Neha Saxena
Kanchi Malhotra

# AN OVERVIEW OF COMPANY LAW

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# CHAPTER 1

# EXPLORING THE KEY FEATURES OF COMPANY: AN OVERVIEW

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**ABSTRACT:**

This paper explores the key features of a company and their significance in shaping its overall performance and success. It discusses various aspects that contribute to a company's distinctive characteristics, including organizational structure, culture, leadership style, and innovation. Additionally, it examines the role of these features in fostering competitiveness, attracting and retaining talent, and achieving sustainable growth. Through a comprehensive analysis of the literature and real-world examples, this paper sheds light on the critical role of company features in creating a unique identity and achieving strategic objectives. The findings highlight the need for companies to strategically manage and develop their key features to gain a competitive advantage in today's dynamic business environment. A business that has already existed is one that was established under a prior company legislation. The definition provided above falls short of explaining what a corporation is or what its distinguishing features are.

**KEYWORDS:**

Accountability, Adaptability, Branding, Collaboration, Communication, Customer Service, Decision-Making.

## INTRODUCTION

A company that was established under this Act or under any earlier company legislation is referred to as a "company" under Section 2 of the Companies Act of 2013. A corporation is an artificial creature that is invisible, intangible, and only exists in the mind of the law, according to Chief Justice Marshall of the United States. Being only a product of law, it only has the attributes that its founding document bestows to it, either explicitly or incidentally to its very being. Professor Haney asserts that "a company is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal[1], [2]. This explanation from Prof. Haney makes it extremely obvious what a firm is and what its key traits are.The following are a company's fundamental traits.

### Association that is corporate

A registered or incorporated association is a firm. Either a legislative act or registration under the Companies Act creates it. A firm cannot be referred to be an unincorporated association in the meaning of the law. A corporation does not become a distinct legal entity until it is incorporated or registered[3], [4].

### A fictional legal entity

In contrast to a genuine person, a corporation is an artificial person. It is produced via a legal procedure. It is not a physical thing. You cannot shake it down in a fit of rage because it has no body. It is referred to as an artificial human since it lacks a soul and a conscience. It also has duties and some rights similar to those of a natural person. It is capable of making property transfers, signing contracts, suing or being sued, and incurring fines for breaking the terms of the Companies Act[5], [6].

**Unique entity**

After being incorporated, a corporation has its own legal identity, which is different from the individuals that make up its membership. It is allowed to own and dispense with property. Both its members and outsiders have the right to bring and defend claims in its name. Even though a shareholder owns almost all of the business's capital, the corporation is seen by the law as a different legal entity from a shareholder[7], [8].

In the well-known case of Salomon v. Salomon & Co. Ltd. A. C. 22, this premise was stated. A leather trader named Salomon sold his company to Salomon & Co. Ltd. for £30,000. Salomon, his wife, four sons, and one daughter made up The Salomon & Co. Salomon received the acquisition money from the firm in the form of 20,000 fully paid shares at £1 each and £10,000 worth of debentures with a floating charge over all of the company's assets. The other six family members, including his wife, four kids, and one daughter, received one share each. Salomon thus had complete control over the business. The firm had financial issues after only one year and was forced to be wound up. On the grounds that the company and Mr. Salomon were one and the same, the creditors of the corporation claimed precedence over the debenture holders. They said that the business was only a "alias" or Salomon's agent. The corporation was only a "sham" and a "fraud," since it was owned and operated by him alone. Salomon was thus required to defend the business from its trade debts. The House of Lords, on the other hand, ruled that a company's existence is completely independent of its members and that its assets must be used to settle its debts before any unsecured creditors[9], [10].

It's important to note the following statements made in this context by Lord Macnaghten: "The company is at law a completely different person from the subscribers 'to the Memorandum', and even though it may be that after incorporation the business is exactly the same as it was before, and 'the same persons are managers, and the same hands receive the profits,' the company 'is not in law the agent of the subscribers or trustee for them'. Additionally, the subscribers are not accountable in any way other than as provided for by the Act in their capacity as members.

