

Biyani's Think Tank

**Concept based notes**

# Company Law & Secretarial Practice

[B.Com. Part-II]

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# Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concept of the topic. The book is self-explanatory and adopts the “Teach Yourself” style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the reader for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director (Acad.)* Biyani Group of Colleges, who is the backbone and main concept provider and also have been constant source of motivation throughout this endeavour. We also extend our thanks to M/s. Hastlipi, Omprakash Agarwal/Sunil Kumar Jain, Jaipur, who played an active role in co-ordinating the various stages of this endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and the students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

**Author**

# SYLLABUS

## **Paper-I : COMPANY LAW AND SECRETARIAL PRACTICE**

### **Section-A**

Definition, essential characteristics and kinds of companies. Detailed study of Public, Private, Government Companies and a demmed Public Company. Provisions regarding Incorporation and raising of capital through shares, Debentures and Public Deposits and concessions of Private Company, Promoters, Memorandum of Association and Articles of Association Prospectus, Statement in lieu of Prospecturs, Membership of a company, Alternation and Reduction of Share Capital.

### **Section-B**

Management of companies - Board of Directors, Managig Director. manager, managerial Remuneration, Powers, Position and Responsibilities of Directors, Prevention of oppression and mismangement. Winding-up of companies.

### **Section-C**

The Position of a Untitled1Company Secretary in the Organisation structure of a Company, Duties and qualification of a Company Secretary. Law and Practice relating to (i0 Allotment of Shares (ii0 Forefeiture of Compnay shares and re-issue of forfeited shares. (iii) Transfer and Transmission of Shares. (vi) Payment of Divident. (v) Company Meetings, Resolution. Notices, Agenda, Quorum and Minutes.

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## Short Question

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**Q.1 Define Company under Company Law.**

**Ans.:** In terms of Section 3(2)(i) of the Companies Act, 1956, a company means “A company formed and registered under company Act 1956 or an existing company. An existing company means a company formed and registered under any of the former companies Act.”

**Q.2 What is Body Corporate?**

**Ans.:** According to Section 2(7), Body Corporate or Corporation includes a company incorporated outside of India but does not include as follows :

- (i) A corporate sole.
- (ii) A cooperative society registered under any law relating to co-operative societies.
- (iii) Any other body corporate declared by Central Govt. in its gazette.

**Q.3 What do you mean by holding company?**

**Ans.:** According to section 4(4) a company shall be deemed to be holding company of another if but only if that other is its subsidiary. Hence, a company has control over another company, the controlling company is known as holding company and the company is known as holding company and the other company is known subsidiary company.

**Q.4 What is a Government Company?**

**Ans.:** According to Section 617 “a Govt. company means any company in which not less than 51% of the paid up share capital is held by the following :

- (i) By the Central Govt;
- (ii) By any State Govt. or Governments; or
- (iii) Partly by Central Govt. And partly by one or more State Governments.

A subsidiary of a Government Company is an also Government Company.

**Q.5 Foreign companies?**

**Ans.:** According to Section 591(1) "A foreign company is the company which is or has been incorporated outside India but establish or has established a place of business within India."

**Q.6 What is one man company?**

**Ans.:** It is also known as family company. The one man holds entire share capital of the company. Other person holds only the minimum or negligible number of shares in the company.

**Q.7 Who is a promoter?**

**Ans.:** A promoter is a person or group of persons who conceives an idea regarding the formation of a company for the first time. He also takes necessary steps for formation of a company and takes other essential steps for its incorporation, raising of capital and making it a going concern.

**Q.8 What is commencement of business certificate?**

**Ans.:** A public company cannot start business without it. Hence, a public company before start of business must get a certificate that is called Commencement of Business Certificate. At the same time a public as well as private company must also commence its business within one year of its incorporation.

**Q.9 What is Ultra Vires?**

**Ans.:** It is composed of two Latin words i.e. Ultra and Vires. Ultra means beyond and vires means power. Hence ultra vires means beyond one's power. In the context of company law, ultra vires means the acts beyond the legal powers or objects of the company. If a company acts/contracts beyond the memorandum either expressly or impliedly, it is null and void.

**Q.10 How doctrine of Constructive notice is opposed to the doctrine of indoor management?**

**Ans.:** This is against the principle of constructive notice which protects the company against outsiders for notice given to all due to public documents on the other hand doctrine of indoor management believes that internal management of the company and rules are according to memorandum and Articles. In case of irregularity and mismanagement, then the company will be held liable.

**Q.11 What is abridged prospectus?**

**Ans.:** Abridged means which is in brief and it is a memorandum containing such salient features of a prospectus prescribed.



**Q.12 What is Statement in lieu of prospectus? Explain the varying conditions of issue of it.**

**Ans.:** If a company requires to get shares or debentures amount from the public. The private company is restricted but the public company is required to issue prospectus. But some time the company privately managed the funds in such a case statement in lieu of prospectus ;must be filed at least three days before the allotment of shares or debentures; so it is substitute to prospectus.

**Q.13 Define a Director?**

**Ans.:** The Supreme Court of India defines "A person who guides policy and superintends the working of a company, is a director". The name by which he is called is immaterial. The term includes a Managing Director

**Q.14 How many directorships can be held by an individual?**

**Ans.:** No person shall hold office at the same time as director in more than fifteen companies. If he does work more than this limit, he has to resign more than fifteen companies.

**Q.15 Define Company Secretary?**

**Ans.:** According to Section2(45) of the Company Secretaries Act 1980 includes any individual possessing the prescribed qualifications and appointed to perform the duties which may be performed as Secretary under the act and any other ministerial or administrative duties.

According to Section 2(1)(C) of the Company Secretaries Act "Company Secretary means a person who is a member of the Institute of Company Secretaries of India."

**Q.16 What is stock of a company?**

**Ans.** Stock is the total of fully paid up shares of a company.

**Q.17 What is Debenture?**

**Ans.** Debenture means a document which either creates a debt or acknowledges the debts company has taken it from the debenture holder.

**Q.18 What is allotment of share?**

**Ans.** The term allotment of share means allotment is the acceptance by the company of the application (offer) made by an individual to take shares in a company. It does not include re-issue of forfeited shares.

**Q.19 What do you mean by member of a company?**

**Ans.** Member is a person whose names has been entered in the register of members because he has subscribed to the memorandum of the company or he agreed in

writing to become member of the company or his name has been entered in the records of the register of members shall be the number of the company (sec. 41). If a person agrees to become director of a company and promises to take qualification shares, he may also becomes a member of a company.

**Q.20 Can a minor become member of a company?**

Ans. A minor cannot become member of the company because he is incompetent to enter into contract, hence any agreement made by him is ab-initio void. When the shares are fully paid up them a minor through his lawful guidance, apply for registration of a transfer of shares in the name of minor but a minor can be transfer of fully paid shares.

**Q.21 What is qualification share?**

Ans. Accordingly to clause 66 of table 'A' provides that atleast one share in a company should be taken by the director that is called the minimum qualification.

**Q.22 What do you mean by Director?**

Ans. A Director is a person or one of the persons through whom the company acts, who guides the policy, manages and controls or superintendents the affairs of the company.

**Q.23 What is the maximum number of directorship can be held by an individual?**

Ans. According to section 275, No person shall hold office at the same time as director in more than fifteen companies. If any person hold more than 15 companies immediately before the commencement of the companies (amendment) Act, 2000 shall, within two months from such commencement shall have to resign from more than fifteen posts.

**Q.24 What is share warrant?**

Ans. A share warrant is a document issued by a public company to its shareholders under its common seal by converting the share certificates issued narrating that the bearer of the warrant is entitled to the shares which are fully paid up and which are mentioned therein under common seal.



**Q.25 What is Share Certificate?**

Ans. A share certificate is a document of title of share issued by a company under company's common seal which declares that the person whose name written therein is a bon a fide holder of company's share specified in it.

**Q.26 What is irregular allotment?**

Ans. Irregular allotment has been made when -

- (i) Without receiving the minimum subscription under section 69 or
- (ii) Without finding the prospectus /in lieu for registration under section 70.

