COMPANY LAW

M. S. RAMA RAO B.Sc., M.A., M.L.

Class-room live lectures edited, enlarged and updated

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INTRODUCTION

In the Commercial World today, Company Law has more relevance than any other law. To the students of law it is an easily understandable subject. It opens up new vistas and horizons to him; it enables him to appreciate the fundamentals of the subject from the legal and Jurisprudential stand-point; it places him in an enviable position in-as-much as when the opportunity presents itself to render his services to the companies, he is equipped with that material and resource which may be absent in others, who enter without the 'Law qualification'. The proliferation of Companies (Private and Public) over the past four decades has called for efficient and qualified legal advisers to guide the officers running the Companies. Lapses or violations of the provisions of the Companies Act entail not merely penalty but criminal prosecutions.

The Parliament-alone has legislative "Competence" to make law, according to our Constitution, in Company law and its affairs. Public Companies are fastened with a number of gorgeous formalities with the attendant penal consequences for non-observance. The rationale for this seems to be the 'Public money' involved. The private companies are spared to a large extent as no public money is involved; If not the Central Govt. who else should be donned with this invisible hand to protect and secure public investments ?

Leading cases like Foss Vs. Horbottle, Cook Vs. Deek, Earlangar Vs. new Sombrero Phosphate co. Ltd. Shantiprasad Jain Vs. Kalinga Tubes Ltd., R.V. Kylsant, Ashbury Railway Carriage co. Vs. Riche, apart from the often quoted Solomon Vs. Solomon & Co., and Deny V. Peek decided by the courts, have shown how difficult and intricate the problems are.

The subject is developing very fast even to the extent of escaping the hold of the experts; Amendments are being made in dozens and our Supreme Court has many decision to add on. However, the **fundamental principles have remained the same**. It is at the specialization of these principles that a sincere attempt should be **made first**, by the students.

Keep company with Company law, it will fetch you money and status: MSR

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QUESTION BANK

1. i) Define a' Company'

   ii) Explain the distinguishing features of a company

   iii) Write a note on Lifting the corporation veil

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   ii) What are the special features of a Private company

   iii) Write a note on Illegal Association

   iv) Distinguish a company from a partnership firm

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4. i) ' M/A is the charter of company' Discuss with reference to the contents & effects. Refer to Ashbury Railway Carriage C. V. Riche & Laxmanaswamy Mudaliar V.L.I.C.

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COMPANY LAW

CHAPTER 1

COMPANY-DEFINITION REGISTRATION And ADVANTAGES

Ch.1-1 Company

(i) **Definition :**

The Companies Act 1956, defines 'company' as a Company formed and registered under the Companies act. A company is a legal or juristic person, apart from its members, capable of rights and duties of its own, and endowed with the potential or perpetual succession and a common seal. It is not a novelty, but an institution of very ancient date, it can sue or be sued. It can own and dispose of properties.

Registration & Incorporation

(ii) **Procedure:**

An application in the prescribed form is to be filed with the "Registrar of Companies" along with

1. Memorandum of Association

2. Articles of Association

3. Declaration that all the statutory requirements of Companies Act have been complied with. This must be signed by an Advocate or Chartered Accountant, and one of the directors, or Secretary. The necessary fee should be paid.

If the Registrar is satisfied that all the requirements are complied with he registers and places the name of the company on the Register of companies and issues a certificate of incorporation as a Limited Company.

The Company is born on the issue of the certificate. The validity of it cannot be challenged in any court (The remedy is to claim for winding up). Private Company: It may start business, soon after incorporation. But a Public company must take out a certificate of commencement of business from the Registrar by filing an application, signed by the Director or the secretary and fulfilling certain statutory conditions.

(iii) **Advantages of Registration:**

i) Corporate Personality:

The outstanding feature of a company is its status as an independent corporate person. By incorporation, the company becomes vested with the legal personality. **The leading case is**

Solomon Vs. Solomon & Co. Ltd.

Solomon was a boot and shoe manufacturer. His business was sound, he incorporated a Company called Solomon & Co. Ltd., for running the business. The seven subscribers to the Memorandum were Solomon, his wife and a daughter and four sons. Solomon and two sons formed the Board of Directors. The business of manufacturing was transferred by Solomon to the company at a cost £ 40,000.

In the company, Solomon had 20,000 shares of one pound each (The company had a debenture of £ 10,000/- to be given to Solomon).

Within a year the company went into liquidation. The creditors who had advanced to the Company, sued and claimed that Solomon & Co. was not a 'Company'.

Held, Solomon & Co. was a Company as it fulfilled all the legal requirements of an incorporated Company; it was a juristic person different from its subscribers. Its liability is therefore limited.

ii) Limited Liability:

This is a privilege and an advantage, in-as-much as the liability is limited to the extent of the shares held by the shareholders and no liability arises beyond this. The members are not the owners of the company and are not liable to its debts. The company is independent and meets its obligations.

iii) Succession:

There is perpetual succession and the company never dies. The membership may be changing from time to time, but this will not affect the company or its continuity. The death or insolvency of a member will not affect it. Members may come and go but the company goes on forever.

iv) Vested ownership of company:

The company as a legal person, may acquire, hold and dispose of property. It is the owner of all its assets and capital. Hence, the shareholders are not the owners.

v) **Shares are transferable :**

The shares (and other interests) of any member are a movable property and are transferable, as per the Companies Act. Once the Company is incorporated, a shareholder may sell his shares in the open market and get back his investment.

vi) Capacity to sue and be sued: As a body corporate, in its own name, a company may sue or be sued. This is one of the essentials of the legal personality of the company.

Ch. 1.2. Differences between Company and Partnership Firm

Company	Partnership Firm
1. Company is a legal person, it is separate from its Members (Solomon Vs. Solomon)	1. Not a person, partners are agents.
2. Members (shareholders) are not liable for the debt of the Company (Limited Companies)	2. Partners are jointly and severally liable & hence unlimited liability.
3. Members are not its agents.	3. Every partner is an agent of the firm.
is not the property of its members,	the property of all the partners.
5. A member of the Company can	5. A partner cannot contract
	4. The property of the firm is
4. The property of the Company	with his firm.
contract with the Company (Farrar V. Farrar Ltd.) 6. A member may transfer his shares freely.	6. A partner cannot transfer and make the transferee, (with out the consent of other partners) a partner.
7. A company is bound by its M/A & A/A which cannot be changed except according to to procedures provided therein.	7. Partners may make partnership agreement which may be changed changed by them if not registered. If registered, changes should be brought on Registrar of Firms Record in the Registrar's Office.
8. There is no limit as regards membership. But for private company the minimum is 2, maximum 50. For public companies minimum is 7, no limit on maximum.	8. The number of partners should not be above 10 for banking and 20 for others.

Ch. 1.3. Illegal Associations :

Large partnerships trading without registration create confusion and uncertainty and many evils flow from them. Hence, to arrest this activity sn. 11 (2) of the Companies Act provides that if a company, Association or Partnership is formed with 20 or more persons (10 in case of Banking business) to do any business, and acquire gains or profits then it should be registered as a Company under the Companies Act. If not so registered it becomes an "illegal Association".

Consequences of illegality:

i) As it has not juristic status, it cannot enter into contract. Each member becomes personally liable and also liable to a fine upto Rs.1000/-

ii) No suit or action can be brought in the name of the Company.

iii) Winding up provisions are not applicable and hence cannot be wound up under the Act.

iv) Claims between members are also not tenable.

Leading case **Badari Prasad V. Nagarmal**

The Supreme Court refused to grant any relief as the Association was illegal.

In **Dayal Singh V. Des Raj (Punjab)**

20 persons engaged in manufacture of "Trunks" formed an "Association', applied to the controller for Steel Quota, got the quota and distributed among themselves. It was not a regd. association, The Court held that it was an illegal association and no suit would lie for dissolution and accounts.

CHAPTER 2 KINDS OF COMPANIES

Ch. 2.1. Kinds of Companies :

1. Unlimited Companies 2. Guarantee Companies

3. Limited Companies 3. Private Companies

1. Unlimited Companies, the liability of the shareholders is not limited to their shares, but liable for all the trade debts, without any limit. Of course, the creditor will have to sue the Company and not the individuals. In case of winding up, the shareholders will have to contribute to the assets to dissolve the liability of the Company. Such a company need not have share capital; but it should have Articles of Association, setting out the number of members and the share capital, if any. It can reduce its own capital without the permis sion of the court. But, it must make annual returns.

Such companies are very rare.

2. Guarantee Companies, the liability of the members is lim ited to a particular sum specified in the Memorandum of Association. Hence, in case of a winding up the guarantee extends to the extent of the sums specified in the M/A only.

3. Limited Companies, the liability is limited to the shares subscribed and does not go beyond. Shareholder not liable.
(Add details from Ch .l).

4. Private Companies, family concerns and small scale units may run business with a small number of persons (Minimum 2, Maximum 50) (Add details from Ch. 2.2).

Ch.2.2. Special features and privileges of Private Companies:

A private company also has the M/A and A/A and is to be incorporated. Infact, it is having the advantages of both the privacy of a partnership and origin and performance of a corporate body.

Public Companies are like bees working in a glass-hive; but Private Companies can keep the affairs for themselves, because of the encouragement and benediction of the Parliament.

i) Number:

The minimum is two and the maximum is 50. Hence, a Private Company can be formed with two persons (Public company minimum is 7).

ii) **Transfer of shares :**

Restrictions may be imposed regarding transfer of shares. The total membership should not exceed 50. (It becomes public, if it is 50 or above).

In it's A/A, it must prohibit issue of prospectus to the public to subscribe for shares or debentures. Hence, all the procedures regarding issue of prospectus are not applicable to it.

iii) Directors :

There are many benevolent provisions. It may have only two Directors. They can be permanent life members (14 days notice, as in Public Company, is not applicable. Similarly rule relating to rotation, of directors number of directors. Reporting to the Registrar within 30 days of taking office as Directors, restriction as to remuneration etc., also do not apply), provisions relating to qualification shares do not apply.

iv) **Statutory Meeting:**

Whereas this is a must in a Public Company, a Private company is exempted from holding a statutory meeting and of filing its statutory report.

v) An interested director i.e., a director interested in the subject matter or issue cannot participate and vote in a Public Company, but not so in a Private Company. A director, who is selling his plot of land to the Company, is an interested director. The reason for giving these and other advantages is that no public money is involved, in private companies.

vi) A Private Company may commence its business on registration.

vii) It is exempted from filing with the Registrar a prospectus or a statement in lieu of prospectus.

viii) Director may vote on a contract in which he is interested. Restriction on remuneration to directors imposed in Public Companies do not apply.

ix) Violation of Conditions:

The various privileges to a Private Company are available to it, as long as it maintains the status as a Private Company by observing the restrictions and limitations imposed on it. However, if it violates them, it will not be entitled to privileges. The Company Law Board may excuse if failure is accidental or due to some reasonable cause.

CHAPTER 3
PROMOTERS

Ch. 3.1. Promoters :

(i) The word Promoter is not defined either judicially or by the Parliament. As Judge Gross has stated; Promoter is not a term of art, not a term of law, but a term of business.

He is a person who brings about the incorporation and Organisation of the Company. He takes all the preliminary steps, procures the subscription, files the necessary documents, gets the incorporation, Registration done and sets the machinery of the company running. He takes out the certificate for commencement of business (Public Company) etc. His functions come to an end, when he hands over the new company to a governing body like the Board of Directors.

(ii) **Preliminary contracts:**

A Promoter stands in a fiduciary position (trustee) ; his dealings must be open and fair. Thus a promoter who starts a company and sells his property to the shareholders must faithfully disclose all the facts relating to the property. If he conceals, and the company incurs a loss, it may sue him and set aside the sale and also recover compensation.