**Infinite existence**

A business continues to exist. A business is considerably more complex than a sole proprietorship or partnership since it has a distinct entity. The company's survival is not reliant on the survival of the individual people that make it up. The life of the firm is unaffected by the demise, bankruptcy, insaneness, or retirement of any member or director. Even if all of the members passed away, the business would still exist. All the employees of a private firm were murdered by a bomb at a general meeting during the war. However, the business survived; a hydrogen bomb could not have destroyed it.

**Common seal**

A firm cannot behave independently since it is an artificial person. It must act through the directors, who must be real people. The legislation requires the company's seal, if it has one, to be affixed by the directors when they sign contracts on the company's behalf.

**Minimal responsibility**

The restricted liability is perhaps the most significant benefit for which a corporation is established. Each business member's liability is capped at the face value or nominal value of a share. He won't be obliged to pay any further money if he has already paid the entire amount owed on his share to cover the company's responsibility. For instance, if a share of a

corporation has a face value of 10 and the shareholder has paid 8, his responsibility to the company is limited to the last 2 cents of that amount. In the case of a company limited by guarantee, the member's responsibility is restricted to the amount he has pledged to contribute to the company's assets in the event of its dissolution.

**Shares' transferability**

Transferability of shares is one of a company's key attributes. A public company's shares are freely transferable. The transfer of shares cannot be restricted by the Articles of a Public Company and must be restricted by the Articles of a Private Company. The transfer of a company's shares cannot, however, be subject to tight limitations. Such a limitation is invalid. A public business that has its shares listed on a reputable stock exchange is required by the Companies Act of 2013 to register any transfer of its shares.

**Unique characteristic**

It is a logical extension of the idea of a distinct entity. A firm is seen as a different legal person from its shareholders. Such a corporation has the legal authority to acquire, own, and transfer property in its own name. Even if the company's shareholders or members contribute funds, they do not share ownership of the company's assets. No member may claim ownership of the company's assets either during the operation of the business or after its dissolution. Even the insurable interest in the company's property is not held by the shareholders.

**Legal capacity**

A business is a distinct legal entity. It may therefore bring a claim and defend one in its own name.

## DISCUSSION

**Lifting The Corporate Veil**

A firm is seen as a different legal person from its shareholders. As a result, the company's actions are not subject to liability against the members. As a result, a barrier exists between the corporation and its employees. In most cases, the Court or Tribunal won't peek beyond the corporate entity, i.e., they won't see who the actual people behind the company's control are.The members of the firm cannot, however, abuse the idea of a distinct organization to avoid paying taxes or defrauding others. The Court or Tribunal cannot remain quiet in such proceedings. As a result, the Court or Tribunal may and should remove or penetrate the corporate veil in order to look at or identify the actual people who are causing trouble while donning the corporate identity. "Lifting or piercing the corporate veil" is what is meant by this.The two sorts of situations in which the Court or Tribunal may lift the corporate veil are as follows.

1. Cases governed by court rulings.

2. Cases covered by specific legislative requirements.

3. Judiciary Decisions

**Revenue protection**

The corporate veil has been removed by the courts in cases when it was being utilized to avoid paying taxes or violate tax laws.The Central Excise officials in this instance sent individual directors of M/s Duncan Agro Industries Ltd. show cause notices for suspected

fraudulent excise tax evasion. The directors contested this on the grounds that the corporation was responsible for the liabilities. In order to identify the directors' responsibility, the High Court peeled back the corporate veil. The Court noted that any director who participates in fraud or orders the conduct of any tort is fully responsible.

**Prevention of dishonest behavior or fraud**

The Court or Tribunal may pierce the corporate veil if the distinct entity of the corporation is being utilized fraudulently to deceive individuals or to evade legal duties.Horne was required by the service agreement not to approach the business' clients. Horne established a business that actively sought for the plaintiff's clients. According to the ruling, the firm served only as a front or front to allow Horne to violate the terms of his service agreement in order to attract consumers. The Court prohibited Horne and the defendant business from recruiting clients.