**Q.27 How much donation may be contributed by a company to the national fund?**

Ans. Companies can contribute the donation as much as amount desired to the National defence fund. There is no limit for it.

**Q.28 What is the maximum limit of managerial remuneration in a company?**

Ans. In cash of public company or its subsidiary the maximum managerial remuneration in a year shall not exceed 11 per cent of the net profit of the company.

**Q.29 How much donation may be company contribute to the political parties?**

Ans. The maximum limit of managerial remuneration which may be paid by a public company or its subsidiary in respect of a financial year shall not exceed 11 per cent of the net profit of a company.

**Q.30 What is meant by 'Manager' under Companies Act, 1956?**

Ans. According to section 2(24) "Manager means an individual (not being the managing agent) who subject to the superintendence, control and direction of the Board of directors, has the management of the whole or substantially the whole of the affairs of a company and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not".

**Q.31 What do you mean by Managing Director?**

Ans. According to section 2(26) defines that "managing direction" means a director who by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its articles of association, entrusted with substantial powers of management which would not otherwise be exercisable by

him and includes a director occupying the position of a managing director, by whatever name called."

**Q.32 What do you mean by oppression?**

Ans. Oppression is any act exercised in a burdensome, harsh and wrongful manner. In relation to companies it implies unjust or unfair dealing in the affairs of a company which is harshly, burdensome or prejudice to some portion of the members of the company.

In brief, oppression takes place when the affairs of a company are brought conducted in a manner which is harsh, burdensome or unfair or prejudicial to the interest some portion of members of the company or to public interest.

**Q.33 What do you mean by winding up of a company?**

Ans. The term winding up is a process by which the dissolution of a company is brought about. Under this process a liquidator is appointed to realize the assets, pay the debts of the company out of assets so realized and to distribute the balance, if any among the members of the company.

**Q.34 What are the various modes of winding up?**

Ans. A company may be winding up in any of the following ways:

- i) Winding up by the tribunal
- ii) Voluntary winding up. This may be of two types:
  - (a) Members' voluntary winding up and
  - (b) Creditors' voluntary winding up.

**Q.35 Which party may apply for winding up?**

Ans. The following may apply for winding up as an individual or collectively-

- (i) The Company
- (ii) Creditors
- (iii) Registrar
- (iv) Central Government
- (v) Any contributory
- (vi) Liquidator

**Q.36 When winding up process commences?**

- Ans. i) The winding up process is deemed to commence from the date a resolution is passed by the company for winding up by the court.
- iii) In all other cases from the time of the presentation of the position for winding up.

**Q.37 What is mismanagement?**

Ans. Mismanagement exists in the following cases :

- i) When the affairs or the company are being conducted in a manner prejudicial to public in trust or to the company's interest.
- ii) When by reason of a material change in the management or control of a company are likely to be conducted in a manner prejudicial to public interest or to the company's interest or to the company's interest.

**Q.38 What is member's voluntary winding up of a company?**

Ans. When members voluntary wish to wind up a company and the majority of the director at a meeting of the board makes a declaration of solvency of the company and deliver it to the registrar within the definite period of time. It is called members voluntary winding up.

**Q.39 What is creditors' voluntary winding up?**

Ans. When a company passes a resolution for winding up of the company without making declaration of solvency by its directors or directors make such declaration and company fails to pay its debts within the definite period mentioned in the declaration, such winding up is called as creditors' voluntary winding up.

**Q.40 What is renunciation of allotment?**

Ans. It is situation when an allottee of shares in a public company renounces all or a certain number of shares allotted to him in favour of another person, it is called renunciation of allotment of shares but is requires and permits by its articles of association.

**Q.41 What is splitting of allotment?**

Ans. When shares are allotted in large numbers to an allottee by one allotment letter. It becomes difficult to sell and transfer the shares in the market. In such a case, the allottee requests the company to letter into a number of allotment letters in market lot or other desired lot. Therefore, when company issues such multiple allotment letters or requested by the allottee, it is to be splitting of allotment.

**Q.42 What is meant by calls on shares?**

Ans. A call on shares is a demand made by the Directors of a company on the holders of shares to a part or whole of the amount.

**Q.43 What is calls in arrears?**

Ans. Calls in arrears means a sum called in respect is not paid before or on the day fixed for payment the person from whom the sum is due shall pay interest thereon from the day fixed for payment to the day of actual payment. The person is liable to pay a definite rate of interest specified in the articles or at lower rate fixed by the directors is called calls in arrears. The board shall be at liberty to waive payment of any such interest, wholly or in part.

**Q.44 Does shareholder making payment of calls in advance entitle to any voting right?**

Ans. No, the shareholder made payment of calls in advance does not entitle to any voting rights until the same becomes payable by virtue of a call made by the company.

**Q.45 What is surrender of shares?**

Ans. When a shareholder is unable to pay the call due on his shares, he gives up the shares and rights attached thereto by a shareholder to the company.

**Q.46 What is meant by forfeiture of shares?**

Ans. It means confiscation of shares and termination of membership of a member by the Board of Directors (B.O.D.) by way of penalty for non-payment of any call over due on such shares.

**Q.47 What is balance ticket?**

Ans. It is a certificate which certifies that the shareholder whose name therein has delivered a share certificate for transfer of certain number of shares and shareholders is still entitled to the balance of shares as specified in it.

**Q.48 What is blank transfer?**

Ans. In a blank transfer a shareholder takes a transfer deed and fills in it the name of the company, number of shares sold his name and sign it and deliver to the same to the subsequent buyer; it is called Blank transfer.

**Q.49 Clearly explain forged transfer of share.**

Ans. When a transfer of shares founded upon forged transfer deed on the transfer does not sign the transfer deed but his signatures are forged on the deed, such transfer is called forged transfer.

**Q.50 What is Transmission of shares?**

Ans. When the shares of a member are transferred to another person by operation of law, it to be the transmission of shares. It happens generally, on the death of a member, insolvency and lunacy.

**Q.51 What is dividend?**

Ans. Dividend is that part of corporate profit which is used for distribution amongst the shareholders by the general meeting to be distributed among the shareholders of the company on the recommendation of its board of Directors.

**Q.52 Explain Interim dividend?**

Ans. Declaration of dividend by the director's in the anticipation of profit before the close of the year to which it is declared and paid shall apply to any interim dividend.

**Q.53 What is meant by meeting of the company?**

Ans. A meeting is a gathering or assembly of two or more persons at a pre-decided date, time and place for transacting certain lawful business of the company concern.

**Q.54 What is meant by Agenda of meeting?**

Ans. Agenda means a statement of the business to be transacted at meeting.

**Qs.55 What do you mean by quorum?**

Ans. The term quorum means the presence of certain minimum member of members which is required at a meeting for transacting its business. Without quorum, the proceedings of the meeting are invalid.

**Q.56 What is Amendment motion?**

Ans. If any alteration proposed by any member in the main motion before it is voted upon and adopted is called amendment motion.



**Q.57 Who is a proxy? To whom can be appointed as proxy?**

Ans. A proxy is a person who is authorized by a member of a company to attend and vote at a meeting on his behalf. A proxy is also an instrument authorizing a person to attend the meeting and cast vote. The instrument appointing a proxy must be in writing and must be signed by the appointer.

**Q.58 What is meant by "Minutes of meeting"?**

Ans. Minutes refers to the official record of the proceedings of a company meeting or the business transacted at a meeting. Its main purpose is to maintain official record and preserve it as decision reached at a meeting in brief.

**Q.59 What do you mean by motion?**

Ans. A motion is a definite proposal submitted for discussion and decision before a general meeting. It is consideration and adoption.

**Q.60 What is resolution and what are kinds of resolutions?**

Ans. A resolution is a formal decision of a meeting on any proposed presented for vote and passed by majority, it becomes resolution.

There are three types of resolutions as follows:

- i) Ordinary resolution
- ii) Special resolution and
- iii) Resolution requiring special notice

**Q.61 What is meant by ordinary and special resolution?**

Ans. Ordinary resolution means which is passed by ordinary majority i.e. member of votes is in yes is more than no. On the other hand special resolution is passed by three fourth majority.