The leading case if **Eranger V. New Sombrero Phosphate Co.**

Facts : E (with a few others) bought a phosphate mine for 55,000. E formed a company with *5* Directors including himself. Two were abroad. The Board of Directors bought the said phosphate mine for 1,10,000/- A prospectus was issued. Many took shares. The company failed. The liquidator sued the promoters, held, promoters liable.

In later cases it has been held that the disclosure should be made to the shareholders. There should be no hoodwinking of the shareholders.

The other leading cases are Gluckstein V. Barnes and Lidney V. Bird.

The disclosure by the promoters should be explicit and complete, otherwise the company may set aside the same and claim damages from the Promoters. The promoters are liable for "secret profits" and the liability arises as soon as the company is formed.

iii) Remuneration:

The promoter is entitled to a reasonable remuneration for his services in as much as he will have put his energy, skill and knowledge in planning out and bring into existence the new company.

Ch. 3.2. **Memorandum of Association:** M/A (Sns **12 to** 23) **:**

Definition :

The M/A is a document of great importance in relation to the proposed company (Palmer). It is the charter of the Company. It defines its Constitution and the scope of the power with which it has been established under the Companies Act. It is the foundation on which there comes into existence, a covenant between the Company on the one side and the members on the other. This creates a Solemn obligation. It must be divided into paragraphs, numbered consecutively and printed or presented to Registrar for purposes of Registration. It can be made in the forms as in Schedule to Companies Act.

a) **Name Clause:**

As the Company is a juristic person, it should have a name to establish it identity. It is the symbol of its existence. The name should not be identical with any company and should not be undesirable according to the Central Government.

The name is part for the business reputation and is protected by registration.

Liability: If the liability of the Members is limited it should be stated as 'Limited' (Ltd.) if Private Company 'Private Ltd.'

In case of religious, scientific, charitable companies, the Central Government may permit to drop the use of 'Ltd', if the Company has prohibited payment of dividend i.e., it must be nonprofit making company.

The name should be used by the company in all its documents and official letters. A painted board should be installed in the place of business.

b) Registered Officer:

The M/A should state the Registered office of the Company, with address (address may be informed within 30 days).

c) Objects :

Three sub clauses are made :

i) **Main objects:** The main objects and the identical or ancillary objects are stated.

ii) Other objects: those not included in (i) above may be added here.

iii) States to which objects extend: Non-trading companies should state to which of the States in India, the objects extend. The objects should not be illegal, opposed to public policy or to any provision of law. The rationale for stating the objects is to enable the shareholder to know how his contribution is being used. It gives him protection and ensures defined use of the Contributions. The creditors are also protected.

d) Powers :

(i) The company should confine to its objects :

The leading case is **Ashbury Railway Carriage Co. V. Riche.**

Facts : The M/A stated the objectives .... to make and sell .... Railway Wagons.......... and General Contractors..... The co. entered into a Contract with Riche, to finance a Railway line in Belgium. The company. later repudiated stating it as ultra vires. Riche sued for damages.

Held, the contract was ultra vires and hence void. It has no powers to finance railway line.

The ambits were prescribed in the M/A. The limits were defined. Hence, even the majority cannot ratify to validate the transaction, the court observed. The M/A is the area beyond which the action of the company cannot go; inside that any regulation may be made.

ii) The company may grant donations to promote the activities stated in the M/A. This is clear from the leading case.

A. Laxmanaswami Mudaliar V. L.I.C.

Facts : The business of an Insurance Company was taken over by L.I.C. The Directors of the Company, as per the resolution of the shareholders, paid Rs.2 lakhs for promotion of education in Commerce and Insurance.

The payment was held ultra vires. As the Company's assets were under acquisition, it had no object to promote and hence, the donation was ultra vires.

e) Liability Clause :

The nature of the liability of the shareholder should be stated, in the M/A. Whether the liability is limited by shares or by guarantee should be specified.

f) Capital Clauses :

The amount of the nominal capital of the Company i.e., Authorised and paid up capital and the number and value of the shares into which it is divided should be stated.

g) Declaration:

The M/A, concludes with a declaration by the shareholder (7 or more in Public Companies and 2 or more in Private Companies) Each subscriber must sign and state the number of shares held by him (minimum share one).With this the M/A is complete.

However, it must be noted that the Companies Act over-rides the M/A.

Ch. 3.3. **Alteration of M/A :**

Amendments or alteration of the provisions may be made, as per Sn.17.

1. Alteration or Change of name of the Company:

This may be made by passing a special resolution and the approval of the Central Government in writing. Change becomes effective when it is registered with the Registrar.

2. Change of Regd. Office and Objects Clause:

This may be made by passing a resolution in the General Body and by getting the sanction of the Company Law Board. A certified copy of the board's order and a printed copy of the amended M/A must be filed with the Registrar within 3 months of the Board's sanction. The change becomes effective on Registration by the Registrar and issue of a copy thereof.

3. Change of objects:

Alteration of objects, capital rights attached to different classes of shares and limited liability of directors.

The purposes for which changes are allowed:

i) To run Company on more economic and effective terms.

ii) To achieve the objective by new or improved means.

iii) To enlarge the area of operation.

iv) Some new business which may be conveniently taken up.

v) To amalgamate with any Company etc

. **Ch. 3.4. Articles of Association. A/A**

(Sns **26 to 31, 36 and** 38) **:**

1. Nature :

This is a document of great importance next only to M/A. It contains the rules, regulations and bye-laws for the general management of the Company.

The A/A must be registered along with the M/A by (i) Unlimited Companies ii) Companies Limited by Guarantee and iii) Private Companies Limited by Shares.

A Company limited by shares may frame its own Articles or may adopt Table A of Schedule I of the Companies Act. But, if it does not register its Articles, then Table A becomes applicable. Table A is advantageous and may be adopted.

2. Form ;

The Articles should be printed : divided into paragraph and numbered consecutively.

Each subscriber should sign the document in the presence of at least one witness. Each should mention his occupation and address.

3. Contents :

The A/A are internal regulation of the Company. It is subordinate to the M/A.

The A/A contains Rules, inter alia:

i) A declaration whether Table A is applicable or not

ii) Adoption of preliminary contracts, if any

iii) Rules about shares, calls, forfeiture, surrender, transfer etc.

iv) Rules about meetings, notice, quorum, proxies, voting etc.

v) Rules about Directors, their officers, qualifications, appointment etc.

vi) Rules about books of Account, Audit, Appointment of Auditor.

vii) Rules about winding up.

viii) Others

It may provide for power:

a) To have official seal to issue shares.

b) To pay dividends.

c) To reduce share capital etc.

Ch. 3.5. **Alteration** of **A/A :**

By a Special Resolution, the Company may alter its A/A. An application must be made to the Registrar to incorporate the Amendments.

i) The alteration must not be illegal or not constitute a fraud on the minority, or a breach of contract with an outsider. (The Company becomes liable) There are cases where the Courts have issued an injunction where damages cannot adequately compensate in terms of money.

ii) The alteration of A/A must be subject to the M/A and should be bonafide for the benefit of the Company.

5. The leading case on alteration is **Southern Foundries Ltd. V. Shirlow:**

In 1933, P was appointed as Managing Director for 10 years as per the A/A. In 1935, the Company was amalgamated with another Company in which there were powers to remove a director. Using these powers, P was removed. P sued. Held, P had a right to continue as per the articles of association. Held, further, "A Company cannot by altering articles, justify a breach of contract".

In case **British Murac Syndicate V. Alperton Rubber Co** there was an agreement to allow P to nominate two directors, as long as P retained 5000 shares in the Company, as per the A/A. An attempt was made to alter the Article. The Court granted an injunction not to alter.

Ch. 3.6. Indoor Management:

As M/A & A/A of a Company are Public documents, there is a presumption that those who deal with the company are having 'Constructive notice' of their contents. This protects the company from outsiders.

The doctrine of indoor management is opposed to the rule of constructive notice. It aims at protecting the outsiders against the Company's irregularities, Commissions and excesses. According to this strangers may assume that the proceedings are and everything is regularly done.

The leading case **is Royal British Bank V. Turquand :**

In this case, the Directors borrowed money from the Plaintiff. The M/A of the Company had provided that the Directors might borrow, on bond, such sums as are authorised by the shareholder's resolutions. The shareholders contended that there was no such resolution and hence not liable. The Court rejected this and held that the company was liable. This is called the **'Turquand Rule'.** The court held, that when there is a provision to borrow there is a presumption, that the formalities have been observed by the directors, hence, they are acting lawfully (in bonam part em).

Though the M/A and A/A are open for inspection by the public, the details of internal procedure are not so open. **Hence, an outsider cannot know the day-to-day internal matters as he has no access to them. The doors are closed to him. Hence, the courts have evolved the rule of 'Indoor Management'.**

The rule is based on convenience, practical utility and justice. No Company should be allowed to take advantage of its own commission and omissions.

Other examples are : Defective appointment of a Director, Defacto exercise of Power, lack of quorum, etc. Outsiders cannot enquire into the regularity or otherwise of internal proceedings.

Delegated Power:

Power may be delegated expressly or impliedly. The Company is liable when such a power is exercised by a delegated person.

The outsider dealing with the Company may rely on the authority of such officer of the company as delegatee.

However (i) the transaction should be one which normally falls within his authority and

(ii) The A/A should have allowed such delegation. How the power is delegated, what formalities are observed is within indoor management and hence third party is protected.

In Freeman V. Buckhurst:

K and H formed a Company to improve an estate and sell. H went abroad. K appointed architects and surveyors, who did their jobs and claimed their fees. The plea that K had no powers was rejected by the Court. K had held out to be a Managing Director having such powers. Hence the Company was held liable.

Exceptions to the Rule:

i) **Knowledge of irregularity:**

If the person who contracted with the company was himself a party to the inside procedure, the rule will not apply.

In **Howard V. Patent Ivory Mfring Co.,** the debentures required the resolution of a general body. Held, he could not take advantage of indoor management. The court held that the Company was not liable to D. The reason was, he had knowledge of the irregularity.

ii) Suspicion of irregularity:

This becomes clear from the circumstances of each case. D, a Director of two Companies transferred money from one to the other to pay off a debt; the court held that this was unusual and bad. Irregularity was patent.

iii) Forgery:

The rule is not applicable to cases of forgery, committed by the officers of the Company. In Ruben's Case, two directors to roged the signature of another Director on the share certificate and negotiated the same. Held, Company not liable.

iv) **Third Party's Ignorance** of **A/A :**

It is still a controversial issue. But, if the Director had ostensible authority, the company cannot escape liability to third parties (Rama Corporation case).

v) **Acts outside authority:**

If an officer of the company acts patently beyond his powers, the indoor management rule cannot be invoked.

In **Anand Bihari V. Dinshaw,** the company's property was transferred by an accountant. Held, this was void. Even a delegation of power, clause could not have saved the position.

Ch. 3.7. Lifting the Corporation Veil:

i) The fundamental principle is that an incorporated Company is a legal person and all its actions are that of the Company. The Company is distinct and separate from them in respect of capacity, rights acquired etc (Solomon's case).

Taking advantage of this, the directors or officers may use the company as a mask or cloak for fraudulent or illegal activity. In such a case, the court will pierce through the veil to know the reality.

This principle is regarded as a curtain or veil between the company and its members. This is the protection enjoyed by the members for the liability of the company. Thus, when there is abuse or misuse by members, they may escape liability but the company would be liable.