**Identifying a company's hostile characteristics**

The Court or Tribunal may uncover the corporate veil when a corporation's management is made up of citizens of an enemy nation since the company then takes on the characteristics of an enemy. In such situations, it would be against national policy to let foreign opponents to do business under the guise of a corporate corporation.

**The avoidance of welfare laws**

If the Court or Tribunal determines that the corporation is abusing its corporate entity to get around welfare laws, it may remove the corporate veil.

**Contempt of court**

When a corporate veil is utilized to avoid being found in contempt of a court or tribunal, the court or tribunal has the authority to penetrate the veil and penalize those responsible.

**Evaluation of the company's technological expertise**

Similar to how a company's corporate veil may be penetrated to establish an enemy's character, so too can it be done to evaluate a company's technological competency.

**Extent of Express Statutory Provisions**

Additionally, the Companies Act has included certain stated measures that allow for the lifting of the corporate veil. Here are some of the significant cases:

1. Members below the required minimum. Every member of a public company who is aware of a decrease in membership at any time and the company's operations continue for longer than six months will be jointly and severally liable for all debts incurred after the six-month period. However, members who left the company during the six-month period will not be held accountable. It should be underlined that members who remain active beyond the required six-month term are only responsible when they are aware that the required minimum number of members has been reached. Thus, despite the fact that the company is a distinct entity and the culpability of the members is restricted, it would seem that the Company Law removes the corporate veil in such circumstances and renders the members personally accountable.

2. Inaccurate information in the prospectus. Every individual who authorized the release of a prospectus is personally accountable to those who subscribed on the basis of false assertions contained in the prospectus if misrepresentation is made therein.Criminal responsibility for prospectus lies. Every person who authorizes the release of such a prospectus shall be liable

under section 447 in the following situations when a prospectus issued, circulated, or distributed under this contains any statement that is untrue or misleading in form or context in which it is included, or where any inclusion or omission of any matter is likely to mislead: civil responsibility for a prospectus' false statements. . In the event that someone purchased shares from a business based on a deceptive statement or the inclusion or absence of information in the prospectus and as a result suffered any loss or harm, the company and anybody who:

Nobody will be held accountable under subsection if they can demonstrate. that the prospectus was issued without his knowledge or consent and that, upon learning of its release, he promptly gave a reasonable public notice that it was issued without his knowledge or consent; or that, having consented to become a director of the company, he withdrew his consent prior to its release and that it was issued without his authority or consent. Every person mentioned in subsection shall be personally liable, without limitation of liability, for all or any losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus, notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with the intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose.

3. Fraudulently encouraging others to make investments. Any individual who, either knowingly or recklessly, makes any statement, promise, or forecast that is false, deceptive, or misleading, or willfully conceals any material facts, in an effort to persuade another individual to enter into, or offer to enter into: any agreement for, or with a view to purchasing, selling, subscribing for, or underwriting securities; or any agreement whose purpose, or the pretended purpose of which, is to secure a profit to any of the parties from

4. Refusal to reimburse application fees. The money received under this section must be returned in the manner and time prescribed by the Securities and Exchange Board if the required minimum amount has not been subscribed and the money payable on application has not been received within thirty days of the prospectus's release date, or within any other time frame the board may specify. The firm and the defaulting official are both subject to fines of 1,000 rupees for each day the default continues or one lakh rupees, whichever is less, in the event that an application is not returned. .5. misuse of the words "Limited" or "Private Limited" after a business name.

Unless properly incorporated as a private company with limited liability, or if any person or persons transact business under any name or title in which the words "Limited" or "Private Limited" or any contraction or imitation thereof is or are the last word or words, as the case may be, that person or each of those persons shall be punishable with a fine that shall not be less than five hundred rupees.

6. Subsidiaries and holding businesses. A "holding company" is a business that manages another business, which is referred to as a subsidiary. Holding and subsidiary firms are distinct legal entities. A 100% subsidiary has been ruled to be an independent legal entity, and as such, its owning corporation will not be held responsible for its deeds.However, the Court or Tribunal may pierce the corporate veil to determine the link between the holding company and the subsidiary firm in order to identify the actual individuals in charge of the company's activities. As a result, the law may not always see a subsidiary firm as an independent business. For instance, each controlling company must provide copies of the balance sheet, profit and loss account, directors report, and auditor's report for each of its subsidiary companies with its balance sheet. Once again, a private firm is essentially considered as a public corporation when it becomes a subsidiary of a public company.