**Q.62 What is meant by statutory meeting?**

Ans. Section 165(1) of the companies act lays down that every company limited by shares and by guarantee and having share capital must hold a general meeting of its shareholders within a period of six months but not earlier than one month from the date on which the company is entitled to commence is called the statutory meeting. It is held only once in the life time of the company. Private companies exempted from holding this meeting.



**Q.63 What do you mean by Annual General Meeting?**

Ans. Every company is mandatory to held at least one meeting of its member during a calendar year is called AGM.

**Q.64 What is meant by extra-ordinary General Meeting?**

Ans. All general meeting other than the statutory General Meeting and annual general meeting is called all extra-ordinary general meeting. It is to be held during the period between two general meetings.

## CHAPTER-II

# Meaning and Nature of a Company

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**Q.1. "A company is an artificial person created by law, having a separate entity with a perpetual succession and common seal". Explain the above statement and briefly describe the characteristics of a company.**

**Ans.: Meaning of Company :** The term company is a voluntary association of persons formed and registered for certain common persons under the present provisions of company law. It exists in the contemplation (eye) of law. It is an artificial person having separate entity from its members with perpetual succession and common seal. The liability of the members is limited. The capital of the company is divided into transferable shares and shareholders are called members.

**Definition of the Company :** Company may be defined under three main heads :

A) Definition given under law

B) Definition given by professors/prolific writers

C) Definition given by judges

(A) **Definition according to Law :** According to the companies Act 1956, a company means "A company formed and registered under the companies Act 1956 or an existing company.: [Section 3(1)(i)]. An existing company means a company formed and registered under any of the former Companies Acts."

This definition is not clear about the elements of a company. Hence definitions given by Professors can be explained.

- (B) **Definitions by Famous Writers** : Professor Haney defined ...." A company is an artificial person created by law", having separate entity, with a perpetual succession and common seal."
- (C) **Definition** : Definition given by Judges. According to Justice (C.J) Marshall "A company is an artificial person created by law, having separate entity, with a perpetual succession and common seal."

To conclude, a company may be defined as an incorporated association of persons, which is an artificial legal person in the eye of law, having an independent legal entity, with a perpetual succession, a common seal, a common capital comprising transferable shares and carrying limited liability. Sometimes it is also called Corporation.

#### **Characteristics of a Company :**

- (1) **Voluntary Incorporated Association** : For the formation of a company ;registration is compulsory under the Company Act otherwise it will become illegal association of persons. It is voluntary and statutory association; hence it is also called body corporate. It is formed by consensus.
- (2) **Number of Members/Subscribers** : For incorporation/registration of a company, minimum seven persons in case of public company and two in case of private are required. The maximum number of members in case of private company may be 50 but for a public company, no limit of members.
- (3) **Artificial Personality** : A company is an artificial, invisible and intangible person, it exists in the eye of law. It is not natural person because it has no physical body, no soul and no conscience.
- (4) **Separate Legal Entity** : A decision is given in case of Soloman v. Soloman & Co.(1877) that a company has distinct legal entity from its members. It has its own legal existence independent of its members. It has its own name, can sue and be sued by its members and even by outsiders. A member can enter into contract with his company in the same manner as other individuals.
- (5) **Perpetual Succession** : Company is created and wind up by law alone. It's existence is ;not affected by the lanacy, retirement, death or lunacy of its members. Man may come, man may go but company goes on for ever like water of river may change but the river like the Ganga is still existing.
- (6) **Common Seal** : Company is an artificial person, hence cannot sign like a natural person, thus the common seal which is engraved should be affixed on any documents for authentication and legally binding on the company.

- (7) **Limited Liability :** The Principle of limited liability for business debts is one of the principal advantages of doing business under the corporate form of business organization. In case of a company limited by shares, the liability of a member is limited to the nominal value of the shares held by him. In case of company limited by guarantee will be liable to pay the amount at the time of winding up of the company.
- (8) **Share Capital :** Every company have to require share capital according to law Section 3(1) of Indian Company - a public company is ;required to have a minimum paid up capital of Rs.5 lakh and a private company must have Rs. One lakh. But, in case of companies engaged in promotion of commerce, art, science, religion, etc. need not require to have minimum paid up capital.
- (9) **Transferability of Shares:** Section 82 of the companies Act, 1956, provides that "the shares; or other interest of any member shall be movable property, transferable in a manner provided for in the articles of the company. Therefore, a member may - (A) sell his shares in the open market, or (B) transfer his shares to anybody he likes in a public Limited company as per conditions laid down in the articles of the company. However, there are certain restrictions on the transfer of shares in respect of private limited companies as the very nature of the company indicates, namely private
- (10) **Separation of Ownership and Management:** A company has a right to own and transfer property since it is a legal entity. A shareholder has no proprietary right in the property of the company but merely to their shares. Therefore, the claims of the company's creditors will be against the company's property and not that of the shareholders. A Company can sue and is being sued for enforcement breach of legal rights as the case may be. The decision was given in the case of Gramophone & Typewriter Co Ltd., vs. Stanley (1908),
- (11) **A Company is not a Citizen:** A company on incorporation assumes a legal personality distinct from its members, but it cannot claim to be a citizen of a country under the constitution of India or the citizenship Act, 1955. Hence, the company cannot claim the fundamental rights guaranteed under the constitution. However, it has certain rights protected under our constitution as a legal entity which is guaranteed to all persons whether holding the citizenship or not. The company is mere abstraction or creation of law on the other hand, the company is deprived of citizenship, has a nationality, domicile and residence. Its domicile is the place of its registration and it is attached to it as long as it is in existence. This establishes the residence of a company at that place where central control and Management of its business is located or exercised. This residence

business is located or exercised. This residence of the company gives jurisdiction to the taxation.

- (12) **Separate Property** : The property of the company is not the property of share holders. It can acquire and keep it in its own name. No member has either individually or jointly a right to the assets of a company during its life or on its winding up. If all the shares be taken by one man, the man cannot insure the property of a company because he does not have insurable interest.
- (13) **Act within Intra Vires** : A company cannot work beyond the scope of memorandum of association. Acts made beyond the scope of memorandum result into ultra vires.
- (14) **Democratic Management** : It is managed by the board of directors, elected by the members of the company. Day to day decisions is taken by the concerned Managers. The shareholders cannot take part in the decision process directly.
- (15) **Governance by Majority** : Company is managed by rule of majority decision is taken by simple or special majority.
- (16) **Statutory Obligations** : A company is required to comply with various statutory obligations regarding management. For instance, filling balance sheets, maintaining proper accounts books, registers and filing annual return and P & LA/CS duly audited are statutory obligations of a company.
- (17) **Separate Name** : Every company must have specific name which must be registered. Once company's name is registered. It must be painted or affixed on the outside of every officer or place of business.
- (18) **Raising of Capital on a Large Scale** : A company can raise the capital on the large scale by selling its shares to the public at large.
- (19) **Shareholders are not the Agents of Company** : Shareholders have only invested capital in the company but their entity is different from that for their company. The company is not bound by its shareholders.
- (20) **May Assume Enemy Character** : Company exists in the eye of law as legal person hence it cannot become a friend nor an enemy. A company may be regarded as enemy company if the persons in control of its affairs are residents in the enemy country or are acting in accordance with directions or instructions of the enemy.



**Q.2. What is lifting of corporate veil? Explain the circumstances under which the corporate veil of a company may be lifted.**

**Ans.:** “Corporate veil” here refers to the ‘partition’ or ‘curtain’ between the company and its members. A company being given a legal status, all dealings with the company will be in the name of the company and men behind the company are disregarded. Lifting of corporate veil is a fiction of law, which means disregarding the separate legal entity of a company and identifying the realities which lay behind the legal façade. In applying this doctrine, the court ignores the company and concern itself directly with the members or directors.

