ofthe 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 businessexpenditure

4.2 SHAREHOLDERS MEETING

Meaning

Normally, gathering of two or more persons means Meeting. If we stick to our topic, the Companies runs their business throughout the year by the management of the company, by the fund i.e. capital provided by members of the company initially. Therefore, it becomes a right of members to be regularly updated about the working of the company and how it is performing, whether company is abiding by law, whether company is making profits or not and other important aspects to be disclosed to them by the management if not on detailed basis but at least in summarized basis.

Hence, Annual General Meeting can be said as meeting which is held yearly for members of the Company which discloses functioning of the company all over the previous Financial Year in details in quantitative and qualitative aspects. Section 96 of The Companies act, 2013 read with The Companies (Management and Administration) Rules, 2014 deals with the convening of Annual General Meeting.

Classification

Annual General Meeting (AGM): Under Section 96 of the Companies Act, 2013, every Company shall hold a General Meeting as Annual General Meeting every year, except One-Person company. There are certain rules which a Company needs to follow while calling and conducting an AGM which are as follows:

- It is conducted once in a year;
- There should not be a gap of more than fifteen months between two AGM.
- Notice of AGM can be either in writing or also in electronic form.
- The member should get the notice at least fore 21 clear days.
- The notice should consist of place, day, date and the proper hour of the meeting.
- It should also contain agenda of meeting.
- Every member of the company, legal representative of deceased and assignee of insolvent member, auditor and every Director of the Company should get notice.

In addition to this there is a Secretarial Standard-2 issued by the Institute of Company Secretaries of India which provide the various guidelines which need to be followed while calling and conducting an AGM.

Extra-ordinary meeting (EGM): Every meeting which is not a AGM or statutory meeting isEGM. An EGM is held for some special business which cannot be transacted at AGM. It is also held to transact some urgent business. This meeting may be called by the Directors or by the member's according to Sec.100 of the Companies Act, 2013.

Resolution

A Company being an artificial person, any decision taken by it shall be in the form of a Resolution. Accordingly, a resolution may be defined as an agreement or decision made by the Directors or Members (or a class of members) of a Company. A proposed resolution is a motion. When a resolution is passed, a Company is bound by it.

Basically, there are four types of Resolutions:

I. **Board Resolution:** A resolution passed at the meeting of Board of Directors of the Company by the Directors is called a Board Resolution. The Board Resolution is said to have been passed if it is supported by a simple majority.

II. **Ordinary Resolution:** When at the General Meeting, simple majority is required to move the resolution, it is called as Ordinary Resolution. At least 51% members should be in favor of the motion.

III. **Special Resolution:** When at the General Meeting, super majority is required to pass the resolution, it is known as Special Resolution. At least 75% members should be in favor of the motion. and Unanimous Resolution.

IV. **Unanimous resolution**: AResolution which is unanimously passed at a duly

convened general meeting of a body corporate at which all persons entitled to exercise the powers of voting conferred by or under this Act are present personally or by proxy or vote in writing at the time of the motion.

In case of Board Meetings, there is no concept of Special Resolutions and also unanimous resolutions are required in very few cases. However, in case of general meetings, all three are covered.

4.3 Directors

Directors refer to the part of the collective body known as the Board of Directors, who are responsible for controlling, managing and directing the affairs of a company. Directors are considered the trustees of company's property and money, and they also act as the agents in transactions which are entered into by them on behalf of the company. Directors are expected to perform their duties and obligations as a rationally diligent person with skill, knowledge, and experience as the person carrying out functions of a director and of that himself. Hence, a director plays several roles in a company, as an agent, as an employee, as an officer and as a trustee of the company.

The Companies Act 2013 does not contain an exhaustive definition of the term"director". Section 2(34) of the Act prescribed that "director" means a director appointed to the Board of a company.

Appointment of Directors

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required. The provision relating to the appointment of Directors can be noted as follows:

- Where no provision is made in the articles of a company for the appointment of the first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed and in case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.
- Every director shall be appointed by the company in general meeting.
- No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number
- Every person proposed to be appointed as a director by the company in

general meeting or otherwise, shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under this Act.

Qualification for Directors

According to The Companies Act no qualifications for being the Director of any company is prescribed. The Companies Act provides minimum age to be a Director is 21 years. Any person with less than 21 years of age cannot become a director.