7. For looking into a company's internal problems. If an inspector is hired to look into a company's finances, he has the authority to look into the finances of any other corporation that is run by the same management or group. The corporate veil or personality may be ignored in order to determine who is responsible for mismanagement, fraud, etc.; in other words, the people hiding behind the legal façade can be found and punished.

8. For determining a company's ownership. In order to identify the real people who are, or have been, financially interested in a company and who are, or have been, able to control or materially influence its policies, the Central Government may appoint one or more inspectors to investigate and report on the membership of any company. The corporate curtain might be pulled back for this reason in order to expose the true owners of the firm.

9. To verify trade that is fake. The Court or Tribunal may lift the corporate veil in order to identify the true individuals accountable if it becomes apparent during the winding-up of a company that the business of the company has been conducted with the intent to defraud the company's creditors or any other person, or for fraudulent purposes. Without any restriction on responsibility, the Court or Tribunal may hold such people personally responsible for all or any of the Company's obligations.

**Types of Businesses**

There are many different types of businesses here, and they may all be categorized in different ways. The following is a crucial foundation for classifying these businesses:

**Upon the Foundation of Creation**

There are three main ways that a corporation may be established.

**Companies with charters**

In the past, monarchs used to establish firms by issuing Royal Charters as a result of the authority granted to them. These businesses were controlled by their charters and were referred to as "Chartered Companies." The East India Company, The Bank of England, and other similar businesses are examples. They were not covered by the Companies Act. These businesses are no longer developed today.

**Statutory businesses**

Statutes or particular Acts of the Parliament or State Legislatures are used to establish such a firm. These businesses are established to conduct important national business. The Reserve, as an example. Indian Food Corporation, Bank of India, Indian Life Insurance Corporation, etc. These corporations are given particular authority and are subject to the rules set out in the Acts that constituted them.

However, insofar as they are compatible with the requirements of the Special Acts under which these companies were formed, sections of the Companies Act may also apply to these businesses. Such businesses are exempt from adding "Limited" to the end of their names. businesses that are registered or incorporated. A registered or incorporated company is one that has been registered under the Companies Act. This is by far the most common method of company formation. These businesses may be public or private, have limited or unlimited liability, and have money in the form of shares or none at all.

**Considering Liability**

Companies are divided into three categories based on their level of liability: limited by shares,Guaranteed limit and unlimited company.

### Limited by Shares

The shareholders are responsible for paying any unpaid amount, if any, due on the shares they own. A company limited by shares is one whose members' responsibility is restricted by the memorandum to the amount, if any, payable on the shares they each possess. There is no chance that members' private property will be utilized to pay off the company's creditors. The corporation has the right to call up any outstanding balance on the shares at any moment. There are by far the most of these kinds of businesses.

### Guaranteed Limitation

Companies formed for non-trading purposes, such as the promotion of art, science, culture, sports, etc., are limited by guarantee companies. Companies limited by guarantee have the liability of their members limited by the memorandum to such amount as the members may each undertake to contribute to the assets of the company in the event of its being wound up. According to the Memorandum, the liability of the members is only limited to the amount that each member has agreed to contribute to the company's assets in the event that it is wound up while he is a member or within a year after he ceases to be a member, as the case may be, in order to pay the debts and liabilities of the company or any debts and liabilities that may have been contracted before he ceases to be a member. Before the firm is dissolved, the sum each member has promised cannot be sought. If the current members are unable to donate the promised amount, these members are responsible. The government may give certain businesses an exemption from the need to include "Limited" or "Private Limited" in their name.

### Unlimited Partnership

The responsibility of the members of an unlimited corporation may be infinite, just as the liability of sole proprietors or partners is unlimited.