This doctrine of lifting the corporate veil is understood as identification of a company with its members when individual member may be held liable for its acts or titles to property. The corporate veil may be lifted when the directors or members use the legal entity of the company for any fraudulent or dishonest purpose or to defeat provisions of the law, public interest or to defeat crime.

The corporate entity is disregarded in exceptional cases which are categorized into :

(1) Excess or Violation of Statutory Provisions

(2) Judicial Interpretation

(1) **Excess Statutory Provisions :**

(i) **Reduction of Membership below Statutory Minimum :** Under section 45 of companies Act, 1956, a company is privileged to carry on its business with a limited liability for six months when the member is reduced below seven in case of a public company and below two in case of a private company. Beyond this period of six months, the members will be held individually liable for debts contracted by the company.

(ii) **Prevention of Fraud or Improper Conduct :** The legal personality of a company is disregarded when registration is used for fraudulent purposes like defrauding creditors, defeating or circumventing law. In such cases, the court may declare those who are responsible for such conduct, personally liable for all the debts of the company without any limitation of liability (See 542). In such a situation the court is empowered to fine. The corporate veil and identify the persons who defrauded to the creditors or any other persons.

(iii) **Misstatement in Prospectus :** Every person who is responsible to issue the prospectus will be held liable in case of misstatement in prospectus. He will be held liable to pay compensation to every person who bought the shares on the honesty and faith of the

prospectus. For any loss or damages, the aggrieved party can claim from such person who believed on the prospectus (See 62(ii)).

- (iv) **Mis-description of a Company** : Each company is required that its name must be fully and properly mentioned on the documents, contract or negotiable instruments like cheque, Bill of exchange and promissory note. This is mentioned under section 147, failing which the person who has committed the act or made a contract is held personally liable for it. Hence, the court lifts the 'veil' where a company is merely a cloak, or a sham
- (v) **Holding and Subsidiary Companies** : Both these are having separate legal existence. But for establishing a proper relationship of a holding and subsidiary company, the court may lift the corporate veil and probe behind it to fix up the persons who control the companies. This is necessary to determine how far a subsidiary company is independent. It is quite possible that subsidiary company may be only a branch of the holding company depending upon how the board of directors is constituted and how the profits, the control and conduct of the subsidiary is conducted.
- (vi) **Investigation of the Affairs of the Company** : Section 239 empowers ;the appointment of an inspector to investigate into the affairs of a company. He will also investigate the affairs of anybody corporate in the same management or group of contral. The object is to investigate the affairs of some companies which are so related that it is necessary or if it is felt necessary to bring the affairs of these companies under investigation.
- (vii) **Investigation of Ownership of a Company** : A company may be investigated by the central government if it is satisfied that it has sufficient ground to investigate. It may appoint the inspectors to investigate and report on the membership or any company or any matters related to the company for the purpose of deciding the true persons who are financially entrusted in the company and who control and materially influence the policy of the company under section 247 by lifting the corporate veil.
- (viii) **Failure to Refund Application more or Excess Money** : Under the following cases, the directors of the company are jointly ;and severally liable to refund the application money or excess of application money :
  - (a) Under Section 69(5) in case no shares are allotted to the applicants.



- (b) Under Section 73(2) the stock exchange did not allow to issue and allot shares.
  - (c) In case of excess money received from applicants for issue of shares that have been allotted.
  - (ix) **Directors with Unlimited Liability** : According to Section 322, if the liability of Directors of public limited is unlimited, in such a case liability of director will be unlimited and he will be personally held liable.
  - (x) **Non Payment of Income Tax** : In case of Section 197 of Income Tax Act, company is liable to pay Income Tax. If not paid then the court will lift the corporate veil and the Director of the Company will be held responsible for the default.
- (2) **Judicial Interpretation:**
- (i) **Determination of Character of the Company** : A company may assume an enemy character when person in de facto control of its affairs are residents in an enemy country. Hence, when a company is suspected of being owned or controlled by enemies, the court may lift the corporate veil and examine the persons constituting it. This is necessary during the time when two countries are at war. This was decided in the famous case of Daimler Company Ltd. vs. M/s Continental Tyre and Rubber Co. As said, Daimler Company, registered in Great Britain was controlled by German residents. Thus, it is against public policy to allow alien enemies to trade under company organization. But a company registered here can carry on business in an enemy country and it is not treated as an alien enemy.
  - (ii) **For Benefits of Revenue** : In the interest of securing the revenue from those who are attempting to conceal it through corporate veil, the court will not hesitate to pierce this veil, particularly when the individual shareholders are avoiding to pay income tax. This action becomes essential. This can be explained with help of the case Sir Dinshaw Maneckjee (AIR-1977), where the assessee was enjoying the dividend and income from investment held by him. The investment was in four companies floated him only. The dividend and investment was again drawn by him as a sole trustee. Thus he was avoiding the tax revenue. In this case the company and assessee were held to be one and same. This was revealed only when the veil was pierced.

- (iii) **In case of Fraud and Misconduct :** The court will also lift the corporate veil where the company is formed to defraud creditors or to defeat the provisions of law or to avoid any legal obligations. This is fully shown in the case of *Gilford Motor Co vs. Horne (1933)* 1 Ch.935. In the present case Mr. Horne was appointed Managing Director of Gilford Motor Co on the condition that he would not solicit or entice away the customers of the company. In the meanwhile, Mr. Horne formed another company to carry on his own business and this company enticed the customers of Gilford Motor Co. It was hence, held that “the company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation.” Hence, it was held that it was a fraud committed by Horne for his own benefit by forming a company.
- (iv) **Company Acting as an Agent or Trustee of the Shareholders :** According to agency contract acts done by agent on behalf of Principal. The principal will be held liable. Where a company is formed for acting as an agent for its shareholders, the shareholders will be liable for the acts of the company. This is illustrated in the case of *F.G.Films Ltd; Re(1953)* 1. WLR.483. The English company acted as merely the nominee of an agent for American Company.
- (v) **Fixing Liability for Economic Offences :** If there are economic offences, the court may draw aside the veil of corporate entity. For example, offences done under FEMA, the Excise Act, Salestax Act etc. The person who have the ultimate control over the affairs of the Company may be held liable. The decision was given in the case of *Santanu Ray vs. Union of India (1989)*65 Comp. cases 196 Delhi.
- (vi) **Fixing Liability under Welfare Legislations :** In India, there are various legislation for welfare of the employees. Such as PF, Gratuity, Bonus are provided. If there is any default or offences under these above acts, the courts are empowered to lift the corporate entity and determine the persons responsible for committing offences or defaults. Sometimes a subsidiary company is formed to reduce tax liability under the welfare legislations. The courts are empowered to lift the corporate veil find the reality. In this context case may be illustrated workmen of associated rubber industry Ltd vs. *Associated Rubber Industry Ltd (1956)* 59 Comp cases 134).
- (vii) **Where the Company is used for Illegal Purposes :** In such a situation the courts are empowered to lift the corporate veil to

detect the real culprit. [(PNB Finance Ltd vs. S.P.Jain (1983) 54 camp cases, Delhi]

- (viii) **To Punish for Contempt of Court :** Where Corporate/Company entity is used for contempt of court, in such a situation the court may lift the corporate veil and punish the person who is responsible for contempt of court.

Case law - Jyoti Ltd vs. Kanwaljit Singh Kaur Bhasin (1987) 62 Camp.cases 626, Delhi.

- (ix) **Determination of Qualifications or Competence :** The court may also set aside the separate legal entity and lift the corporate veil in case of determination of qualifications or technical competence. Case Law - New Harisons Ltd vs. Union of India (1997) 89 camp cases 849 SC)

- (x) **When Company is Sham or Cloak :** If the company is incorporated to mere sham or cloak, in such a situation corporate veil may be lifted for knowing the reality.