Position of Directors

It is not easy to explain the position that a director holds in a corporate enterprise. A director is not a servant or any master. He is the controller of the company's affairs. Director of a company is neither an employee nor a servant to the company. They are professional people who were hired by the company to direct its affairs. However, there is no restriction under the Act, that a director cannot be an employee to the company. In Lee v. Lee's Air Farming Ltd, it was held that, a director may, however, work as an employee in different capacity. There is no definite definition for director under the Companies Act, 2013. Director includes any person who is occupying the position of a director, whatever name called.

Director as Agents

The company has no person; it can act only through directors and the case is, as regards those directors, merely the ordinary case of a principal and agent. When the directors' contract in the name, and on behalf of the company, it is the company which is liable on it and not the directors.

Director as Trustees

Directors are the trusties of the company's money, property and their powers and such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not their own sectional interest.

Directors as employees

When the director is appointed as whole-time employee of the company then that particular directors shall be considered as employee director or whole-time director.

Directors as officers

Director treated as officers of a Company. They are liable to certain penalties

if the provisions of the Companies Act are not strictly complied with.

Managing Director

A "Managing Director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Appointment of Managing Director

In India, appointment of Managing Director in a company is done in accordance with the provisions of the Companies Act, 2013. A company shall not appoint or reappoint any person as its Managing Director for a term exceeding five (5) years at a time and no reappointment shall be made earlier than one year before the expiry of his term.

The appointment of Managing Director is first approved by the Board of directors at a meeting and then by an ordinary resolution passed at a general meeting of the company. A return in the prescribed form i.e. MR.1 is required to be filed with Registrar electronically within 60 days from the date of such appointment on the website

Qualification of Managing Director

There is no such prescribed qualification for a Director. However, a person who is below the age of Twenty-one (21) years or has attained the age of Seventy (70) years cannot become Managing Director of a company in normal course. However, person who has attained the age of Seventy (70) years can become Managing Director if approved by Special resolution passed by members of the company. This provision clearly indicates that Managing Director should be mature enough to assume and discharge the responsibilities of the business effectively and should be productive and add value to the company.

Disqualification of Directors

Section 164 of the Companies Act 2013 deals with disqualification of Directors. According to the Companies Act 2013, the following conditions can be reasons for disqualifying a Director:

- The Director is of unsound mind and stands so declared by a competent court.
- The Director is an undischarged insolvent.
- The Director has applied to be adjudicated as an insolvent and his

application is pending.

- The Director has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence. Also any person who has been convicted of any offence and sentenced to imprisonment for a period of seven years or more, will not be eligible to be appointed as a director in any company.
- An order disqualifying the Director for appointment as a director has been passed by a court or Tribunal and the order is in force.
- The Director has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call.
- The Director has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years.
- A company in which the Director is a part of the Board has not filed financial statements or annual returns for any continuous period of three financial years.
- The company has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more.

Resignation of Director

A director may resign from his office by giving a notice in writing to the Company. the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar by filing E-Form DIR-12. The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

Removal of Directors

A Company has the authority to remove a Director by passing an Ordinary Resolution, given the Director was not appointed by the Central Government or the Tribunal.As per section 167 of the Companies Act, 2013 if a Director does not attend a Board Meeting for 12 months, starting from the day on which he was absent at the first board meeting even after giving due notice for all the meetings, it will be deemed that he has vacated the office and a Form DIR – 12 will be filed on his name and his name will be removed from the Ministry of Corporate Affairs.

Powers of Directors

- to make calls on shareholders in respect of moneys unpaid on their shares;
- to issue shares;
- to issue debentures or any instrument in the nature of redeemable capital;
- to borrow moneys otherwise than on debentures;
- to invest the funds of the company;
- to make loans;
- to authorize a director or the firm of which he is a partner or any partner of such firm or a private company of which he is a member or director to enter into any contract with the company for making sale, purchase or supply of goods or rendering services with the company;
- to approve annual or half-yearly or other periodical accounts as are required to be circulated to the members;
- to approve bonus to employees;
- to incur capital expenditure on any single item or dispose of a fixed asset in accordance with the limits as prescribed by the Commission from time to time;

Duties of Director

- Director to act in accordance with Articles of Associations.
- A Director of a Company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
- A Director of a Company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- A Director of a Company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- A Director of a Company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates
- A director of a company shall not assign his office and any assignment so made shall be void.