A member may be required to contribute an infinite sum in proportion to his ownership stake in the firm to satisfy the creditors. The nature of the members' obligation in an unlimited organization differs significantly, though. An unlimited company's members are not personally liable to its creditors. In the event of a partnership business, the partners may be sued directly by the creditors. A business, whether limited or limitless, is seen as existing independently of its members. These days, it's hard to find such businesses.

### Considering the Total Number of Members

A private limited corporation may only be owned and managed by intimate friends and family. As a result, a private corporation is a kind of organization that allows a family or group of close friends to profit from limited liability while still enjoying all the benefits of a partnership organization, such as tight control and corporate confidentiality, etc. 'Private Limited' or its abbreviation "Ltd." must be at the end of a private company's name. A private business is often conducted as a family business and does not use public finances. Consequently, a private corporation has advantages over a public company. Individual Company Section 2. "One person company" refers to a business with only one member. It will be a privately held business.

One Person Companies are a brand-new idea that was established in Section 3 of the Companies Act of 2013. To be a member of the company in the event of the subscriber's death or inability to contract, the other person must have his prior written consent in the prescribed form, and his name must appear in the memorandum of the one-person company.

The one-person company's memorandum and articles must also be filed with the Registrar at the time of incorporation.

1. Furthermore, this additional party may withdraw his permission in any way deemed appropriate.

2. Additionally, the One Person Company member may change the name of the other person at any time by providing notice in the way specified by law.

3. The member of a One Person Company must inform the company of any changes, if any, to the name of the other person he has nominated within the time frame and in the manner specified by the company, and the company must notify the Registrar of any such changes within the time frame and manner specified by the Registrar:

4. Furthermore, any such change in the person's name will not be regarded as a modification to the memoranda.

Private Company Section 2. A corporation that is not private is referred to as a "public company." With the exception that a subsidiary of a non-private business will be treated as a public company for the purposes of this Act, even if the subsidiary company's articles still refer to it as a private company. Simply said, a private firm that is a division of a publicly traded corporation will transition to become a publicly traded company. As a result, a public corporation is exempt from the constraints that apply to private companies. Its shares may be freely transferred; there are no restrictions on this. The maximum number of members is unrestricted, and a prospectus may be used to make shares and debentures available to the general public for subscription. Consequently, the general public has both ownership and control of a public firm.

## CONCLUSION

In conclusion, a company's characteristics are very important in determining its identity, performance, and long-term success. An organization's competitiveness and uniqueness are largely influenced by its organizational structure, culture, leadership, and innovation. Companies may stand out from rivals, draw in and keep top personnel, and promote innovation and development by proactively controlling these traits. The organizational structure of a corporation defines its hierarchies, means of communication, and decision-making procedures.

A well-designed structure encourages productivity, teamwork, and flexibility, allowing the company to react to changes in the business environment with effectiveness. The common values, opinions, and actions of a company's workers are reflected in its culture. Strong and supportive cultures encourage employee engagement, increase output, and improve client happiness. Additionally, a culture that values inclusiveness, diversity, and ethical conduct enhances the standing of the business and its overall success.

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# CHAPTER 2

# A COMPREHENSIVE REVIEW OF PRIVILEGES OF A PRIVATE COMPANY

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**ABSTRACT:**

This paper explores the privileges associated with private companies and their significance in the business landscape. It examines the advantages that private companies enjoy over their public counterparts, including increased flexibility, confidentiality, control, and long-term strategic planning. Additionally, it discusses the impact of these privileges on decision-making, operational efficiency, and the ability to adapt to market changes. Through a comprehensive analysis of the literature and real-world examples, this paper highlights the benefits of being a private company and provides insights into the strategic considerations for organizations choosing this business structure. Private corporations are exempt from restrictions on the inter-company investment of capital within the same group. If the Company Law Tribunal determines that a proposed change to the board of directors would be detrimental to the company's interests, it cannot intervene to block the change. A private company's profit and loss account must be submitted with the Registrar of Companies in order for members to see and copy it. Additional justifications for directors' disqualifications may be included in a private business.

**KEYWORDS:**

Financial Management, Flexibility, Innovation, Leadership, Market Research, Mission Statement.