Case Law - Delhi Development Authority vs. Skipper Construction Company P.Ltd [(1997) 89 camp. Cases 362 SC]

- (xi) **In case of Fraudulent Scheme of Management or Compromise :** If under section 349 of Company law 1956, company makes any fraudulent scheme of arrangement or compromise, then the corporate veil may be lifted. Case law - Bedrock Ltd [R.(1998) IT SCL 385 Bombay]

### Q.3 What is a Private Company? Distinguish between Private and Public Company.

**Ans.** The term Private Company means a company which has a minimum paid up capital of Rs.one lakh or more as may be prescribed by the articles :

- (i) Restricts the transfer of its shares from one share holder to another.
- (ii) Limits the number of its members to 50, excluding its present or past employees.
- (iii) Prohibits an invitation to the public to subscribe to its shares and debentures and
- (iv) Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives. Section 3(i)(III) amended Act 2000

To distinguish well it is necessary to know what is a public company? A public company is a company which (i) is not a private company (ii) has a minimum paid up capital of rupees five lakh or such higher paid up capital as may be prescribed. (iii) The subsidiary of a public company is also a public company [Section3(1) as per amendment Act, 2000]

**Distinction between Private Company and Public Company :**

S.No.	Basis of Distinction	Private company	Public company
1-	Minimum Capital	It requires atleast 1 lac or more as paid up capital.	Min. paid up capital of Rs.5 lacs or more as prescribed.
2-	Membership	In case of private company, minimum atleast two and maximum 50 members are required.	Min.7 and no limit of maximum of persons.
3-	Transfer of Shares	Transfer of shares is restricted by its articles and its shares cannot be transferred.	The shares of public company are freely transferable from one person to another and they can be quoted on the stock exchanges. A public company must file a prospectus with the registrar before allotting shares.
4-	Prospectus	It is not needed to file a prospectus or statement in lieu of the prospectus.	A public limited company must file a prospectus with the registrar before allotting shares.
5-	Statement in Lieu of Prospectus	It need not be issued before allotment of shares.	In case of public company, if it issues shares to its existing members or directors or to their relatives or friends it must file a statement in lieu of prospectus to the registrar earlier to allotment of

			shares.
6-	No. of Directors	Atleast two directors are required in case of private company.	3 Directors are required in case of Public Company.
7-	Commencement of Business	A private company can commence its business after obtaining certificate of incorporation.	Contrary to it, a public company can start its own business merely after obtaining certificates of commencement of business.

S.No.	Basis of Distinction	Private company	Public company
8-	Right Shares	In case of private company, the existing share holders have no right to get allotment in further issue of shares.	A public company can commence its business only after getting Certificate of commencement of Business.
9-	Statutory Meeting and Report	A private company need not hold any statutory meeting to file to the registrar.	A public limited company is required to hold a Statutory meeting and file a statutory report with in the specified time to the registrar.
10-	Directors' Consent	The Directors of private company are not required to file with written consent to work as directors to the registrar of the company.	But in case of public company, it is required to do so.



11-	Appointment of Directors	All the directors may be appointed by the single resolution.	But contrary to it, in public company, a separate resolution is required for appointment of each director atleast two third directors of public company must retire by rotation at every general meeting.
12-	Retirement of Directors	Here directors are not required to be retired by rotation.	Atleast two third directors of public company must retire by rotation at every general meeting.
13-	Maximum No. of Directors	More than 12 directors may be appointed without the approval of Central Govt.	Beyond 12 directors cannot be appointed without the consent of central govt.
14-	Quorum	If two members personally present in the meeting, can form quorum of the meeting.	For legality atleast five members must be present personally to form quorum of the meeting.
15-	Managerial Remuneration	There is no fixed limit of remuneration in case of a private company.	It cannot exceed the limit of 11 per cent of the net profit.

S.No.	Basis of Distinction	Private company	Public company
16-	Share Warrant	Cannot be issued in case of a private company.	With the consent of central government, it can be issued.
17-	Loan to Directors	With the consent of central Govt. it can grant loans to its Directors.	Without the approval of the Central Govt. public company cannot grant loan to its Directors.



18-	Provisions as to General Meetings	It can prescribe its own regulations regarding the general meetings.	It follows all the provisions of company law in this context.
19-	Index of Members	It is not required in case of private company.	But it is a must in case of index of members if its membership is beyond 50.
20-	End Words of the Name	A Private Company have the words "Private Limited" in its name.	But the Public Company must have only the word "Limited" in its name.
21-	Preparation of Articles	A private company has to prepare articles of Association.	In case of public company, need not to prepare article of Association, it can use table 'A'.

**Q.4. Discuss the legal formalities that are required to be complied with under the Indian Companies Act, regarding the formation of a company.**

**Ans.:** Without incorporation a company cannot be formed. It comes into existence only after registration and issue of certificate of incorporation. A promoter for registration takes the following steps.

- (1) Preliminary Steps
  - (2) Delivery of Documents to the Registrar
  - (3) Scrutiny of Documents by the Registrar
  - (4) Obtaining Certificate of Incorporation
- (1) **Preliminary Steps** : Following preliminary steps are taken by promoter for registration :
- (i) **A Promoter decides the type of Company** : either private or a public company he wants to be registered. It will be either limited by shares or guarantee or with or without share capital. The company may be registered with unlimited liability
  - (ii) The promoter also decides the place of registered office of the company. If the proper place is not decided then the name of state is at least decided by him.
  - (iii) **Selecting the Name of the Company** : The promoter also suggest four names of a proposed company as alternatives in form 1-A with

a free of Rs.500 to the registrar of the company to decide about the availability and desirability of the name out of four names. This name will be decided by the registrar within seven days it will be reserved for six months.

- (iv) **Drafting Memorandum** : The promoter may draft the memorandum with help of his solicitor, company secretary and etc.
  - (v) Drafting of Articles of Association for private company is essential but for a private company it is optional in place of it, it can use Table-A.
  - (vi) **Vetting of the Drafts** : The registrar may help in avoiding mistake and unnecessary delay in avoiding mistake and unnecessary delay in registration of the company.
  - (vii) **Printing of Memorandums** : Such as Memorandum and Articles of Association are required to be printed by the promoter.
  - (viii) Stamping on both the documents is a must according to laws applicable to them.
  - (ix) **Signature by the Subscribers** : Atleast 7 and 2 in case of public and private company respectively, signed by the subscribers on these public documents. In case of illiterate subscriber, he may give his thumb impression or mark.
  - (x) **Dating** : The subscribers must mention the dates on both the documents but not before the date of stamping.
  - (xi) **Statutory Declaration** : The legal compliance is completed nothing remain to be declared in connection to registration of the company. It is duly signed by the competent person prescribed in the act.
  - (xii) Getting consent of directors that they will act as directors of the company by the promoter.
  - (xiii) Getting undertaking to take atleast one share which is called qualification shares by the director this consent is also taken by the promoter.
  - (xiv) Other contracts such as preliminary are to be drafted by the promoter.
- (2) **Delivery of the Documents to the Registrar** : The promoter delivers the following documents to the registrar.
- (i) Triplicate copies duly signed on printed copies of Memorandum of Association, which should be divided into different paragraphs each copy should be signed by the witnesses also.

- (ii) **Articles of Association** : Three copies duly printed, signed ;and evidenced by one witnesses should be submitted to the registrar. It is compulsory in case of private company but a public company may be exempted due to use of Table-A in place of Article of Association. It should also be dated and stamped.
  - (iii) The promoter also attach agreement copy with the whole time Managing Director or Manager.
  - (iv) Statutory Declaration by the advocate of Supreme Court or of High Court or An Attorney or a pleader who is entitled to appear before the High Court or a C.S/C.A.
  - (v) **List of Directors** : A list of persons who have agreed to act as Directors of the proposed company shall also be filed with other documents by the promoter.
  - (vi) A written and signed consent of directors shall also be submitted to the Registrar in prescribed form.
  - (vii) A written undertaking to take atleast one share known as qualification share shall also be filed with the Registrar.
  - (viii) **Information of Registered Office** : The promoter is also required to intimate about the registered office address or if not possible of location, then name of state so that the full address of the location may be submitted within 30 days of the registration of the company.
  - (ix) Copy of the letter confirming availability of the name of the company must be submitted by the company.
  - (x) **Power of Attorney by any Subscriber** : The corporate subscriber must be given power of attorney to any specific person who can sign on memorandum. They should also be given the power of attorney to make corrections also.
  - (xi) Document in support of payment of fees. The fees receipt is also to be attached in the file.
- (3) **Scrutiny of Documents** : When the promoter duly file all the documents relating for incorporation to the registrar, the registrar then will scrutinize these documents from legal point of view. If all the documents found correct, he may issue a certificate of incorporation, but if finds any minor defect in the documents, then he may require for rectification. But if there is no defect, then he may be compelled to register if he denies.
- (4) **Certificate of Incorporation** : When the registrar ;after scrutiny of document feels satisfaction regarding formation formalities, he may retain

all the relevant documents with him and he shall issue a Certificate of Incorporation to the company.