Here the **Court will pierce or lift the screen** (Veil) to see the transactions inside the screen. In such a case the protection given to such Director or Officer is taken away and he becomes liable.

ii) Circumstances to lift the Veil:

a) To find out the enemy character of the Company. This means, during war the Courts may lift the screen to know the persons inside and their character. If they belong to enemy State, the company also has the enemy character. Hence, it will be banned

(Dailmer Co. V. Continental Tyre & Rubber Co.).

b) **Tax evasion :**

If the objective of formation of the Company is tax evasion, then the Courts may tear the Corporate veil.

In Dinshaw Maneckji's case, the. court held that the four Companies formed by him, were to avoid super-tax.

In Harald Holdsworth V. Caddies, though there were several subsidiary companies, in reality there was only one Company.

Other cases: firestone Tyre & Ruber Co. V. Llewton; Com. of I.T. V. Sri Meenakshi Mills.

c) Fraud or improper conduct:

The court may pierce the Veil to find out whether the Company was **formed to defraud, or to avoid legal obligations**. Such sham Companies have no legal status.

The leading case is **Gilford Motor C. V. Home**.

H was an employee of G. Company, but left the job under an agreement not to solicit the customers of G. Company. H. formed a Company carried on a similar business and solicited the customers of G Company. G company sued and the House of Lords granted an injunction against H Company. Though H was bound under an agreement and H Company was separate, still in reality, i.e., by lifting the veil, the court said H Company was a sham or a cloak to engage in business and to solicit the customers of G Company.

d) Agency or trust:

When the company is used as an agency or trust the veil may be

lifted. A govt. Company discharging Sovereign functions is a trustee and hence, courts may lift the screen, to know the functions.

If the Company is acting as an agent of the shareholders, the shareholders become liable (Smith Stone etc. V. Brimingham Corporation).

iii) Personal liability of persons:

This liability is fixed on the persons in charge of the management by Statutes. These persons are personally liable. Hence the screen can be lifted, to know the persons responsible.

CHAPTER 4
PROSPECTUS

Ch. 4. Prospectus :

a) Definition :

The term 'Prospectus' means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting offers from the public for subscription to purchase any share in or debenture of a company Sn. 2(3.6).

Every prospectus must disclose all the matters set out in part I of the schedule to Companies Act and also the reports specified in parts II and III. It is essential that the information requiring disclosure is stated fully and precisely so that the investing public may get all the information that is likely to affect their mind in taking a decision.

b) Contents :

The following are matters to be set out

i) The main objects of the Company

ii) The No. of shares, if any, fixed by the A/A as the qualfication shares of the Directors.

iii) The name, address, occupation, etc., of the Directors or the proposed Directors, the Managing Directors, Manager.

iv) Subscribed Capital.

v) Minimum subscription required.

vi) The time of opening and the closing of the subscription list.

vii) The amount payable on application and on allotment of each share.

viii) The number, description and amount of shares and debentures issued.

ix) The estimated amount of preliminary expenses,

x) The names and addresses of auditors etc.

As the prospectus is the means to know the soundness of the Company, certain rules are imposed.

1. Every prospectus is to be dated.

2. it must be registered, with the Registrar of Companies, filing the required documents.

3. It must be issued **within 90 days of its** Registration.

c) **Deemed Prospectus : Sec. 4 :**

This is a document which may not be a prospectus but the Company offers for sale to the public, its shares or debentures and is signed by at least two Directors. All provisions relating to prospectus will apply.

d) Mis-Statement in the Prospectus :

It gives rise to both tortious and criminal liability. Under S. 65 an untrue or mis-statement is one which is misleading in form and contents. An omission in a prospectus which is material and calculated to mislead, amounts to untrue statement. The liability arises under the principle that the Directors and other persons who issue hold out to the public. Hence they are estopped from denying the contents of the prospectus. The shareholders are entitled to proceed against both the Company and the Directors.

The misrepresentation must be material. The nature, extent and quality of the advantages the prospectus holds out, are inducements to take shares and hence everything should have been stated with accuracy, otherwise liability arises. The inducement must be factual.

e) The Rights:

1. The subscribers to the shares have a right to file a suit against the Company and may ask for rescission of contract i.e., to cancel.

The subscribers may bring a suit for damages against the Directors and others for mis-statements.

The liability is (i) under Sec. 62 of the companies Act or (ii) for deceit under tortious liability.

The statement in prospectus should have been actually relied upon by the subscriber. He must start the legal procee-dings within a reasonable time or before the Company goes into liquidation and claim for rescission of the contract.

f) Leading cases :

i) Derry Vs. Peek :

Directors issued a prospectus stating that the Company, had powers to use steam for propelling their tram cars. In fact such a grant was subject to the consent of the Board of trade. The Company had believed that the consent of the Board was a mere formality. The board refused to give its consent. In consequence, the Company was wound up. P as shareholder sued for deceit. Held no Deceit. There was an honest mistake in stating that the consent of Board was a formal procedure. The false statement made carelessly and without reason to believe to be true was not fraud.

This decision criticised by Jurists and Judges, is no longer good law today.

Apart from the liability to compensate the shareholders who have suffered a loss, every person who had authorised the issue of such prospectus will be liable to prosecution for a criminal offence, extending to imprisonment or fine or both.

ii) Green-wood Vs. leather Shod Wheel Co.

The prospectus said that orders have already been received from the House of Commons. In reality, no such order had been received. Held that this was a false statement. Though there was bonafide intention, the Directors were held liable.

iii) A prospectus stated that more than half of the shares have already been subscribed. The truth was that the promoter had signed the documents applying for the shares. Held : Liable (Ross Vs. Estates Investment Co.).

iv) King Vs. Lord Kylsant:

Here the prospectus gave a table mentioning the dividends given for a number of years. This created a good impression about the company. The truth was that there were losses during many years, hence it was held that it was a misstatement. Hence a false representation and liable.

v) A prospectus stated that two big business people X and Y have become Directors. The truth was that they had only assured some co-operation if the Co., is formed. This was mis-statement (Metropolitan Coal consumers Association Case).

vi) In Edgington Vs. Fitzmaurice, the Directors of a Company issued a prospectus inviting debentures from the public, stating that the money would be used to put up buildings, to buy horses and vans and to develop business. But, in reality the amounts were used to pay off liabilities. The company became insolvent, held, the Directors were liable.

g) Criminal liability :

The Companies Act has made provisions making every Director and every person who is authorised to issue the prospectus liable to pay compensation to every person who has subscribed for shares or damage resulting from such untrue statements. The criminal liability is imprisonment for two years or fine up to Rs.5,000/- or both.

Ch. 4:2. Statement in lieu of prospectus :

Public Companies are empowered to raise money from the general public. But, it is not necessary that it should so raise the capital. It may contact individuals personally. In such a circumstance, it must issue a prospectus having details contained in Schedule III of the

companies Act. This document is called as 'Statement in lieu of Prospectus'. It should be duly signed by the Directors or authorised agent. A copy of this statement should be filed with the Registrar at least 3 days before allotting any share. The objective is to have an authentic record of terms and conditions of issue.

Mis-representation:

If there are mis-leading statements or misrepresentations in the 'Statement in lieu of Prospectus', the Civil and Criminal liability are the same as in respect of prospectus that is Rs.5,000/- fine or imprisonment for 2 year or both.

Allotment made violating the rule of filing the statement in lieu of prospectus, is voidable and claims if any should be made within 2 years.

Ch. 4:3. Alteration of Prospectus or Statement in lieu of Prospectus:

The company is not entitled to vary or alter the terms of contract mentioned in the prospectus : or statement in lieu of prospectus. The proposed alteration should be approved by the General Body Meeting before issuing to the public.

CHAPTER 5
ULTRA VIRES

Sn.5. Doctrine of Ultra vires :

i) Ultra Vires means **'beyond powers'**. The legal phrase 'Ultra Vires' is applicable only to acts done in excess of the legal powers of the doer.

This presupposes that the powers are in their nature limited. The ordinary rule is that whatever is not expressly forbidden by the law is permitted. In the case of a Limited Company, powers may be limited to the objects for which it was created. Whatever is not permitted expressly or by implication by the M/A is prohibited by the doctrine of 'Ultra Vires'.

It is a fundamental rule of company law that the objects stated in its M/A should not be departed from. In consequence, any act done or any contract made by the Company which travels beyond the M/A, or which is not expressly or implicitly warranted by it is beyond the powers of the Directors and of the Company. As a result, such an act or contract is wholly void. Hence a Company can be restrained from employing its fund other than those sanctioned by the M/A. Similarly it may be restrained from carrying on a trade not authorised by the M/A.

The essential feature of the doctrine of Ultra Vires is that the Company being a Corporate Personality should not be penalised for its acts or for the actions of its agents. The reason is that a Company cannot authorise to act beyond powers.

ii) Remedies :

1. By ratification :

The General Body may ratify an act of the Director or Manager, which otherwise would be ultravires. The scope is limited to the main objects clause.

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2. By amending A/A :

Where-ever it is necessary. This is limited to main objects caluse.

iii) Main object clause :

The courts have held that this limits the powers of the Directors, the Manager etc.

In Cotman V. Barougham (1918) the company had put thirty-sub-clauses to include every possible kind of business. To control such a tendency, the main objects clause rule was made by the courts. In this case it was held that it was not ultra vires for the Rubber Company to underwrite shares in an oil company.

Ashbury Railway Carriage Co. V. Riche (1875) : In this case, the M/A provided that the objects were to make, sell, lend on hire, Railway Carriage.... and to carry on business of Mechanical Engineers and General Contractors.

The Company entered into a Contract with Riche to finance the construction of railway lines in Belgium. It, later repudiated. Riche sued the Company.

Held, the main object referred to Railway Carriages and this did not include the putting of Railway lines. Hence, the Contract was void.

Held, further that even ratification by the shareholders would not cure this basic defect.

The interpretation of objects clause in the M/A is now governed by Company (Amendment) Act 1965. A Company should state separately in its M/A

i) Main objects and

(ii) those objects which are incidental or ancillary to the main objects

(iii) other objects. The parliament by this amendment has prevented companies from venturing on entirely a new object risking its capital without notice to the members or creditors.

iv) Charitable Contributions: The funds of the Company can be used to carry out authorised objects only.

In A. **Laxmanaswamy Mudaliar V. L.I.C**.

the Directors of a company were authorised by the M/A, 'to make payments towards any charitable or any general or useful object...'. The shareholders passed a resolution to pay 2 lakhs to a trust for promoting technical and business knowledge.

Held, the payment was Ultra Vires.

Held, as the Company's insurance business had been taken over by the L.I.C. it had no business left and its payment was without authority.

Hence, the Company's funds cannot be used to give charities except in a limited way. The power to given charity is not an object of the Company

. Such a charity or grant must be (i) Incidental to Company business (ii) Bonafide and (iii) Must be for the benefit of the Company.

e.g. Ex gratia payment to workers as incentive, payment to widows of an ex-workers etc. are examples.

Leading case is Trevor V. Whotworth.

v) **Consequences :**

The Directors, as agents of the company **cannot do anything** which the company itself cannot do under M/A.

However, if the contract is within M/A but the Articles have not conferred powers on Directors, the company may ratify (Grant V. Switback Rly). If not so ratified, Directors will be liable (Collin V. Wright).

a) The members may bring an injunction from the Court, when the breach is about to take place.

b) The Directors become personally liable to the Company and hence, they will have to pay or account for, to the Company.

c) In case of excess of authority, if damage is done to third parties, the **Directors become personally liable**.

In Weeks V. Propert ….
exceeding the authorized debentures, Directors accepted 500 pounds.
Held, this was void. Directors were **held personally liable.**

CHAPTER 6
MEMBERSHI
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Ch. 6-1. Membership :

1. Modes of Acquision of Membership :

A person may become a member of a Company in any of the following ways:

i) **Subscribing to** M/A **:** (Sn.41) :

All the subscribers to the M/A, are deemed to have agreed to become members and hence on registration of the Company, they are members and their names should be entered in the 'Register of Members'. Every subscriber acquires this full status on registration.