Liabilities of a Director

The Directors will have to make good for any loss on account of:

- An ultra vires act where the Directors have entered into a contract beyond their powers. In such case Directors are personally liable for the loss caused to the Company;
- Breach of trust where the Directors make a secret profit out of the business;
- For negligence or for not performing his duties honestly and carefully;
- For dishonest act to make personal profits;
- For the activity of the co-directors.

4.3 AUDITOR

Appointment of Auditor

- The First Auditor of the company other than a government company shall be appointed by the Board of Directors within 30 days of Incorporation. In case of Board's failure, an EGM shall be called within 90 days to appoint the first auditor.
- Every company shall, at the first Annual General Meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
- The Company shall file Form ADT-1 with the MCA for appointment of Auditor.

Removal of Auditor

The Auditor appointed in a Company may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner. Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the E-Form ADT-3 with the company and the Registrar.

Rights and Powers of Company Auditors

1. **Right of Access Books of Accounts:** Every Auditor of the company has the right to access at all times to the books of accounts and vouchers of the company,

whether kept at the head office of the company or elsewhere.

2. **Right to Obtain Information and Explanations: An** auditor can call for any information or explanation from different officers of the company which he may think necessary for the performance of his duties.
3. **Right to Receive Notices and Other Communication Relating to General Meetings and to attend them:** an auditor of a company has the right to receive notices and other communications relating to the general meetings in the same way as that of the members of the company.
4. **Right to Visit Branches**: The Auditor of the Company has the right to visit the branch office or offices of the company.
5. **Right to Correct Any Wrong Statement:** The company auditor is required to make a report to the members of the company on the accounts examined by him of the final accounts and the related documents which are laid down before the company in the general meeting.
6. **Right to sign the Audit Report:** As per the Companies Act only the person appointed as auditor of the company or where a firm is so appointed, only a partner in the firm practicing in India, may sign the audit report or authenticate any other document of the company required by law to be signed.
7. **Right to Being Indemnified:** An auditor is considered to be an officer of the company and he has the right to be indemnified out of the assets of the company against any liability incurred by him in defending himself against any civil and criminal proceedings by the company if it is proved that the auditor has acted honestly or the judgment is delivered in his favour.
8. **Right to seek Legal and Technical Advice**: The company auditor has the full right to seek the opinion of the experts and to take their legal and technical advice so as to discharge his duties efficiently.
9. **Right to Receive Remuneration:** The company auditor has the right to receive remuneration provided he has completed the work which he has undertaken to do so.

Duties of a Company Auditor:

i. Report shareholders about true and fair state of affairs of the company
ii. State that balance sheet and profit and loss a/c give all information required by law
iii. State that balance sheet and profit and loss a/c agree with the books of account
iv. State that balance sheet and profit and loss a/c agree with accounting standards
v. State that he has obtained all the necessary information

vi. State whether the company has maintained all books as required by law;

vii. State the reasons of qualification in his report

viii. State that he has received the audit report on the branch accounts audited by other auditor and how he has dealt with the same in preparing his report

ix. Auditor shall state in his report whether:

a) The loans taken are properly secured and the terms of loans are not against the interests of the company

b) Loans given are shown as fixed deposits and the terms of loans are not against the interests of the company

LIABILITIES OF AN AUDITOR: -

Following are the liabilities of an auditor: -

i. If an auditor is guilty of negligence in the execution of his duty, he may be held liable to make good any damage resulting from that negligence.

ii. An auditor is appointed to detect frauds, errors etc. He is responsible on account of negligence in performance of his duties.

iii. Any clause in the agreement between the company and the auditor whereby the auditor is freed from liability has been declared void.

iv. If in the course of the winding up of a company it appears that the auditor has been guilty of any misfeasance or breach of trust in relation to the company, he may be held liable as an officer of the company. The court may examine into his conduct and compel him to contribute such sum to the assets of the company by way of compensation in respect of the breach of the trust as the court thinks fit.

v. If the dividends have been improperly declared and paid of the accounts audited by him and which did not show a true and fair picture and were incorrect and misleading, he will be liable to refund such an amount.

vi. Where a prospectus is issued inviting persons to subscribe for shares or debentures of a company, an auditor is liable in respect of an untrue statements which is made by him as an expert, to pay compensation t every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damages, he may have sustained by reason of untrue statements included therein.

vii. If an auditor makes a false statement, particularly knowing it to be false or omits any material fact, knowing it to be material, he may be punishable with imprisonment or a fine.

viii. If an auditor is a party to anuntrue statement in prospectus, he shall be punishable with imprisonment or fine or both.