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## CHAPTER-3

# Memorandum of Association and Articles of Association

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**Q.1. What are memorandum of Association and Articles of Association. Make out clearly Relationship and the difference between the two?**

**Ans.:** Memorandum of Association is the charter of the company. It is generally called the constitution of the company which contains all those fundamental conditions upon which alone a company is incorporated. It is the foundation on which the complete structure of the company is to be built up. It includes six clauses namely, name, registered office, object, capital, liability and subscription clauses. It explains the scope and limitations of the company and it establishes the relationship between the company and the outside world.

**Article of Association :** It is another document which is very important document for the company. It includes all the rules, by laws and procedures for management, administration and control of a company. It directs and supervises the employees, officers, and management of the company regarding the conduct of Business. It establishes the relationship between the company and its employees.

**The Relationship between the Two :** Both the documents are very important for the company. They may be regarded as two blades of the scissor, or two wheels of a vehicle or two legs of an handicapped. Memorandum states the limitations within which a company has to work. While articles of association drafts the guidelines for management and administration of the company. Memorandum decides what is to be done, while Articles of Association decides how can it be done. These two are supplementary to each other.

The relationship between the two can be explained as follows :

- (1) Articles of Association are subsidiary to the Memorandum of Association. Articles of Association can be made only within the limits as decided by

the Memorandum of Association. Articles cannot go beyond the Memorandum of Association.

- (2) **Supplementary to Each Other :** These two documents are not competitors to each other but they are supplementary to each other. Memorandum directs for the limit and power of the company whereas Articles of Association guides for the internal Management of the company.
- (3) Articles of Association cannot amend a memorandum of Association, because articles of Association are subsidiary of the Memorandum. They cannot control/amend the memorandum.
- (4) Memorandum states objects while articles provide the manner in which objects may be attained.
- (5) Memorandum can be explained as constitution or foundation stone where as articles are relating to internal regulations.

**Distinction between Memorandum and Articles of Association :**

S.No.	Basis of Comparison	Memorandum of Association	Articles of Association
1-	Meaning	It is the charter of a company which defines the fundamental conditions upon which the company is incorporated.	It is a document which contains the rules and regulations for the internal affairs of a company.
2-	Definition	It is defined under section 2(28) of company law, 1950.	But is defined under Section 2(2).
3-	Importance	It is a fundamental document which is required to be framed by every company.	It is a supplementary document and not required to be prepared by the public company limited by shares.
4-	Contents	It contains the objects of a company, name, place, capital, liability and Association clause.	It contains management of internal affairs of the company.
5-	Purpose	Its main purpose is to state the objectives for which the company has been established.	Its main objective is to carry out the company's objectives.
6-	Dominant and Subordinates	It is the main & dominant document which is	It is regulated and controlled through memorandum



		beyond the control of Articles.	
7-	Necessity	It is originally framed by every company.	It is not required by public company limited by shares because Table A applies there.
8-	Alteration	Memorandum rarely altered by ;the permission of Central Law Board/Company Law Board.	Articles can be converted by the special resolution passed in the meeting of the company.
9-	Compliance of Provisions	Memorandum is made according to provisions of Company law.	Articles of Association is framed with help of Memorandum & Company law.
<b>S.No.</b>	<b>Basis of Comparison</b>	<b>Memorandum of Association</b>	<b>Articles of Association</b>
10-	Ultra Vires	Any act done ultra vires are absolutely void.	Any act which is intra vires of memorandum and company law but ultra vires Articles of Association may be legal.
11-	Ratification	If any act is ultra vires of memorandum, then it will be null and void. Such act cannot be ratified.	If any act is ultra vires of Articles of Association, may be made intra vires by the special resolution passed.
12-	Basis of Relations	It is concerned with relations between company and outsiders.	Articles, defines relations between company and its members.
13-	Remedy with Outsiders	Where the acts are beyond the memorandum, there is no remedy for outsiders against the company.	If acts are done without following of the Article, the outsiders can enforce rights against the company.
14-	Explanation	Memorandum does not explain Articles.	But articles can be used to describe as supplement of the memorandum but in no case it can be extended the scope of memorandum.

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## Prospectus

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**Q.1. Discuss the consequences of omission, misrepresentation and fraud in connection with prospectus of a company. Explain the circumstances under which a director may be relieved from the liability.**

**Ans.: Meaning of Misstatement or Untrue Statement :** It is a false statement. It means any statement which may confuse or which may have a wrong impression in the minds of the public about facts of the issue. A general recommendation even if it is true highly coloured, cannot be a false statement. A statement that something is expected or it has been done, when it is not so in real, will be a mis-statement of the fact. If there is omission of a material fact from a prospectus, it may also be deemed to be untrue. Hence, a prospectus should honestly be framed and should not contain any incomplete statement or any ambiguous statement. Hence, a prospectus containing false, misleading, ambiguous or fraudulent statement of material facts may be termed as a misleading prospectus e.g. the case of *Rex vs. Kysant* : A prospectus was issued in 1928 with a statement that the company has regularly been paying dividend ranging from 5% to 8%. The truth was that the company had been incurring substantial trading losses during the seven years preceding the date of prospectus. The court held that the prospectus was false, not because of what is stated but because of what was not contained in it.

It must be observed that there must be misrepresentation of facts and not of law, to be called a misleading prospectus, e.g. if the prospectus of the company states that the shares of company will be issued at half of their normal rates but it is not the real statement, the prospectus may not be held misleading because it is only a misrepresentation of law because section 79 does not allow a company to issue its shares at a discount exceeding 10%.

According to Section 65, a prospectus shall also be deemed to have untrue statement if omission of any matter from it is calculated to mislead to those who act on the faith of the prospectus. Therefore, if the statement in prospectus is untrue and mislead those who act on the faith of the prospectus, is misstatement and untrue.

**Remedies or Consequences of Misleading Statement of a Prospectus :**  
Following are the remedies to a person against the company for the misrepresentation or misstatement in the prospectus.

- (1) Remedies against the Company
  - (2) Remedies against the Directors, Promoters etc.
  - (3) Remedies against the Experts
- (1) **Remedies against the Company :** The company is held liable for every misstatement in its prospectus to any person who on the faith of it subscribes for shares in the company. The aggrieved parties have following remedies against the company.
- (A) Rescission of the Contract
  - (B) Damages for Deceit
- (A) **Rescission of the Contract for Misrepresentation/Untrue Statement :** Rescission means avoiding the contract and entitles the allottee to immediate removal of his name from the register of members and repayment of the amount paid on the shares with interest. But the contract can be rescinded subject to satisfaction of the following conditions :
- (i) The prospectus must contain a false statement or misrepresentation, whether fraudulent or innocent. Untrue statement is defined in section 65 of the company law if it is in misleading form and context as well as if it is misleading due to omission and untrue statement.
  - (ii) The statement which induced the allottee to subscribe for the shares must relate to fact and not law, an expression of opinion or expectations.
  - (iii) The false statement must be material to the contract to take shares (Peek v. Gurney (1873))
  - (iv) The shareholder must have relied on the statement in the prospectus.
  - (v) The omission of material fact must be misleading before the rescission is granted.
  - (vi) The proceedings for the rescission must be started by the allottee within a reasonable period of time and before the company goes on liquidation.
- (B) **Loss of Right of Rescission :** The subscriber loses his right to rescind the contract in the following circumstances :

- (i) If he does not start the proceedings within a reasonable time after knowing the misrepresentation.
  - (ii) If he confirms his contract, either expressly or impliedly after becoming aware of the false statement. If a subscriber attends any of the meetings of the company, accepts any payment of dividend by the company, pays any call money on his shares or tries to sell his shares, it will be taken as his affirmation of the contract by his acts and in all such cases he will not be allowed to rescind the contract.
  - (iii) If a company goes on liquidation before he starts the proceedings to rescind the contract.
  - (iv) If the company proves that he is a man of such caliber and such experience that he is not likely to be misled by the misstatement in the prospectus.
- (C) Right to claim damages for fraud : If a person has purchased any shares or debentures of a company induced by a misstatement, in the prospectus of the company, he does not enjoy only the right of rescission of contract but also to recover the damages for such statement.