When 'Qualification of holding certain shares' is prescribed (in Public Limited Companies) to become a Director, the person who signs & files with the Registrar with an undertaking to take such number of shares, becomes a member on the Registration of the Company.

ii) Application and Allotment:

A person becomes a member when shares are allotted to him. The application for shares should be duly filled up and signed by the applicant quoting the number of shares he wants. Shares are allotted by a resolution of the Directors. The allotment in complete when appropriation is made, and the allottee becomes a member. Notice or certificate is only an evidence of it.

iii) Transfer : (Sn. 82)

A person who buys shares in the open market, may apply to the Company to get his name duly registered as a member. He becomes a member only when so entered on the register.

iv) **By transmission:**

On the death of a member, his legal representative becomes entitled to the shares, according to law. In such a case the legal representative may himself become a member, or transfer the shares. He must decide in 90 days.

If he decides to become a member, his name must be entered in the register of the Company. This is called transmission.

v) **By holding out:**

Allowing one self to be held out as member. This is based on the principle of holding out and estoppel. Hence, if his name is continued as a member, on winding up, he becomes liable as a contributory (Hansraj 's case).

2. Who can become a Member :

i) Persons who have attained majority and who are not insane or insolvent and otherwise disqualified, may become a member.

ii) Minor: is allowed to become a member but during minority he incurs no liability, e.g. He cannot be called to pay the 'Contributory' in the winding up of the Company. On attaining majority, within a reasonable time, he must opt to the membership. In Palaniappa V. Official liquidator shares were allotted to a minor, but on winding up, the minor was held not liable as **contributory**.

iii) Company : As company is a legal person, it can become a member of another company, if the M/A so authorises.

iv) Partnership firm: As partnership firm is not a legal person, it cannot buy shares in its own name.

3. Membership when **ceases :**

Membership of a person ceases on i) death ii) transfer of shares iii) forfeiture or surrender of shares iv) winding up of the Company v) other methods, if any, provided in A/A.

4. Rights of a Member :

i) To receive share certificate

ii) To receive information of allotment of shares

iii) To transfer shares (subject to A/A)

iv) To attend meetings, to receive notices of meetings, to vote at the meetings as per A/A.

v) To associate in the declaration of dividend, vi)

To inspect the register kept by the Company.

vii) To obtain copies of M/A and A/A on request and payment of fees if any.

viii) To have the first option to buy any new shares on future issue of shares.

ix) The right of appointing Directors and auditors at the Annual General meeting.

x) The right to approach the court in the event of oppression or mismanagement.

5. Liabilities of a Member :

i) To take shares when they are allotted.

ii) to pay for the shares allotted to him, this is debt by him to the

Company.

iii) To abide by the doings of the majority of members.

iv) To contribute to the assets of the company, in case of winding up i.e., as 'Contributory'.

v) To contribute to loss suffered by the company under some circumstances. (S.45) e.g. in unlimited Companies. This will not arise in case of limited companies.

6- Cessation of Membership :

A member of a company ceases to be a member.

i) By transferring his shares, the name of transferee brought on record of register.

ii) By forfeiture of shares, iii) By surrender of shares, iv) By the death of the member. v) By the insolvency of the member.

vi) On winding up of the company, but becomes liable as "Contributory".

vii) On rescission of the contract for misstatement in prospectus etc.

CHAPTER 7 SHARES

Ch. 7.1. Shares :

i) Meaning :

A share represents such a proportion of the interest of the share-holders, as the amount paid up thereon bears to the total paid-up capital of the Company. It is the measure of the interest in the Company's assets to which the member holding the share is entitled. The courts have held that a share is a right to participate in the profits of the company while it is running and in the assets when wound up.

ii) **Allotment of shares :**

a) According to the Supreme Court 'Allotment' is the appropria tion of a certain number of shares to a person (from the un-appropriated capital of the Company) and shows the assignment of interest in the capital of the company, of a fixed fiscal value, in favour of a sub scriber,

b) Valid allotment: Sn. 69. Requirements of a valid allotment are :

1. Authority :

Allotment must be authorised by a resolution of the Board of Directors or a committee of Directors.

2. Minimum subscription :

The prospectus should state the amount of minimum subscription and also the application money. The amount payable on application must be not less than 5% of the nominal value of the share.

These amounts must be received and deposited in a scheduled Bank.

If this minimum is not received in 120 days of the issue of prospectus the money should be refunded. If not so refunded in 130 days, the Directors become liable personally for the money with interest. Any waiver of this by share-holder is void.

There must be a prospectus issued duly observing the formalities. If not issued, a 'statement in lieu of prospectus' must be filed with the Registrar.

d) Opening of subscription List: - The time of opening must not be within 5 d?ys after issuing prospectus (or filing the statement). If this rule is not followed, a penalty is imposed.

e) Stock Exchange : - Listing is essential; the prospectus should specify the particular stock exchange and shares must be dealt with by that stock exchange.

f) Time : All allotment must be completed within a

reasonable
time.

g) Communication : - The allotment must be communicated to the applicant.

h) Conditions : If the allottee has put some conditions, the condition should be fulfilled by the Company. A had applied on the condition that he would take 4000 shares if he is appointed as a cashier in the new branch of the Company. Held, the condition must be fulfilled (of course, the company may refuse to allot the shares) (Raman Bhai V. Ghasiram). iii) Irregular allotment:

Any allotment without observing the statutory conditions is irregular.

Making allotment without the minimum subscription : or without receipt of 5% on application or, without filing "statement in lieu of prospectus' is irregular.

It is voidable at the option of the applicant. He must exercise his option within 2 months of the General Meeting of the company.

Any Director making such irregular allotment, knowingly or unknowingly is personally liable to the company and to the applicant for any loss incurred. Period of limitation is 2 years, to sue the Director.

Ch. 7.2. Calls:

i) One of the essentials of allotment is that the application money must not be less than 5%.

ii) ' Calls': The liability of a shareholder to pay the value of the share, held by him, is enforced by making 'Calls' for such payment. Payment is a statutory liability, but the call must be valid. To be valid it must have the following requisites.

a) Resolution of the Board of Directors is necessary.

b) The Resolution must state the amount of call and the time at which it is to be paid.

c) As the call-money is a trust, the call must be bonafide for the objects in M/A.

d) Uniformity must be maintained. No call should exceed l/4th of the value of the share, the interval between two calls should be more than 14 days.

iii) Remedy :

If calls are not answered by the applicant/shareholder, the remedy is forfeiture, but the rules under the Companies Act should be followed.

Ch. 7.3. **Forfeiture of shares :**

When a member does not attend the calls to pay but defaults, the Company may (a) sue him or (b) forfeit his share.

Certain conditions are to be fulfilled to forfiet the share,

i) **Authority :**

The A/A must have expressly provided for such a power or authority.

The procedure so laid down must be strictly followed.

ii) Resolution and Notice :

Resolution of forfeiture must be made. Notice under the authority of the Board of Directors must be served on the defaulting member. It should state the date. At least 14 days time should be given. It must warn him about the forfeiture. Even if slight defect is there the forfeiture becomes bad. In Pramila V. Wearwell Cycle Co., regd. notice sent was returned unserved. The shares were forfeited. Held, this was bad.

iii) Good faith :

The basic requisite is that the power of forfeiture must be exercised with utmost good faith.

iv) Consequences:

After forfeiture, the member remains as a contributory as a past member for one year from the date of forfeiture. He may be treated as a debtor if the A/A so provide. (Ladies Press Assn. V. Pulbrook).

Ch. 7.4. **Surrender of shares:**

A member, who has failed to pay according to calls, may surrender the share to the Company. There must be a valid call and default. The Directors may accept the "Surrender of the shares". A surrender amounts to a reduction of the capital.

Forfeiture	**Surrender**
1. It is made by the Directors for default of payment on calls.	1. Voluntarily made by the member to the Company.
2. All the formalities must be strictly observed. Otherwise forfeiture become invalid.	2. There are no formalities,
3. Sanction of court is not necessary.	3. As this amounts to reduction of capital, courts permission is required.

Ch. 7.5. **Reduction of shares:**

Any Creditor to the company, looks to the capital of the Company and hence capital should not be reduced but only subject to certain safeguards. Sn. 100 provided that a Company may, by special resolution and with the confirmation of the court, reduce the share capital in any way provided under the Act. This power is vested in the company but it has no powers to return the capital to members. The question of reducing capital being a domestic one, it should be decided by a majority. The company is to determine the extent, the mode and the incidence of the reduction. The court has powers to sanction a reduction which is, according to it fair and equitable. The interest of the creditors and of the shareholders is paramount.

If not sanctioned by the Court, the reduction is unlawful.

The procedure for reduction must be strictly followed. The Company may

i) reduce the liability if any, on its shares

ii) cancel any paid up share capital which is lost

iii) pay off any paid up capital which is in excess of the requirements of the Company.

In Marwari Stores Ltd., V. Goenka, the Company had a capital of Rs.1,92,000 i.e., 1920 shares of Rs.100/- each. By a special resolution, it reduced the capital to half. 1920 shares of Rs.50/- each, i.e., The paid up capital of Rs.50/- on each share was cancelled bringing the capital to Rs.96,000/- this was challenged by a shareholder. Held, the reduction was valid. The court confirmed the scheme of reduction.

CHAPTER 8
SHARE CAPITAL

Ch. 8-1. Share Capital:

The M/A states the Capital of the Company

i) Amount stated in the M/A : Authorised Capital (e.g. This may be 50000 shares of 100 Rs. each i.e., 50 lakhs).

ii) Only *Vz* of this may be issued : This is called issued capital,

iii) Allotment is made: Subscribed capital

iv) It need not 'Call' the entire amount. It may call certain amounts which is paid. This is paid up capital.

Ch. 8.2. Kinds of shares:

There are two kinds of shares:

i) Preferential shares

ii) Ordinary shares (Equity shares)

iii) Preferential shares (Sn. 85). It is assured of a Preferential dividend. It may be (say Rs.25,000/- per year) a fixed amount or 5% of the nominal value of the share.

Classes: Cumulative Preferential Share means the dividends accumulate year after year. If there are no profits in one year, the next year when there are profits, these shares get the previous years dividend also. This is cumulative.

Non-cumulative Preference shares:

Here, the dividend, if unpaid, lapses and will not accumulate.

Redeemable Preferential Shares. As per the A/A, the Company may choose to pay back the holders of such shares. Such shares are called redeemable Preferential Shares.

If redemption (repayment) is made out of profits an equal sum is put to a reserve fund called. The Capital Redemption Reserve Account. Bonus shares may be issued from this fund.

Ch. 8.3. Share Certificate (Sn. 113) :

i) A Share Certificate is a document issued by the Company, under its seal certifying that the member holds a number of shares specified therein. This must be issued within 3 months of allotment.

The Certificate is evidence of title and the shareholder can sell in the open market.

ii) Legal consequences:

a) The Certificate binds the Company. It is estoppd from denying the title of the share.

b) If the Certificate states that it is fully paid up, the bonafide purchaser is protected and the Company is estopped from denying the title.

iii) Duplicate: May be issued if the Original is lost (under an indemnity bond).

Ch. 8-4. Share Warrant: (Sn. 114)

A Public Company has a right to convert its fully paid up shares into share warrants. For this A/A must give the power and the Central Govt. must give its approval.

A Share Warrant must be issued under the seal of the Company. It must state the shares held by the member. Such a share warrant may be transferred by mere delivery. Registration of transfer is not necessary. Dividends may be paid by issuing coupons.