Auditors are Watchdogs not blood hounds

It is the duty of an auditor that he should use reasonable skill, care while performing his work. What is reasonable skill, care and caution mustdepend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as wassaid, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He isa watch dog but not a blood-hound. If there is anything calculated to excite suspicion, he should probe it tothe bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious andcareful. Professional misconduct is a term of fairly wide import but generally speaking, it implies fairly seriouscases of misconduct of gross negligence. Negligence per se would not amount to gross negligence. In thecase of minor errors and lapses, which do not constitute professional misconduct and which, therefore, donot require a reference to the disciplinary committee, the Council would nevertheless, bring the matter to theattention of its members so that greater care may be taken in the future in avoiding errors and lapses of asimilar type.

Unit-5

ADMINISTRATION REGULATION AND WINDING UP

5.1 Central Government Control by Registrar of Company

The Registrar of Companies (ROC) is an office managed by the Ministry of Corporate Affairs (MCA), that deals with the administration of Companies and Limited Liability Partnerships across the country. According to Section 609 of the Companies Act, 2013 ROCs are tasked with the principal duty of registering both the companies and LLPs across the states and Union Territories. ROC also certifies that LLPs comply with the legal requirements that are contained in the Companies Act, 2013. It maintains a registry of records of the Companies that are registered with them and permits the general public to access information on payment of a stipulated fee. The Central Government preserves administrative control over the Registrar of Companies with the help of Regional Directors.

Functions of ROC

- Registrar of Companies is liable to register a company in the country.
- It meets all regulation and reporting of companies and their shareholders, directors and also administers government reporting of several matters, including annual filings of various documents.
- It serves as an essential role to foster and facilitate business culture.
- Since every company in a country need the approval of the ROC for its establishment, ROC provides incorporation certificate that serves as the evidence of the existence of the company. Once incorporated, a company cannot cease unless the name of the company is struck-off from the Register of Companies.
- ROC also demands supplementary information from any company. It might search the premises and seize the books of accounts with prior approval of the court.
- The Registrar of Companies also files a petition to wind up a company.

- There is no end to the association of the ROC and a company. A company might require changing its name, objectives or registered office. In each of these requirements, a company intimates the ROC after the completion of the formalities.

5.2 COMPANY LAW TRIBUNALS

National Company Law Tribunals

The Central Government has constituted National Company Law Tribunal (NCLT) under Section 408 of the Companies Act, 2013 (18 of 2013) w.e.f. 01st June, 2016.

National Company Law Tribunal is the outcome of the Eradi Committee. NCLT was intended to be introduced in the Indian legal system in 2002 under the framework of Companies Act, 1956 however, due to the litigation with respect to the constitutional validity of NCLT which went for over 10 years, therefore, it was notified under the Companies Act, 2013. It is a quasi-judicial authority incorporated for dealing with corporate disputes that are of civil nature arising under the Companies Act. However, a difference could be witnessed in the powers and functions of NCLT under the previous Companies Act and the 2013 Act. The constitutional validity of the NCLT and specified allied provisions contained in the Act were re-challenged. Supreme Court had preserved the constitutional validity of the NCLT, however, specific provisions were rendered as a violation of the constitutional principles.

NCLT works on the lines of a normal Court of law in the country and is obliged to fairly and without any biases determine the facts of each case and decide with matters in accordance with principles of natural justice and in the continuance of such decisions, offer conclusions from decisions in the form of orders. The orders so formed by NCLT could assist in resolving a situation, rectifying a wrong done by any corporate or levying penalties and costs and might alter the rights, obligations, duties or privileges of the concerned parties. The Tribunal isn't required to adhere to the severe rules with respect to appreciation of any evidence or procedural law.

Major Functions of NCLT

1. **Registration of Companies**

   The new Companies Act, 2013 has enabled questioning the legitimacy of companies because of specific procedural errors during incorporation and registration. NCLT has been empowered in taking several steps, from cancelling the registration of a company to dissolving any company. The Tribunal could even render the liability or charge of members to unlimited. With this approach, NCLT can de-register any company in specific situations when the registration

certificate has been obtained by wrongful manner or illegal means under section 7(7) of the Companies Act, 2013.