But to avail this remedy the subscriber must prove the following:

- (i) That the statements made fraudulently and not innocently, if a fraudulently statement was made innocently, only the right of rescission of contract is available for the subscriber.
- (ii) That he has actually been deceived by the misstatement. It is to be remembered that the right to claim any damages can be exercised only after the rescission of contract has been allowed by the court. It makes it clear that if the right to rescind a contract is lost, right to claim the damages will be lost automatically.

It is to be remembered in this context that the right to claim damages for fraud is an elective right. First the allottee must rescind the contract and secondly then he can claim for damages.

- (2) **Remedies against the Directors, Promoters etc. :** Every Director, promoter and every other person who authorized the issue of prospectus, which contains untrue or misleading statement is liable to compensate to every such persons who subscribed the securities of the company on the faith of such prospectus.

The liability of such persons may be classified into two groups :

- (A) Civil Liability
- (B) Criminal Liability
- (A) **Civil Liability** : Every director and promoter and others who authorized to issue prospectus, the allottee has the right to get remedies because there is misleading and untrue statement in the prospectus. They have the following remedies.

(i) **Damages for Misstatement** : According to Section 62(1) every aggrieved party being a subscriber may sue director, promoter etc for the payment of loss or damages caused by him due to misstatement in the prospectus. He can claim for damages within three years from the date of the allotment of shares.

**Defenses available to Directors etc** : If the director, promoter and others may be exempted to pay damages or compensation if he proves any of the following :

- (a) That he had withdrawn the consent to become director or before the issue of prospectus or the prospectus was issued without his consent.
- (b) The prospectus was issued without his knowledge or consent and on becoming aware, he forthwith gave public notice to that effect.
- (c) Unaware about the misstatement made in prospectus, when came to know he withdrew his consent by a public notice before allotment of shares or debentures.
- (d) Reasonable ground for belief : If the director understands that ;he had reasonable ground to believe and did upto the time of allotment that the statement was true, I have no doubt at that time.
- (e) Statement by expert : The director will not be held liable if he says that the misstatement is correct to the best of my knowledge ;because it is based on reasonable ground and expert was competent to make it and he had given his consent and had not withdrawn that consent before registration of prospectus.
- (f) A copy or extract of official document : According to section 62(2) if the director proves that the statement given in the prospectus is a copy of or extract from an

official document or is based on the statement made by an official person.

- (ii) **Damages for Omission** : Every matter of the prospectus must be according to specified schedule II, even though if certain things are omitted, then the subscriber gets the right of an action for damages to subscriber for shares, who actually suffered the loss thereby.

Under the following cases a subscriber will not be liable for omission of any matter from the prospectus :

- (a) If he proves that he had no knowledge of the matter not disclosed.
- (b) If he proves that non-disclosure arose from an honest mistake of fact on his part,
- (c) If the non-compliance was immaterial in the opinion of the court.
- (d) If in the eye of the court, the person sued ought to be executed for non compliance under section 56 (4).

- (iii) **Damages under General Law** : If a subscriber is defrauded by inducement by the prospectus of the company. The subscriber took the shares and was defrauded by it and substantial loss due to fraud, the subscriber can claim for damages.

The remedy can be given under the following conditions :

- (a) Where the aggrieved subscriber has lost the right of rescission of contract as against the company due to laches or negligence.
- (b) The company became liquidated, the directors will not be held liable for loss if it is proved that they honestly believed the statement to be true [Derry v. Peek, 1889)

- (B) **Criminal Liability** : The criminal liability of the Directors will be as follows (according to Section 63(1) as amended in 2000)]

- (i) **Criminal Liability for Misstatement in Prospectus** : If a prospectus contains any untrue statement every person authorizing the issue of prospectus shall be punishable with an imprisonment for a term which may be upto 2 years or with fine may be upto Rs.50,000 or with both.



But a Director may be free from liability under the following terms :

- (a) The statement was immaterial.
- (b) He had reasonable ground to believe and did upto the time of issue of the prospectus he believed that the statement was true.

(ii) **Criminal Liability for Inducing Persons to Invest Money :**

According to Section 68(Amended Act 2000), sometimes a person fraudulently either by knowingly or recklessly making any statement, promise or forecast which is false deceptive and misleading or dishonestly concealed material facts and propelled or induced or attempts to induce another person to enter into or to offer to enter into the contract as follows :

- (a) An agreement for acquiring, disposing of subscribing for, or underwriting shares/debentures.
- (b) An agreement to secure a profit to any of the parties from the benefit of shares/debentures or by references to fluctuations in the value of shares/debentures.

If the above position is found by any such agreement, he shall be punishable with imprisonment for a term, may be upto 5 years or with fine which may be extended to Rs. one lakh or with both.

(3) **Remedies against Experts :** According to Section 58 if an expert gives his consent to issue prospectus containing untrue statement made by him, shall be made liable to all the subscriber because he bought the shares due to induced by the false statement in the prospectus. They believed and after deceived. The subscriber is entitled to claim the following from the expert :

- (i) Damages under the General Law
- (ii) Damages under Section 62

But the expert has no criminal liability for his untrue statement because he is not deemed to be a person who has authorized to issue of a prospectus [ See 63(2)].

**Defenses available to an Expert:** He may be escaped from his liability if he proves:

- (i) That having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration.

- (ii) That after delivery of prospectus for registration but before allotment of shares, he became aware of the untrue statement and withdrew his consent in writing and gave a reasonable public notice of the withdrawal of his consent and reasons thereof.
- (iii) That he was competent to make the statement in question and believed it on reasonable ground that it was true.

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## CHAPTER-5

# Directors: Position, Appointment and Removal

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**Q.1. How the Directors of a company appointed? What restrictions have been imposed by the Company Act in respect of appointment of Directors?**

**Ans.:** Section 253 of the Indian Companies Act, 1956 states that only an individual can be appointed as a Director in a company. It follows that a partnership firm or an incorporated body cannot work as a Director. The Indian Companies Act provided the following provisions regarding the appointment of Directors :

The modes/methods of appointment of directors: The directors may be appointed by the following ways.

- (1) Appointment of First Directors
- (2) Appointment by the Member/Company
- (3) Appointment by Board of Directors
- (4) Appointment by the Third Parties
- (5) Appointment by Proportional Representation
- (6) Appointment by the Central Government

- (1) **Appointment of First Directors :** The first directors are appointed by the promoters of the company. They are appointed by the subscribers of the memorandum. If the articles do not provide for the appointment of first directors and table A is excluded, the signatories of the memorandum must be deemed to be first directors of the company's articles. According to section 254, such directors shall act as director till the directors are duly appointed at the first general meeting after incorporation of the company