The name of the member shall be removed from the Register of members and date of issue of warrant should be written in the Register.

The bearer of such Share-Warrant may get the Warrant cancelled and his name entered as a member.

Ch. 8.5. Annual Returns :

Every company is under an obligation to file Annual Returns to the Registrar furnishing particulars as per Schedule V. part I of Companies Act regarding.

i) Its registered office.

ii) Register of members, debenture holders.

iii) Names of Directors, Secretaries, Managing Director, etc.

vi) Shares and Debentures, etc.

(Separate returns are to be filed by Companies having no share Capital).

It should be filed within 50 days from the date for the General Body Meeting. It must be duly signed by a Director and a Manager or Secretary.

A Private Company should also file its Annual returns with the necessary certificates.

If not so filed, penalty may be imposed on 'every officer in default'.

Ch. 8.6. Register of Members (Sn 150)

a) Every Company should maintain a Register of Members with the particulars :-

i) Name, address, occupation of each member, ii) The number of shares held by him paid up or not - The share certificate number should be entered, iii) Date of entry in the Register. iv)Date of ceasing to be a member v) Index of Members - if more than 50.

b) Default in maintenance of the Register is penalised.

c) The Register is to be kept in the Regd. Office and should be open for inspection by any member or debenture-holder. Mistakes, if any, may be rectified.

CHAPTER 9
BORROWING

Ch. 9.1. Borrowing Powers:

The General Rule is that the M/A must authorise the Company to borrow money. However, a trading company need not have such an authority and borrowing is an implied power. Borrowings without express or implied authority is Ultra Vires.

A non-trading Company cannot borrow unless such power has been expressly given by the M/A.

The power to borrow includes the implied power to provide for the security to repay ; Further uncalled capital can be so charged if the M/A so provides. Reserve Capital cannot be charged.

Borrowings may be done in various ways : i)

Any unsecured loans ii) By making

P/N.

iii) By mortgage or charge on property

iv) By issuing debentures.

In all these cases, it is necessary to know whether the Company has power to borrow, whether the Director has power to borrow without the sanction of the General Body, whether there is any limit to borrow etc.

The restriction imposed by the Companies Act:

1. For the Directors to borrow :

Sanction in the General Meeting is essential (This will not apply to a private company).

2. Directors shall not issue debentures except by means of resolution passed at the Board meeting (Board's power may be delegated). The loan and the security both become ultra vires if borrowed beyond powers. Hence null and void.

But if a person lends in good faith without knowledge of excess of limits, then the loan is valid. Re-payment can be enforced by an injunction if the money can be identified. If already utilised, he may recover by suit. If the money is already paid to discharge a loan, he is suborgated to the place of such a creditor and hence can sue.

Ch. 9.2. Debentures :

A Debenture is a certificate of loan issued by a Company. It is a type of security. Sn. 2(12) of the Companies Act defines it. Debenture includes debenture stock, bonds and other securities, of the Company whether constituting a charge on the company's assets or not.

Features:

i) It is issued in the form of a Certificate under the seal of the Company.

ii) It is a debt or acknowledgement of indebtedness, iii) Debentures may be subject to some contingency, iv) It carries a fixed interest per annum. **Kinds of debentures:**

1. Redeemable Debentures:

On the expiry of the term of loan, the Company has a right to pay back the debenture holders. The property gets released from the mortgage or charge.

2. Perpetual Debenture:

This is irredeemable. The debenture may be subject to a contingency and on the happening of it, may become irredeemable.

3. Registered holder:

A Company which floats debentures should keep a separate register of holders of Debentures. The names of the holders must be placed on the Certificate and the Register. Such a person is a registered holder. Transfer of debenture is allowed, but must be registered with the Company.

Share-holder	Debenture-holder
1. He is a member of the company and is entitled to various rights and privileges.	1. Not a member
2. He gets a dividend when declared.	2. Gets a fixed rate of interest.
3. Cannot be paid back as long as the company is there.	3. Company may pay back (Not in case of Irredeemable Debentures)
4. On winding up share-holder gets, after all other claims are paid.	4. As a secured creditor he gets priority.

Ch. 9.3. Floating Charge:

There are two types of charges: Fixed and floating. A mortgage is a charge on fixed asset. But, the floating charge is highly beneficial to run the company without the assets being tied up. It is floating with the property it intends to cover. It is a charge which floats like a cloud over the whole assets from time to time. It does not get attached to any specific asset.

Stock in trade: The floating charge on this enables the Company to borrow, without fixing up the stocks. It may use the stock from time to time. However, if the creditor or bank desires to enforce its floating charge and legally seize the stock, then the stocks become 'crystallised' i.e., fixed.

In Panama New Zealand Company case, the Company under a floating charge raised debentures for affixed period. But before that the Company was wound up. It was held that the floating charge over the entire asset of the Company past and present.

The essentials are:

1. It should be a charge on the *warn* both past and present.

2. The asset-stock in trade-must be one which is changing from time to time.

3. the company has a right to use the stocks until some legal steps are taken by the debenture-holder or mortgagee to crystallise it.

Restriction: According to Companies Act Sn539any floating charge created 12 months earlier to winding is invalid.

Jones &Co. V. Ranjit Roy executed a deed charged all its machinery, stock in trade to be in the lender's possession. It was held that this was not a floating charge, as this took away the rights of the Company to use the assets in the ordinary course of business.

CHAPTER 10 DIRECTORS

Ch. 10.1. Directors :

i) As the Company is a legal or juristic person, its business and affairs are entrusted to the officials of the Company.

ii) Status :

According to the companies Act there should be at least three Directors in a Public Company and at least two Directors in a Private Company.

A Director is not a servant of the Company. He is the Controller of the affairs of the Company.

The Directors are sometimes described as agents, as trustees and as Managing Partners. The latest concept is that they form the **Primary Organ** of the Company.

The Directors form the Board. The Board is the brain and the only brain of the Company. The Company can and does act only through them (Bath V. Standard Land Co.). Hence as Lord Bowen says **when brain functions, the Corporation is said to function.**

The success of a Company is dependent on the Board Directors. Hence, individuals alone can be Directors.

iii) Appointment:

The first Directors are those appointed by the subscribers of the M/A (If not appointed all become Directors).

They should take within 30 days the consent of the Registrar to act as Directors. They hold offices as Directors until the First Annual Meeting of the Company. The new Directors are appointed by that meeting.

To prevent any mischief of permanent Directors, provisions are made in the Companies Act (Sn. 255) to appoint by rotation. In a Public Company, only one third can be permanent Directors. The others are appointed by rotation. At the Annual Meeting 1/3 of these Directors, are to retire. Provisions have been made for reappointment.

Method :

1. Each Director should be individually appointed by voting at the General Meeting. If two or more are appointed in a resolution the appointment is bad. But by unanimous resolution more than one may be appointed.

2. In some circumstances, by special resolution, the Directors are to be appointed.

3. The Board has powers to appoint to fill casual vacancy, of a Director.

4. To prevent oppression and mismanagement, the Central Government, has powers to appoint Directors (Sn. 408).

5. Courts have power to appoint to prevent oppression and mismanagement.

iv) a) Qualification:

The A/A of a Company may provide for certain number of shares to be held by a person to become a Director. These are 'Qualification shares'. If appointed, without this qualification shares, he may acquire them within 2 months, or his place becomes vacant. But if he continues he becomes liable to penalty.

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The other qualification may be prescribed by the share holders.

The majority of shareholders may exercise their right to control the actions of the Board in cases of its malafides or incompetency.

Certain powers are stated in the companies Act, which should be exercised with a resolution of the Board Meeting i.e., to make calls, to issue debentures, to borrow money etc. Certain other restrictions are in Sn. 291. The General Meeting should authorise the Board in selling or leasing the Companies undertaking/borrowings etc. They have no powers to make political contribution.

vi) Duties of the Directors :

a) duty to attend Board Meetings : The Directors should attend the periodical Board Meetings. If a Director is absent for three consecutive meetings, (without the permission of the Board), he is deemed to have vacated his seat. It shows his negligence and is liable if due to his absence, there is a breach of trust by others.

b) To discharge duties personally : The shareholders appoint a Director on the strength of his integrity, managerial skill and compe tence, hence, he should not delegate his duties to others. But accord ing to A/A only, he may delegate his duties.

c) He must discharge his duties with utmost good faith and work for the benefit of the Company. He should not take advantage of his status to enrich himself.

The leading case is Cook V. Decks. The Directors diverted a contract of the Company to themselves. They had 3/4 majority voting power and hence got a majority resolution. Held that the benefit of the contract belonged in equity to the Company and hence the Directors were liable.

Statutory restrictions have been imposed on the Directors (in Sns. 319 to 321) of the Companies Act to trace any extra money that Directors may make.

d) Fiduciary position demands that the Director should disclose his interest to the Board.

Liability : The Director is personally liable to various circumstances for violation of statutory duties.

Ch. Managing Director (Sn. 275)

He is a Director who is entrusted with 'substantial power of management'. Such a power may be conferred on him by M/A or A/A or by a resolution of the Board of Directors. It may be conferred even by arrangement. Hence he has a dual capacity as Director and as employee(whole-time).

He is appointed according to the A/A. Usually, it is the Board that appoints one among them as M.D. The appointment of the first M.D. must be approved by the Central Government. Otherwise, the appointment becomes irregular.

The maximum tenure is 5 years, at a time. The remuneration should not exceed 5% of the profits of the company. The Central Government, i.e., Company Law Board has the powers to fix the salary.

His qualifications are the same as a Director for appointment.

The Qualification are the same as a Director for appointment.

The entire management of the Company are in his hands. He is not a servant of the company (though an employee).

His powers and functions are determined by the A/A generally.

CHAPTER 11

SECRETARY, AUDITOR, etc. C.

11.1. Secretary:

He is an individual, appointed to perform the duties which are to be performed by the Secretary under the Companies Act. He may perform ministerial and administrative duties. He must posses the prescribed qualifications.

Status : A Company having 25 lakhs paid up capital or above, must have a Secretary. He is a full-time paid Executive officer. The courts have held that the Secretary is not a humble servant as was understood earlier. He is not a clerk. He is a very important person, with extensive duties and responsibilities e.g. He may hire cars for the administrative purposes of the Company.

In Panorama Development Co. case : P was running car-hire business. D's Company Secretary hired them telling that the cars were to meet the customers, but, he used them for his own purposes it was held that hiring the Cars was essential part of his functions and is within his ostensible authority.

He is the Chief Administrative Officer. He has ostensible Authority to sign contract on behalf of the Company.

He cannot borrow on behalf of the Company. Thus where a Director paid advances to the Company on the request of the Secretary, it was held that the Company was not liable.

He can call meetings and carry on administrative functions as per the A/A.

Liability : The Secretary is liable like a Director of the Company.

Ch. 11.2. Auditor:

The **Auditor is the Watchdog of the Company's affairs**. He is a servant of the shareholders. He is appointed by the General Meeting once in a year and may be re-appointed. He is an independent agency and hence, the shareholders may rely upon his report.

Appointment (Sn.224) :

i) An Auditor is appointed by the General Body at its annual meeting. He must be informed of his appointment within 7 days, and such an auditor must inform the Registrar about his acceptance within 30 days.

ii) The first auditor is appointed within one month of the incorporation of the Company and he holds his office, until the auditor appointed by the first General Body takes over.

iii) In specified cases, e.g. where a Company is partly held by Government or financial institution an auditor may be appointed only by a special resolution. In such a case, if no auditor is appointed, the Central Government may appoint an auditor.