2. Transfer of shares

NCLT is also empowered to hear grievances of rejection of companies in transferring shares and securities and under section 58- 59 of the Act which were at the outset were under the purview of the Company Law Board. Going back to Companies Act, 1956 the solution available for rejection of transmission or transfer were limited only to the shares and debentures of a company but as of now the prospect has been raised under the Companies Act, 2013 and the now covers all the securities which are issued by any company.

3. Deposits

The Chapter V of the Act deals with deposits and was notified several times in 2014 and Company Law Board was the prime authority for taking up the cases under said chapter. Now, such powers under the chapter V of the Act have been vested with NCLT. The provisions with respect to the deposits under the Companies Act, 2013 were notified prior to the inception of the NCLT. Unhappy depositors now have a remedy of class actions suits for seeking remedy for the omissions and acts on part of the company that impacts their rights as depositors.

4. Power to investigate

As per the provision of the Companies Act, 2013 investigation about the affairs of the company could be ordered with the help of an application of 100 members whereas previously the application of 200 members was needed for the same. Moreover, if a person who isn't related to a company and is able to persuade NCLT about the presence of conditions for ordering an investigation then NCLT has the power for ordering an investigation. An investigation which is ordered by the NCLT could be conducted within India or anywhere in the world. The provisions are drafted for offering and seeking help from the courts and investigation agencies and of foreign countries.

5. Freezing assets of a company

The NCLT isn't just empowered to freezing the assets of a company for using them at a later stage when such company comes under investigation or scrutiny, such investigation could also be ordered on the request of others in specific conditions.

6. Converting a public limited company into a private limited company

Sections 13-18 of the Companies Act, 2013 read with rules control the conversion of a Public limited company into the Private limited company, such conversion needs an erstwhile confirmation from the NCLT. NCLT has the power under section 459 of the Act, for imposing specific conditions or restrictions and

might subject granting approvals to such conditions.

National Company Law Appellate Tribunal

National Company Law Appellate Tribunal (NCLAT) was constituted under Section 410 of the Companies Act, 2013 for hearing appeals against the orders of National Company Law Tribunal(s) (NCLT), with effect from 1st June, 2016.

NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by NCLT(s) under Section 61 of the Insolvency and Bankruptcy Code, 2016 (IBC), with effect from 1st December, 2016. NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by Insolvency and Bankruptcy Board of India under Section 202 and Section 211 of IBC.

NCLAT is also the Appellate Tribunal to hear and dispose of appeals against any direction issued or decision made or order passed by the Competition Commission of India (CCI) – as per the amendment brought to Section 410 of the Companies Act, 2013 by Section 172 of the Finance Act, 2017, with effect from 26th May, 2017.

5.3 SEBI (SECURITIES AND EXCHANGE BOARD OF INDIA)

Securities and Exchange Board of India (SEBI) is a statutory regulatory body entrusted with the responsibility to regulate the Indian capital markets. It monitors and regulates the securities market and protects the interests of the investors by enforcing certain rules and regulations.

SEBI was founded on April 12, 1992, under the SEBI Act, 1992. Headquartered in Mumbai, India, SEBI has regional offices in New Delhi, Chennai, Kolkata and Ahmedabad along with other local regional offices across prominent cities in India.

The objective of SEBI is to ensure that the Indian capital market works in a systematic manner and provide investors with a transparent environment for their investment. To put it simply, the primary reason for setting up SEBI was to prevent malpractices in the capital market of India and promote the development of the capital markets.

Functions of the Board

It shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit. The measures referred to therein may provide for -

a) regulating the business in stock exchanges and any other securities markets;

b) registering and regulating the working of stock brokers, sub-brokers, share

transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

c) registering and regulating the working of the depositories, depository participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;

d) registering and regulating the working of venture capital funds and collective investment schemes,including mutual funds;

e) promoting and regulating self-regulatory organisations;

f) prohibiting fraudulent and unfair trade practices relating to securities markets;

g) promoting investors' education and training of intermediaries of securities markets;

h) prohibiting insider trading in securities;

i) regulating substantial acquisition of shares and take-over of companies;

j) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities marketintermediaries and self- regulatory organizations in the securities market;

k) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;

l) performing such functions and exercising such powers under the provisions of [18] [...]the Securities Contracts (Regulation) Act, 1956(42 of 1956), as may be delegated to it by the Central Government;

m) levying fees or other charges for carrying out the purposes of this section;

n) conducting research for the above purposes;

o) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;

p) performing such other functions as may be prescribed.