- (2) **Appointment at the General Meeting of the Members of the Company :** According to Section 255, atleast two third of the total number of directors of a public company or of a private company must be appointed by the company in general meeting. So far as public company or private company, which is a subsided of a public company, atleast two thirds of the total number are called Rotational Directors and shall be appointed ;by the shareholders in general meeting. Only 1/3 directors out of the total number of directors hold permanent directorship.
- (3) **Appointment of the Directors by the Board of Directors :** Board of director of a company may appoint directors of the following nature :
- (i) **Additional Director :** According to Section 262, if the articles so permit, Board of directors may appoint additional directors subject to maximum number of fixed in the articles of the company who shall hold office only upto the date of next Annual General Meeting.
  - (ii) **Casual Vacancies :** Section 262(i) empowers Board of ;directors that a casual vacancy occurring amongst the directors may be filled up by the Board of directors itself unless the articles provide a different procedure but the persons so appointed shall hold office only upto the time his predecessors would ;have continued.
  - (iii) **Alternative Directors :** According to Section 313, if it is permitted ;by the articles of the company or by the company's resolution at the general meeting may appoint an alternative director. Such an alternative director has to act for the original director during his absence for a period of more than three months from the State in which the meetings of the company are held. The alternative director can continue as director only for the period for which the original Director was eligible Further, on the return of the original director, the alternative director may vacate the office of the directorship.
- (4) **Appointment of the Directors by the Third Party :** Sometimes the articles give a right to financial corporation, debenture holders and banking companies which have lent money to the company to nominate directors on the board of the company with a view to ensuring that the funds advanced by them are used by the company for the purpose for which they were borrowed. The number of directors so nominated should not exceed one third of the total strength of the board and they are not to retire by rotation.
- (5) **Appointment by Proportional Representation :** Normally directors are appointed on a straight vote of the members of the company. But section 265 of the act allows a public company or a private company which is

subsidiary of a public company to provide in its articles for the appointment of not less than 2/3 majority of the total number of directors by the Principle of proportional representation either by a single transferable vote or according to the principle of cumulative voting or otherwise. If the company decides to appoint directors, under this method, the director may be appointed for a period of three years at a time.

(6) **Appointment made by the Central Government :** According to Section 408, the Central Government may appoint such number of directors when the company law board decides that it is necessary to safeguard the interests of the company or its shareholders or the public if :

- (i) Not less than 100 members of the company apply to company law board to make such an appointment.
- (ii) Member holding not less than one tenth of the total voting power to make an application to the company law board for making such an appointment.
- (iii) On its initiative.
- (iv) The directors appointed by the government may or may not be the shareholders of the company. They are appointed to prevent the oppression of the minority of the shareholders or to prevent mismanagement of the company or in the public interest. They are appointed for a maximum period of three years. They are not required to hold qualification shares and are not liable to retire by rotation but they may be removed by the central government at any time and other persons may be appointed by it in their place. Considered for the purpose of reckoning 2/3<sup>rd</sup> or any other proposition of the total number of directors of company [Section 408(3)].

**Restrictions on Appointment of Directors :** According to section 253 of the companies Act lays down that a person cannot be appointed a Director by the articles or named as director in the prospectus or statement in lieu of prospectus unless before registration of articles, publication of the prospectus or filing of the statement in lieu of prospectus, he has :

- (a) Given his consent in writing to act as director and his consent has been duly filed with the registrar.
- (b)
  - (i) Signed the memorandum for his qualification shares.
  - (ii) Taken his qualification shares and paid or agreed to pay for them.



- (iii) Signed and filed with the registrar an undertaking to take and pay qualification shares.
- (iv) Made and filed with the registrar an affidavit stating that his qualification shares are registered in his name.

The above restrictions do not apply to:

- (i) A company without share capital.
- (ii) A private company.
- (iii) A private company now converted into a public company.
- (iv) A company which has issued prospectus after the expiry of one year from the date on which it was entitled to commence business.

**Q.2. Describe the statutory provisions relating to a Manager and clearly distinguish between a Managing Director and a Manager.**

**Ans.:** The Statutory provisions relating to Manager are as follows :

- (i) Every public company having a paid up share capital of rupees five crore or more shall have a Managing Director or a whole time Director or Manager (Section 269(2)).
- (ii) According to Section 269 (2), if the conditions specified in schedule XIII are fulfilled, the Managing or Whole time director or Manager in a public company can be appointed/reappointed without the approval of Central Government. A return in the prescribed form No.25C is however required to be filed within 90 days of appointment.
- (iii) If the conditions specified in schedule XIII are not complied with an application seeking approval to the appointment must be made to the Central Government/reappointment [(Section 269 (2)(3)].
- (iv) The Central Govt. may grant approval for a period lesser than the period for which the proposal has been made.
- (v) If the appointment or reappointment is not sanctioned or approved by the central government, the appointee shall vacate office immediately on communication of the decision by the Central Government otherwise he shall be punishable with fine upto Rs.5000 for every day during which he fails to vacate such office.
- (vi) In addition to the above where the central Government on information received is prima facie of the opinion that any appointment made without its approval has been made in contravention of the requirements of schedule XIII, the Central govt. may refer the matter to the company Law Board for decision. The company Law Board after giving reasonable



opportunity of hearing to the company and the appointee may make an order declaring whether contravention of the requirements of schedule XIII has or has not taken place. If the company Law Board comes to the conclusion that such contravention has occurred, the appointment shall be deemed to have come to an end on the date of such declaration and the person so appointed shall be addition to being liable to pay a fine of one lakh rupees refund to the company the entire amount of salaries and perquisites etc received by him. However, all the acts of Managerial/personnel whose appointment is invalidated will be deemed to be valid. It is stated (Section269(7)(8)(9)(10) and 12]

- (vii) No change can be made in the context of appointment/reappointment of Managing Director or a whole time director without the approval of the central government or schedule XIII of company's act.
- (viii) The remuneration payable to M.D. or whole time director cannot be more than 5% of the net profits of that financial year. If there is more than one M.D or whole time Director in a company, the maximum limit fixed at 10 per cent of the annual net profit explained in Section 309 (3) These limits are, however, subject to the overall ceiling of total management remuneration of 11 per cent of annual net profits of the company.
- (ix) At a time the maximum term of appointment can be five years. Reappointment is possible but it may be made within the last two years of his present terms only mentioned in Section317.
- (x) No person can act as a M.D of more than two companies at a time including both public and private. Out of these two atleast one is a public company.
- (xi) No person can be appointed a Managing Director or whole time Director who :
  - (a) Is an undischarged insolvent.
  - (b) Suspends or has at any time suspended payment to his creditors or makes or has made a composition with them.
  - (c) Is/has been convicted by the court of an offence involving moral turpitude.

**Distinguish between Manager and Managing Director :** They are distinguished as follows :

- (i) **Compulsion of being Director and Managing Director :** A Manager may be a director or may not be a director of the company but a Managing Director must be a director of the company.

- (ii) **Rights or Scope of Authority** : M.D is entrusted with substantial powers of Management whereas a Manager has the Management of whole or substantially a whole of the affairs of a company.
- (iii) **Number** : There may be more than one Managing Directors in a company but in case of a company only one manager is required.
- (iv) **Appointment** : MD may be appointed either by agreement with the company or by a resolution of the Board or general meeting or under memorandum or Articles of the company. Manager is usually appointed under a contract of service by the Board of Directors.
- (v) **Cessation of Office** : A person as M.D when ceases to be a director is automatically ceases to be the M.D contrary to it a manager remain manager after ceasing to be director.
- (vi) **Employee**: M.D. may be an employee or not, it depends on the terms of employment On the other hand, Manager is an employee of the company.
- (vii) **Disqualification**: Some disqualifications of M.D. are for whole life whereas the disqualification of Manager are only of five years and even the central government may waive these disqualifications.
- (viii) **Membership of the Board** : MD is the member of the Board of Directors whereas manager is not the member of Board of Directors.
- (ix) **Relationship** : MD is a co-director of the other directors of the company. Managers in relation of employee with directors.
- (x) **Practice** : Usually MD is appointed in a company whereas Manager is rarely appointed in a company.
- (xi) **Qualification Shares** : According to the Articles of Association, an M.D. must have qualification shares. But a manager on the other hand need not require qualification shares because he is not a director.
- (xii) **Remuneration** : The maximum remuneration payable to a person holding the office of a Manager cannot exceed 5% of the annual net profits of the company . Contrary to it if the company has more than one M.D, the total remuneration payable to all of them should not exceed 10% of the total net profits of the company.
- (xiii) **Control** : A manager functions under the control and direction of the board while a Managing Director functions under the control and supervision of the board.

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