Qualifications :

i) He must be a Chartered Accountant.

ii) If a firm of auditors, is appointed, all its partners must be duty qualified.

iii) Disqualifications: An officer, or employee of the Company, or a body corporate or a person indebted to the Company or a Director of another Company which is a managing agent of the Company is disqualified.

Removal:

i) At the expiry of the term of appointment the General Body may appoint another auditor.

ii) With the approval of the Central Government an auditor may be removed even before the expiry of his tenure of office.

Powers and duties :

i) He has access to all the books of accounts, vouchers etc. of the Company. No doubt, it is the Directors who prepare the accounts, but it is the Auditors who report to the members on the accounts and on certain vital aspects. The members, get a true and fair view through the Reports. He must enquire into a number of circumstances (Sn. 227) relating to loans, advances, entries in the registers or books, expenses incurred on revenue accounts etc.

ii) He must check the accuracy of the Accounts. It is not just a mechanical addition or substraction. It is a complete examination of what the management has done. He must certify, in his report, that the accounts are correct and reflect true and fair view of the state of affairs of the Company.

iii) He must exercise reasonable skill and care in discharging his functions. He owes his duty to the Company. A person misled by his certificate may sue him for damages.

Hadley Byrne & Co. V. Heller & Partners. Here, A an advertising firm, asked its bank to get the opinion of a Company C whose bank was B. A's bank wrote to B which gave a favourable report but added "without responsibility". A placed orders with C and lost heavily. It sued B.

The court held that the Bank was not liable.

But, when confidence is reposed and opinions are asked of persons who have the skill, the court said, a duty arises.

Applying this principle, the auditor owes a duty of care to the Company and to the shareholders.

iv) Liability for fraudulent misrepresentation :

The Auditors are liable for fraudulent statements made and also for reckless statements.

Leading case : Ultramares Corp. V. Touch.

CHAPTER 12
MEETINGS

Ch. 12.1. Meeting : i)

Meaning:

Meeting is derived from Meet which means 'Face to Face'. Hence, at least two persons are required to constitute a meeting.

A meeting is an assembly of persons at a particular place and at a particular time for determining certain specified matters which may be put before the meeting.

All powers relating to the management of the affairs of the Company vest in its shareholders. They may express their views and assert their will by majority votes. The Directors are subservient to the wishes of the shareholders. General meetings and Board meetings are the means of action. The policy and other decisions are taken at the meetings.

ii) Kinds : There are three kinds of Meetings.

1. Annual General Meetings or General Body.

2. Extraordinary General Meeting.

3. The Statutory Meeting.

iii) General Meeting :

Every Company must hold an Annual General Meeting in each year. (S.166). The interval between two Annual General Meetings should not be more than 15 months. In special cases, the Registrar may allow a maximum of three months time. The First General Meeting must be held within 18 months of the date of incorpo-ration. A public company may by its Articles, fix the time of its General Meeting. It must be held at the Registered office and during business hours.

If there is default in holding this meeting, a member may put an application to the Central Government, to call for a meeting (Sn. 186). This Board acts in a quasi-judicial capacity. It may order for the calling of the Annual General Meeting.

Not calling a General Meeting is an offence and is punishable with fine.

In Sri. Meenakshi Mills C. Ltd. V Asst. Registrar the co. was prosecuted for not holding its Annual General meting. It had held one such Meeting in Dec. 1934. This was adjourned to March 1995 and it was held then. The next was in Feb. 1936. Held guilty as no General Meeting was held in 1935.

The business transacted in the General Meeting is called the

Ordinary business, if it takes up any other business, it is called special business.

Relevance: The General Meeting is one of the most important and significant features of the Companies Act. The controlling lever of the affairs of the company is in its hands.

The shareholders get on opportunity to meet to discuss and to direct how the company should function.

Election of Directors, appointment of auditors, declaration of dividends, presentation of annual report by the Directors, approval of the Annual account etc. are the important functions of the General Meeting.

iv) Extra ordinary General Meeting :

If there is any important matter which requires consideration by the shareholders (before the next General Meetings) then an extra-ordinary General Body may be convened either by the Directors or on Shareholder's (10% of them) requisition. The business done is special business.

Ch. 12.2. General Rules Regarding Procedure (Sns. 171 to 186) :

a) **Duty of Directors :**

The Board of Directors is empowered to call for the General Meeting.

b) **Notice :**

21 days notice in writing must be given to all shareholders. It must specify the place, date and time of the meeting. It must contain an Agenda of the Meeting.

General Business: It may relate to the consideration of accounts, Director's Report, appointment of Directors and Auditors, fixing remuneration etc.

Special Business : Statement regarding it must be annexed to the notice.

c) **Quorum :** (Sn. 174) :

This is generally fixed by the A/A. This is the minimum number of persons who should be present at the Meeting. The Companies Act provides a minimum of 5 in Public Companies and at least 2 in case of Private company. If within half an hour, the Quorum is not available, the meeting stands adjourned to the same day during next week. That day the meeting may be held irrespective of the Quorum. But, there must be at least two.

The leading case is **Sharp V. Dawes.** Though there were many shareholders, only one attended the meeting. (He of course had proxies of some others). He took the Chair passed a resolution and also proposed a vote of thanks. Held, meeting involved more than one person. Hence it was held not a meeting. A minimum of two is essential.

d) **Voting:**

Every member has a right to vote. Each member has one vote. Voting is done by show of hands unless a poll is demanded. Chairman's declaration of the passing of the resolution is final (For *non*-payment of calls due, a member may not be allowed to vote).

e) **Proxy:**

A proxy is an instrument in writing executed by a shareholder authorising another person to attend a meeting and to vote there at on his behalf and in his absence. S. 176 gives every share-holder who is entitled to attend and vote a statutory right to appoint another person as his proxy to attend to vote only on a poll. He need not be a member. He has no right to speak. Instrument appointing a proxy must be lodged with the company, 48 hours in advance. No invitation be issued by the Company at its expense for appointing a specified person as Proxy. But a list of persons who are willing to act as proxies may be sent to all members.

f) Resolutions:

They may be ordinary or special. A simple majority will suffice for an ordinary resolution. But, for a special resolution 3/4 majority is required. The details are to be found in the A/A of each Company.

Such resolutions must be registered with the Registrar within 15 days of passing them.

Ch. 12.3. Statutory Meeting and Statutory Report:

Statutory Meeting is the first meeting of the shareholders.

Every public company limited by shares (or limited by guarantee) and having a share capital must hold a general meeting of the members of the Company which is called the statutory meeting. It is to be convened not within one month, but not later than six months from the date on which the Company is entitled to commence business. The Statutory Meeting is to be held only once in the life-time of the Company (Private Companies are not required to hold such a meeting).

Palmer in his Company law explains the importance of this meeting.

The Statutory Meeting is intended to afford an opportunity to the members to consider the progress the Company may have made. This is disclosed by the Statutory Report which is circulated 21 days in advance among the members and filed with the Registrar. The members are at liberty to discuss at the meeting any matter relating to the formation of the Company, its prospects, method and management arising out of the Statutory Report.

Even if the Report is forwarded late it shall be deemed to have duly forwarded if the members agree to it. The particulars to be set out in the report are contained in Sn. 165 (3).

i) Names, addresses and occupation of Directors, Secretaries etc.

(ii) Number of Share allotted

(iii) Contract details of the Company

(iv) Abstracts of receipts and payments (v) Commissions paid, if any etc.

The report must be certified as correct by at least two Directors, one of whom should be a Managing Director if any. The Auditors should certify that it is correct, in respect of allotment of shares and cash received and payments made.

If the meeting is not held or the Statutory report is not filed, as required with the Registrar, a member may petition to the Court for the winding up of the Company. The court may instead order the meeting to be held (or the report to be filed) within the meaning of S. 443 (3). The Directors are also punishable.

CHAPTER 13

OPPRESSION AND MISMANAGEMENT

Ch. 13.1. Rule in Foss V. Harbottle :

It is an elementary principle of the law relating to Public companies that the court will not interfere, at the suit of a share holder with the internal management of the company acting within its powers. In such a circumstance the action should be brought by the company itself to recover any money or damages. But what is the position if the directors themselves defraud the Company ?

In the case of Foss Vs. Harbottle, two shareholders took proceedings against the Directors of the Company to compel them to make good the loss sustained by the Company owing to the Directors fraud.

But majority in the General Meeting had approved of the acts of the Directors. Held, the loss was to the company and hence it may sue. There was no injury exclusively to the plaintiffs and hence they had no locus standi.

This is called the majority supremacy rule. The essence is this where the directors commit a fraudulent act and the majority confirms it in the General Meeting, the minority is incompetent to object to it by suing in the court.

ii) Exceptions to the Majority Supremacy :

Where the persons in the wrong, hold and control a majority of shares in the Company, and do not permit an action, in the name of the Company, the individual share holders can sue, in the following Circumstances:

1. To restrain the company from doing any illegal or ultra vires act e.g. **Bharat Insurance Co. V. Kanhayalal.**

Directors were granting loans contrary to M/A. Held, the shareholder could sue. Injunction was granted. Fraud on the Minority:

When the majority acts, not in good faith and not for the benefit of the company, ignoring the minority the suit is maintainable.

Leading cases:

i) **Cook V. Decks** : The majority holding 3/4th shares, got a contract in their own names and made profits. Held, this was fraud on the minority.

ii) **Brown V British Abrasive Wheel co.** Majority had 98% shares. They passed a resolution to compulsorily acquire 2% shares of the minority. Brown minority shareholder sued, held fraud on the minority.

iii) Lack of required majority or special majority is the cause of action for suing by any shareholder.

iv) Control by wrongdoers leading to oppression and mismanagement. Any shareholder may sue. Sns. 397 and 398 Companies Act.

v) For protection of individual membership rights guaranteed in the Companies Act and A/A a shareholder may sue.

Courts have wide powers in the above circumstances. Instead of winding up the Company, the courts may issue suitable orders, on the basis of facts and circumstances of each case.

Ch. 13.2. Prevention of Oppression and Mis management (Sns. 397 to Sn. 409) :

These provision are made to meet Foss V. Harbottle (Add facts and decision Ch. 13.1) :

1. Oppression :

a) In case of Oppression and mismanagement, at least 10 members or 1/10 of total members (whichever is less) may make an application to the court. The conduct of the company must be oppressive to any member or members or prejudicial to public interest

b) The other remedy is that on an application made, the Central Government may allow a shareholder to sue, if there are just and equitable grounds.

2. Meaning of Oppression :

Oppression means lack of probity and fair dealing in the affairs of the Company. Oppression may result from not acting also. Hence, it may take different forms. The idea is to get power and control.

In Elder V. Elder & Watson Ltd., the court defined oppression. The essence is that the conduct complained of should involve a visible departure from the standards of fair dealing and a violation of the conditions of fairplay. There must be an unjust and harsh or tyrannical conduct to constitute oppression.

In Hindustan Co-operative Insurance Society Ltd., case (1956), the Life Insurance Corporation of India was formed by taking over the Insurance Society on payment of compensation to the previous Directors. The Directors refused to distribute the amounts among the shareholders. They passed a resolution to use the money for new objects. Held this was oppression as the majority had exercised the powers wrongfully.

3. Examples of Oppression :

i) New and more risky business ventured against minority's opinions.

ii) Depriving right to vote or right to dividend.

iii) Continuously ignoring Board's decisions and making it impossible for the Company to do business, etc.

However, an unwise or careless performance of function is not oppression. Mere irregularities were held no oppression in another case.The leading case is **Shanti Prasad Jain V. Kalinga Tubes :**

In this case there were three groups of shareholders A, B and C in a Private Company. It was converted into a Public Company. B and C group did not offer shares to the existing members, but passed a resolution and issued to outsiders who were their own men. A challenged this as oppression. Question was whether the resolution by B and C to entertain outsiders was for the benefit of the Company or not ? Whether this amounted to the squeezing of 'A'. Held by the Supreme Court, that this was not oppression.