## INTRODUCTION

The protection of the public's interests is one of the key goals of business law. As a result, several safeguards have been implemented to protect the interests of the shareholders of a public corporation that raises its capital from the public. Private businesses, on the other hand, do not get any of this public interest since they do not seek money from the general public. As a result, private businesses have been given a variety of benefits and exemptions [1], [2]. The following are the exclusions that private firms may use.

1. It can only be founded with two members, as opposed to the seven needed to form a public business.

2. Instead of the three necessaries for a public business, it may function with only two directors.

3. A prospectus need not be submitted.

4. Shares may be distributed without requiring the required minimum subscription.

5. It is not required to provide current members right shares.

6. It is not required to maintain a member index.

Unless the Articles specify a higher number, the quorum will only consist of two people who are personally present. If there are less than seven participants, one participant may demand a

poll; if there are more than seven participants, two participants may demand a poll [3], [4]. A member of a private corporation may not designate more than one proxy to attend the meeting at the same time, unless the company's articles specifically state otherwise. Directors are not required to register their authorization to serve as directors or to acquire and pay for Qualifying Shares. Before the first of April 1952, directors of private companies who held their positions for life could not be fired. A private corporation may provide direct or indirect financial support for the acquisition or subscription of its own shares [5], [6]. Private corporations are not subject to any limits on director loans. There are no limitations on who may be appointed or paid a salary as a director or managing director. There are no limitations on the number of businesses a director may oversee. If the firm is publicly traded, no one individual may serve as managing director of more than two companies and as a director in more than 20 companies [7], [8].

All Directors may be permanent and are not required to retire in succession. A private firm is not required to abide by the provisions relating to general meetings, voting, etc. No limitations on loans to businesses with the same management in the event that a private business fails to record a transfer or transmission of shares, there is no right of appeal to the business Law Tribunal.A private firm may provide extra justifications for a director's leave of absence. There are no limitations on a director's ability to vote or participate in board meetings [9], [10].

**Changes in Companies**

A private firm may choose to become public or may do so by default.

**Automatic conversion**

A private business loses its status as a private company and is classified as a public company if it fails to comply with the requirements of Section 2 in a timely manner. The rights and exemptions granted to private corporations under the Act are not applicable to it. However, the Company Law Tribunal may give relief from such penalties if it is convinced that the non-compliance was unintentional, caused by mistake, or was the result of another adequate reason. Additionally, it may provide relief on reasonable and equal grounds. When providing relief, it has the right to impose any terms and conditions that appear fair and reasonable to it.

**Private Business**

In order to eliminate the limitations placed on a private business, it is possible to convert a private company into a public corporation by amending the articles. The Company will be required to adopt an ordinary resolution to enhance its paid-up share capital. Once again, appropriate amendments to the Articles are made to fulfill the requirements of a public company, such as those relating to general meetings, the election of directors, annual accounts, and audit, among other things. In these circumstances, it is customary to draft additional Articles or to adopt A.Within 15 days of changing its articles, the firm must submit the following paperwork to the Registrar of Companies:

1. A printed copy of the amended or new Articles,

2. If applicable; a copy of the special resolution; and

3. A duplicate of the prospectus.

4. A duplicate of the regular resolution to raise the share capital, if it is raised.

The firm will no longer be a private corporation after conversion, and it will also lose all of its benefits and exemptions.

**Public company conversion to private company**

Similar to how a private firm might become a public corporation. A special resolution must be adopted to change the company's articles to restrict the power to transfer shares and cap membership at 200, with the following exceptions:

1. Current workers who are members.
2. Former workers who are still affiliated with the business.
3. Forbid inviting the public to make a deposit or subscribe for any shares or debentures of the firm.
4. Within 15 days after the order granting authorization, the following papers, together with the required fees, must be submitted with the Registrar of Companies:
5. A copy of the Special Resolution; 2. a printed version of the amended Articles; and 3. a copy of the Tribunal's ruling approving the firm's conversion to a private company:

**DISCUSSION**

**On the Basis of Ownership Government company**

**Government Enterprise**

Government company refers to any company in which the Central Government, a State Government, or Governments hold at least 51% of the paid-up share capital, or the Central Government and a State Government or Governments jointly hold at least 25% of the paid-up share capital, and includes a company that is a subsidiary of such a Government Company. Such businesses are subject to the amendment as agreed by both Houses of Parliament and are governed by the businesses Act.