POWERS OF THE BOARD

The Board shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908),while trying a suit, in respect of the

following matters, namely:

i. the discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;

ii. summoning and enforcing the attendance of persons and examining them on oath;

iii. inspection of any books, registers and other documents of any person referred to in section 12, at any place;]

iv. inspection of any book, or register, or other document or record of the company referred to in sub-section (2A);

v. issuing commissions for the examination of witnesses or documents.

5.4 WINDING-UP

Meaning

Winding up is the process of closing down the legal existence of a company or LLP. During this process, theassets of the entity are realized, its liabilities are paid off and any surplus is distributed amongst the contributories.Once the adjudicating authority is convinced that these processes are completed, the entity is dissolved.

During winding up, the management of the company / LLP is in the hands of the liquidator and not the governingbody / board of directors. However, the assets and liabilities still belong to the company until dissolution takesplace. On dissolution, the entity loses its legal existence.

Section 270 of the Companies Act, 2013 regarding the Modes of winding up, has been deleted after theenforcement of this Insolvency and Bankruptcy Code, 2016. It has been substituted by Winding up by Tribunal.

Definition

As per Section 2(94A) of the Companies Act, 2013, "winding up" means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.

5.4.3 Classification

1. Winding up by Tribunal

Section 271 of the Companies Act, 2013 provides grounds for winding up of the company by the Tribunal.According to section 271, a company may be wound up by the Tribunal in following cases:

a) If the company has, by special resolution, resolved that the company be wound up by the Tribunal;

b) If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

c) If on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

d) If the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

e) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

2. Voluntary liquidation of corporate persons

The provisions relating to voluntarily winding up of Companies have been removed from the Companies Act (w.e.f April 01,2017) and are now governed by Insolvency and Bankruptcy Code.

Section 59 of the code and IBBI (Voluntary Liquidation process) Regulations, 2017 govern this.

Section 59 of the code provides that a Corporate person(includes Company, LLP etc in terms of definitionunder Section 3(7) who intends to liquidate itself voluntarily and has not committed anydefault may initiate voluntary liquidation proceedings under the provisions of Chapter V, Part II of Code.

A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation. Below is the brief procedure of voluntary liquidation of a corporate person under IBC:

Step I: Submission of declaration(s) to ROC, stating that the company will be able to pay its dues and is not being liquidated to defraud any person;

Step II: Passing of special resolution for approving the proposal of voluntary liquidation and appointment of liquidator ("Approval"), within 4 (four) weeks of the aforesaid declaration(s). If a corporate person owes debts, approval of two-third majority creditors would also be required;

Step III: Public announcement inviting claims of all stakeholders, within 5 (five) days of such Approval, in newspaper as well as on website of the

corporate person;

Step IV: Intimation to the ROC and the Board about the Approval, within 7 (seven) days of such Approval;

Step V: Preparation of preliminary report about the capital structure, estimates of assets and liabilities, proposed plan of action etc., and submission of the same to a corporate person within 45 (forty-five) days of such Approval;

Step VI: Verification of claims, within 30 (thirty) days form the last date for receipt of claims and preparation of list of stakeholders, within 45 (forty-five) days from the last date for receipt of claims;

Step VII: Opening of a bank account in the name of the corporate person followed by the words 'in voluntary liquidation', in a scheduled bank, for the receipt of all moneys due to the corporate person.

Step VIII: Sale of assets, recovery of monies due to corporate person, realization of uncalled capital or unpaid capital contribution;

Step IX: Distribution of the proceeds from realization within 6 (six) months from the receipt of the amount to the stakeholders;

Step X: Submission of final report by the liquidator to the corporate person, ROC and the Board and application to the National Company Law Tribunal ("NCLT") for the dissolution;

Step XI: Submission of NCLT order regarding the dissolution, to the concerned ROC within 14 (fourteen) days of the receipt of order.

LIQUIDATOR

In law, a liquidator is the officer appointed when a company goes into winding-up or liquidation who has responsibility for collecting in all of the assets under such circumstances of the company and settling all claims against the company before putting the company into dissolution. Liquidator is a person officially appointed to 'liquidate' a company or firm. Their duty is to ascertain and settle the liabilities of a company or a firm. If there are any surplus assets,they are distributed to the contributories.

CONTRIBUTORY

Contributories are person who are liable to contribute to the assets of a company in the event of its being wound up. The concept of contributory arises only at the time of winding up of a company. A contributory refers to a shareholder or member of a company.