In **Lalita Rajalaxmi V. Indian Motors co**., the allegations were that petrol consumption was heavy, that ticketless travelling was not checked, that second hand buses have been disposed of at low price etc. were held to be not oppression.

The other leading cases are : Needle Industries Ltd.,

V. N.I.N. Holding Ltd. Turkish Baths Case. R.S.

Mathur V. Har Swarup Mathur.

Prevention of Mismanagement (Sn. 398) :

An application for relief against mismanagement should be made to the court. It must be established that the affairs are being run prejudicial to the affairs of the Company. The court may make a suitable order.The leading cases are

a) **Rajamundry Electric Supply Corporation V. Nageswara Rao** and

b) Richardson Cruddas V. Haridas Mundhra.

In **Rajahmundry case,** it was shown that the Vice-chairman had grossly mismanaged the affairs and that a considerable amount had been drawn by him for personal use, much of the machinery was in a state of despair and a powerful local junta was ruling the roost. It was held that there was mismanagement.

The court appointed two administrators for 6 months for the management of the company.

There must be an existing and continuing mismanagement to get the court relief.

13.3. Oppression and Mismanagement:

Powers of the Court: Sn. 402.

In case of oppression and mismanagement the court has wide powers. The major objective is to end the matters complained of before the court.

Some specific remedies that may be provided are as follows:

a) To regulate the conduct of the affairs of the company. In L.I.C. V. Haridas Mundhra, the court appointed a Special Officer to function according to the orders of the court.

b) To allow some members to purchase the share of others.

c) The company itself may be allowed to buy the shares.

d) To terminate, or to modify any contract.

e) To set aside any fraudulent preferences.

f) To alter the M/A or A/A (Bennett Coleman's case) :

Ch. 13.4. Central Government's Powers (Sn. 408)

1988 Amendment:

When there is oppression or mismanagement (under Sns. 397 and 398) the shareholders, instead of applying to the court may apply to the Central Government for relief.

The Government after inquiring may appoint a number of Directors so as to prevent oppression or mismanagement. These Directors are independent persons and not members of the Company.

Under Sn. 409, the Central Government has power to prevent any change in the Board of Directors, if the change is likely to prejudice the interests of the Company.

The Central Government interferes, only if there is gross mis-management or oppression.

The 1988 Amendment has empowered to appoint any number of persons, as the Company-Law Board specifies as Directors for a period of three years.

This is to effectively protect the interest. In this regard the Board, may hold on enquiry; require the company to amend its A/A and make fresh appointment of Directors, the Board appointed work with these Directors.

Prevention of change in the Board : Sn. 409 :

The Central Government has the powers to prevent any proposed change in the membership of the company, if the change is to affect or damage the interest of the company. Any Director or secretary of the Company may file an application for such prevention.

CHAPTER 14

RECONSTRUCTION AND AMALGAMATION

Ch. 14.1. Reconstruction :

A reconstruction takes place, when a Company's business and undertakings are transferred to another Company, formed for that purpose. The new company does the same business as the old one.

This reconstruction may become necessary

i) When a court does not allow major changes in the existing Company or

(ii) When the rights of share holders are to be changed. The new objects or changes may be made by the process of reconstruction.

Ch. 14.2. Amalgamation :

Amalgamation is not defined in the Companies Act. The ordinary meaning is Combination. The objective of amalgamation of one Company with another is to facilitate the reconstruction of the Amalgamating Company. This is the pereogative of the shareholders and an affair coming within the internal administra-tion of the companies.

The company should have a provision for amalgamation in the M/A. If not it may duly amend to include the power to amalgamate.

Amalgamation takes place where two or more companies combine to form another Company or when one Company absorbs another.

Forms : Amalgamation takes place in any of the following methods:

i) By sale of shares

ii) By sale of undertaking

iii) By sale and dissolution

iv) By a scheme of arrangement v) By Central Government in National interest **Procedure:**

The Companies Act has provided for a detailed procedure for Amalgamation.

The scheme for amalgamation made by the Company is to be approved by the court. The court makes its decision on the Report of the Company Law Board or Registrar. This Report must show that the Amalgamation was made for the benefit of the Company and not prejudicial to its members and creditors The courts objective is to protect public interest.

The scheme must be fair if the court is to approve the amalgamation.

It must hear the Central Government before deciding. In Wood P'olymer Ltd. Company's case, the court held that the only purpose of amalgamation was to transfer the buildings to a new company to avoid Capital gains tax. The court refused to approve the amalgamation.

Certain restrictions have been imposed to prevent the tendency f making monopolies, e.g.

i) Restrictions relating to acquisition of shares.

ii) The court refusing to give the sanction

iii) The approval of the Central Government for such amalgamation.

14.2. Amalgamation in National Interest (Sn. 396) :

Besides the usual modes of amalgamation provided for in Sns. '94 and 395, occasions may arise when it may be desirable in the oiblic interest that 2 or more companies should amalgamate.

When amalgamation in the National interest is clearly a necessity, the observance of the usual procedure will lead to delay and may be detrimental to the public interests.

A special rule is, therefore made to amalgamate 2 or more Companies in such cases.

The Central Government may be order notified in the official gazette, amalgamate two or more companies, in public interest.

The powers, functions, rights, liabilities, privileges etc. of the amalgamated Company are stated by the Government in its order.

Every member or creditor of each of the combining, companies shall have as nearly as he had in the earlier companies as may be, the same interest in or rights against the Company. But if his interest is less in the new Company, he is entitled to compensation.

Before amalgamation, the Central Government should send a copy of the proposal to amalgamate, to each of the Companies. This enables the would be amalgamating companies, to file objections if any, within the time fixed by the Government (2 months).

Copies of order to amalgamate should be laid before both Houses of Parliament, by the Government at the earliest convenience.

CHAPTER 15
WINDING UP

Ch. 15.1. Winding Up

Winding up is a process whereby the life of the Company is ended and its property administered for the benefit of its creditors and members. A liquidator is appointed who takes control of the Company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights (Gower).

Winding up, precedes dissolution. This means the status of the Company continues until the winding up proceedings are completed. Thereupon it is dissolved. Its life comes to an end.

Modes :

The Companies Act provides for 3 modes of Winding up :

1. Compulsory winding up under the orders of the court.
2. Voluntary winding up.
3. Voluntary winding up under the supervision of the court.

Ch. 15.2. Compulsory winding up :

Winding up on the orders of a court is called compulsory winding up.

1. Application or petition may be filed to the court by (a) the Company (b) A shareholder (c) The Registrar (d) A contributory (e) Central Government, as the case may be.

2. The circumstances for winding up are :

a) By special resolution:

By a special resolution, the General Meeting, may decide to wind up the company. The court at its discretion may order for winding up.

b) Not holding statutory meeting :

A company which has failed to hold its statutory meeting or submit its report, may be ordered to be wound up by the court. This may be done on the petition of the Registrar or a contributory.

c) Not commencing business:

If business is not carried on, or is suspended for one year and above, the court may order to wind up. The petition may be made by any shareholder (Muralidar V. Bengal Steamship Co.). The Company employed a steamer and took two flats for its business. During World War II, the Government acquired them. Hence, no business for one year. Held, no reason to windup.

d) Reduction in Membership:

When the number goes down below 7 (Public Companies) or 2 (Private Companies), the court may order for winding up.

e) Inability to pay debts:

1. To the creditors

cases :

i) Vanaspati Industries V. Dayal.
ii) Govardha Das V. Madhu Wollen Industries.

2. To the decreed debts case :
Mehta V. Steel Equipment.

Just and equitable grounds:

This is resorted to after giving due weight to the interests of the Company, its creditors, shareholders, its employees and in general public interest.

e.g. 1. Deadlock in the management: Yendije Tobacco Co. Ltd. case. In this case hostility developed between the only two Directors of a private Company resulting in a deadlock - court ordered winding up, even though business was good.

2. Squeezing the minority, by oppression.

3. Main object itself is lost or not materialising.

Ch. 15.3 Voluntary winding up :

1. A/A :

The provisions relating to voluntary winding up contained in the A/A are to be followed.

2. Special Resolution:

B a 3/4 majority the General Meeting should resolve to wind up the Company, Winding up commences from the date of the resolution. But the status and powers continue, until finally dissolved. The business comes to a stop, except so far as is necessary for the beneficial winding up.

3. Notification:

Gazette and newspaper notification should be given within 14 days of the resolution.

4. Solvency test :

A majority of the Directors, with an affidavit, may make a declaration about solvency of the Company and its capacity to pay within a maximum of 3 years. Such a declaration must be made by a special resolution and registered with the Registrar. Copies of profit and loss accounts, Balance Sheet and Assets and liabilities should also be filed. The objective is to make the winding up the members choice.

If the above procedure is not followed it becomes creditor's choice of voluntary winding up. If the Directors fail to pay within 3 years as per declaration then also it is creditors choice to wind up.

In member's winding up, a liquidator is appointed and his remuneration is fixed by the general meeting. This is reported to the Registrar. The liquidator should call a meeting of the shareholders within a year and present the accounts. He files the document with the registrar and the official liquidator. If the accounts are not prejudicial he reports to the court. The court if satisfied with the Report, orders dissolution.

In the Creditors winding up, the official liquidator also calls a meting of the creditors. The other procedures are the same as in Member's winding up.

Ch. 15.4. Official Liquidator:

1. The Central Government by notification in the official gazette may appoint, attached to each High Court an Official liquidator and an official receiver attached to district court.

2. It is the duty of the official liquidator to conduct the proceedings in the winding up of the company and also to perform such other duties as directed by the court.

3. Directors statement:

The Directors should submit a statement of the affairs of the Company, with all details of assets and liabilities etc., to the official liquidator within 21 days of the winding up order of the court. Within 6 months, the liquidator should submit a preliminary report to the Court furnishing all details and the progress made. He must submit accounts to the court twice a year and file a copy with the Registrar. He must send copies to the creditors and contributories.

4. Powers:

With the sanction of the court the liquidator may exercise the following powers:

i) To institute or defend any suit or prosecution in the name and on behalf of the company.

ii) To carry on the business, for beneficial winding up.

iii) To sell movable and immovable properties and actionable claims (by auction or otherwise),

iv) To raise any requisite money, on the security of the asset.

v) To do all other things as may be necessary for winding up.

5. Other powers:

He has many other powers which he can exercise without the sanction of the court.

i) To execute all documents with the seal of the company,

ii) To inspect the records, and the returns of the company,

iii) To draw or accept any Negotiable Instruments P/N, B/E, draft, cheque on behalf of the Company,

iv) To collect money from contributories. v) Any other power incidental thereto.

6. Duties :

He must call the meetings of the Members or Creditors or Contributories as the case may be as provided under the winding up proceedings.

7. Removal:

He may be removed and necessary action taken by the Central Government, on complaint received for the dereliction of duty, abuse or misuse of authority.

8. Dissolution:

The official liquidator continues to exercise his powers, until the court makes its order of dissolution of the company.

9. Filing :

The liquidator files a copy of the order with the Registrar.

Ch: 15. 5. Effects (or consequences) of winding up : ..

Winding Up :

Winding up is a process whereby the life of a company is ended & its property administered for the benefit of its creditors and members. The liquidator appointed takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members according to their rights.

When the winding up proceedings are completed, the company is dissolved and its life comes to an end.

The modes of winding up may be

i) under orders of the Court, ii) voluntary of iii) winding up under the supervision of the court.

Effects:

Winding up of the company has many consequences or effects. These are to be examined with reference to : i) Contributories. ii) Creditors, iii) Officers, Servants, iv) The Company,

i) **Effects on contributories, members.**

Means every person who is liable to contribute to the assets of the company in the event of its winding up. The definition includes past and present members.

As Pennington,,leading authority, says the term 'Contributory' is misleading. It seems to be confined to holders of partly paid up shares, or members of a company limited by guarantee, and members of an unlimited company.

The courts have held that a fully paid up shareholder is also a contributory. But such a member has nothing to contribute towards payment of the company's debts, but he has an interest in the company meeting its debts and paying surplus, If any, to the members.

Liability: It is not contractual, but it is ex lege i.e., by virtue of his name in the register as a shareholder (member).

The liability arises only when the winding up court makes an order, and a call-notice is served on the contributory. This becomes a debt. Hence, the unpaid balance of the share-amount should be paid by the contributory to the company.

The liability extends to the past members also. But a past member is not liable if he had ceased to be a member for one year before the commencement of winding up.

The primary liability is on the present members. It may then be on the past members subjects to certain conditions, as per the Companies Act.

Members :

Transfer of shares by members after the commencement of winding up proceedings is void in case of voluntary winding up. In case of winding up under court order, the transfer of share is void unless the court otherwise directs. (Sn. 536)

ii) Effect on Creditors:-

The creditors to the company may be secured, or unsecured creditors.

A secured creditor may rely upon the security offered to him, and, ignore the liquidator. He may realise his dues from the security. But, he may, in the alternative, Join the unsecured Creditors & claim & abandon his security.

In respect of unsecured creditor the Companies Act, puts all of them equally and provides for payment pari passu.

iii) Officers Servants etc.

Officers of a Company mean, Directors, Secretaries, Treasurers, Managers, but does not include an Auditor. But, it includes an accountant and Cashier.

According to the Companies Act, on the winding up, the directors etc cease to have their powers.

The officers are liable for misfeasance or breach of trust. They are subject to examination by the court. The court may order for restoring the property or money to the company in case of breach of trust or misappropriation.

The Palani Central Bank's case payment of dividend was made by showing false entries under profits.

It was held that though there was no fraud, there was gross & culpable negligence and hence directors etc were liable.

Criminal liability:-

Under Sn 539, the officers of a company are liable for punishment for falsification, destruction, mutilation etc of books of account papers, securities of the company, if the intention is to defraud any person^

Failure to keep proper accounts is also punishable.

However, if the offer has acted honestly & reasonably in the circumstances then the court may relieve him (Sn. 633).

iv. Effects on proceedings against company.

When the winding up proceedings start, the court under Sn. 442, stays all suits against the company.

After the winding up order is made by the Court, no suit or legal proceedings can be initiated by any person, against the company except with the permission of the Court.

For example income tax proceedings can continue with the permission of the court. Similarly secured creditors should take the permission of the Court, if they proceed against the "Security" that belongs to the company.

CHAPTER 16

I MISCELLANEOUS

Ch. 16.1. Investigation:

The Central Government may appoint inspectors to investigate into the affairs of any Company and to report thereon (Sns. 235,236).

Under S. 237 the Central Government shall initiate investigation, if the Company by a Special resolution, or the Court by an order, declares that the affairs of a Company ought to be investigated. The Inspectors may, if directed by the Central Government, make an interim report to the Government and shall make a final report at the conclusion of the investigation. A copy of it, is to be given to the Company.

If from the report, it appears that any official is guilty of a criminal offence against the Company, the Central Government may give legal notice and institute a prosecution against such persons.

The Government has powers to start proceedings (Sn. 234) :

i) For the winding up of the Company on the ground that it is just and equitable to do so (through petition).

ii) For relief in case of oppression and mis-management.

iii) For the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation or management of the affairs of the Company.

iv) For recovery of any property which has been mis-applied or wrongfully retained.

The expenses of investigation shall be borne by the Government in the first Instance. It may be recovered from the convicted person or from persons who are to pay damages or from the Company to the extent of property recovered by it.

Ch. 16.2. Committee of Inspection:

The court, at the time of an order for winding up of a Company or at any time thereafter, direct that there shall be appointed a Committee of inspection to act with the liquidator. The liquidator shall, within two months from the date of such director convene a meeting of the creditors of the Company for the purpose of determining who are to be the members of the Committee.

It shall consist of not more than 12 members (being creditors and contributories of the Company). It shall have the right to inspect the accounts of the liquidator. It shall meet at suitable intervals. It acts on majority decision. There must be a quorum for its meetings. It is a coordinating body.

Ch. 16.3. Contributories (Sn. 428):

Means every person who is liable to contribute to the assets of the Company in the event of its winding up. The definition includes past and present members.

As Pennington points out, the term contributory is misleading. It seems to be confined to holders of partly paid up shares, or members of a Company limited by guarantee and members of an unlimited company.

The courts have held that a fully paid up shareholders is also a contributory. But such a member has nothing to contribute towards payment of the company's debts, but he has an interest in the Company meeting its debts and paying surplus, if any, to the members.

Liability : It is not contractual, but it is ex lege i.e., by virtue of his name in the register as a shareholder (member).

The liability arises only when the winding up court makes an order, and a call notice is served on the contributory. In case of Voluntary winding, the "Call" may be made by the liquidator, without the orders of the Court. This becomes a debt. Hence, the unpaid balance of the share amount should be paid by the contributory to the Company.

The liability extends to the past members also. But a past member is not liable if he had ceased be a member for one year before the commencement of winding up.

The primary liability is on the present members; it may then be on the past members, subject to certain conditions, as per the Companies Act.

Ch. 16.4. Conversion of Private Company into Public :

A Private Company has many privileges and exemptions and it may enjoy these benefits, as long as it maintains its character as a Private Company. When this character is lost, the private company becomes public and the provisions of the Company act relating to public companies become applicable to such a company.

Circumstances:

i) Default: The Court may examine to find out whether any provisions of the Companies Act have been violated by the Company. If the default is due to inadvertence or some sufficient cause based on just and equitable grounds, the court may declare that Company as Private; otherwise as public.

ii) Operation of Law: Deemed Public Company:

a) Conversion: No public money is to be involved in a Private company. But a Public Company may incorporate a number of Private Companies who may still maintain private character. These are not allowed to have the privileges of a private company. Hence, it is provided (Sn 43-A) that if 25% or more of the paid up capital is held by a Public company, such a private company becomes public.

b) Turnover: As per 1988 Amendment, if the turnover exceeds a sum fixed by Central Govt. the company becomes public. This conversion is effective on the expiry of three months from the end of the accounting year.

c) Notice: Notice, within 3 months of such a Private Company becoming public, must be given to the Registrar, who shall effect the necessary changes.

d) Special features : Such a deemed Public company may (i) retain the characteristics of a Private company (ii) the membership may be below 7.

iii) Conversion by Choice: A private company may by passing a special resolution, changing its articles, convert itself into a Public Company. Within 30 days it must file a prospectus (or statement in lieu of prospectus) with the registrar. It must comply with all other requirements of a public company, e.g. increasing the membership to 7, appointment of Directors etc.

Ch. 16.5. Conversion of a Public Company into Private Company:

A Public Company may be passing a Special Resolution, changing its articles, convert itself into Private Company. However, the approval of the Central Government is essential, for such a change.

Ch. 16.6. Foreign Companies:

a) It is a company incorporated outside India. It is still a Foreign Company, if it has a place of business in India. However, such a company must file the relevant documents with the Registrar of the State (where incorporated) and also at New Delhi.

i) Certified copy of its charter or M/A and A/A

ii) Address and Place of Business.

iii) List of Directors and Secretary - their names and addresses.

iv) Contact person to serve notice etc.

b) If this procedure is not followed, the foreign company, may do business, but it cannot sue in the courts in India.

c) It may issue a prospectus, but must comply with all the requirements of the Companies Act.

d) It must maintain its accounts and file its balance sheets etc., as per the Companies Act.

Ch. *16. 7.* Government Companies (Sn. 617):

It is a company in which the paid up shares capital of fifty one percent and is held by the central Government or by a State Government or by State Governments or jointly by Central Government and State Governments. It includes a subsidiary company of a Government Company.

Some special provisions are applicable to such Government Companies.

i) The auditors of such companies are appointed by the Central Government on the advice of the Controller and Auditor General of India. The Auditor prepares annual audit report, which shall be submitted to the Annual General Body Meeting.

ii) Within 3 months of such meeting, a report on the affairs of the company should be placed before the Parliament or the State legislature, as the case may be.

iii) The Central Government by Gazette Notification declares what provisions of the Companies Act are applicable to such companies. It shall not appoint any Managing Agent. Further, the Govt. Company is not an Agent of the Govt.(Central or state) It has a juristic personality of its own. All other provisions of Companies Act are applicable to it.

Ch. 16.8. Holding Company and Subsidiary: Sn. 4.

a) Definition: Where one company called H is having control over another company called S, H is Holding Company and S is the subsidiary.

b) Modes of Formation:

i) If H Company controls the Board of Directors of S company, H is a holding company and S is the subsidiary.

ii) If H company holds a majority of the shares in S company, then H is a holding company and S, a subsidiary.

iii) If S company is subsidiary of H and C company is a subsidiary of S company, then C company is a subsidiary of H. (Majority holdings, or power of appointment of Directors in the test) :

c) Special Provisions:

i) The Holding Company should submit its Report to the Registrar, along with the balance sheet, audit report etc., of each of its subsidiary.

ii) A subsidiary is not allowed to have its membership or shares in the holding company.

Ch. 16.9. Bonus shares:

A Company which has undistributed profits may convert that into shares capital, by issuing bonus shares. These are ordinary shares, issued as fully paid up shares. These are issued in proportion to the holdings of the shareholders e.g. one bonus share to every 3 shares held.

The A/A must authorise the company to convert its accumulated undivided profits into bonus shares.

The bonus shares are financed from the above undivided profits, or from share premium account or from Capital Redemption Reserve Account.

Ch. 16.10. "Company Law Board" (Sn. 10 E) :

The Companies Act has provided for a Company Law Board to exercise those powers and to discharge those functions fixed on the Central Government by the Companies Act.

1. Composition:

It consists of 9 members. One of them is appointed as the Chairman, by the Central Government.

2. Powers and functions:

The Board is empowered:

i) To confirm any alteration of M/A or A/A

ii) To issue shares at a discount

iii) To call a general meeting.

3. Judicial Powers:

It is deemed to be a Civil Court. The Board has the powers of the Civil court in the following:

i) Inspection of documentary evidence,

ii) To enforce attendance of witnesses,

iii) To examine witnesses on Oath.

iv) To punish for Contempt of the Board.

v) To execute its orders.

4. Appeal:

From the orders of the Board, appeal is allowed to the High court, by any person who is aggrieved by the order, within 15 days from the date of receipt of such order on any question of law.

Ch. 16.11: Defunct Company: Sn. 560.

If a Company exists for name's sake without doing any business as per its M/A or A/A, but continues on the register of Companies in the Registrar's office, without being dissolved, the Registrar is empowered under Sn.560 to strike off the name of the Company from the register. The reason is, no useful purpose is served by continuing its name in the Register Before doing so, he should issue notices and

if no reply is received, he should publish in official Gazette., Then after giving 3 months notice, he may strike off the name, in which case, the Company stands dissolved.

Courts Power:

If the Company, or a member or a creditor is aggrieved, a application may be filed to restore the name on the register. If the Court is satisfied, at its discretion, it may issue on order to restore the name of the Company in the Register.

Courts have power to declare such removal as void. (Wood V. Martin]

The period of limitation is 20 years.

[Purushotham Dass V. Registrar]

THE END