**Non-Government Organization**

Non-government firms are businesses that are not owned and managed by the federal government or any state governments, i.e., businesses that are not government corporations. Typically, a public limited business belongs to the private sector.

**Based on a unit's basis for control**

Companies may be divided into holding companies and subsidiaries based on who controls a certain unit.

**Corporate holding**

A firm whose subsidiaries include one or more other companies is referred to as a holding company. subsidiary business. A company is a subsidiary of another if the holding company exercises or controls more than half of the total share capital either on its own or jointly with one or more of its subsidiary companies. This is referred to as a "subsidiary company" or "subsidiary" in relation to any other company. As long as the class or classes of holding corporations that may be mandated do not include any more layers of subsidiaries than may be required.For the purposes of this clause, a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in subclause or is of another subsidiary of the holding company; the composition of the Board of Directors shall be deemed to be controlled by another company if that other company, by exercise of some powers exercisable by it at its discretion, can appoint or remove all or a majority of the directors, shall be deemed to be the controlling company.The Act explains the conditions

under which a business shall be regarded to be a subsidiary of another in order to identify a holding company and a subsidiary company.

**Considering National Interest**

Corporations may be categorized as Indian corporations or foreign companies based on their national interests. Company of India. An Indian firm is one that was established in India and has a location there. All other businesses are Indian businesses, unless they are international businesses. Company from abroad. A foreign corporation is defined as any firm or body corporate that was established outside of India and that: maintains a place of business in India, either directly or via an agent, physically or virtually; and engages in any other kind of commercial activity there. However, a foreign company must adhere to any additional regulations that may be prescribed with regard to the business it conducts in India as if it were an Indian company if fifty percent or more of the paid-up share capital is held by Indian citizens and/or companies incorporated in India.

**Organizations not for Profit**

According to Section 4, a business created for profit must conclude its name with the words "Limited" or "Ltd." if it is a public company, and "Private Limited" or "Pvt. Ltd." if it is a private corporation. However, a business established to further trade, the arts, sciences, religion, charity, or any other beneficial endeavor with limited liability may be free from the need to add the words limited or private limited to its name. These businesses are often referred to as "Licensed Companies." Such a business must use its revenues, if any, and other income to further its goals. It is unable to provide its members any dividends. A license may be granted by the central government under the terms and circumstances it sees suitable. The Central Government may also order that these terms be included in the company's memorandum, articles of association, or both, partially or entirely. This agreement imposes obligations on the firm to follow certain terms and laws. Such a firm is not permitted to change the Memorandum's purpose provision without first receiving Central Government consent. The company's license may be revoked if it violates this clause.

**Unlawful Organization**

An "association" is a group of people working together toward a shared goal. Such an organization may, in general, be for-profit or not-for-profit, i.e., for the advancement of religion, art, culture, etc.

The Companies Act of 2013 mandates their mandatory registration in order to safeguard the public from the harm that huge trade groups, whose membership may be continually changing, might cause. Every organization of people with more members than the required number for doing any activity for profit is required to register under the Companies Act, 2013, or be created under another Indian law, according to Section 464. Such an organization will be referred to as an unlawful association and have no legal existence if it is not registered. Even though a Hindu Undivided Family is not registered under the Companies Act of 2013 or any other legislation, it is not an unlawful organization if it does business with more people than the required number. However, if two or more Hindu joint families come together to create a partnership, then each adult member of each joint family, rather than counting as one person, will be counted. The number of children in each joint family will be disregarded. A partnership firm's partners will be regarded as independent members of the business since it lacks a separate legal entity. However, the maximum number of individuals who may be prescribed under this rule is 100.

**Changing From A Public To A Private Company**

A corporation is an organization comprising many people. In a firm, decisions are made in accordance with the consensus of the majority. Meetings between the members and the directors are where various issues are addressed and determined. Several provisions for these meetings to convert a private company into a public company, and vice versa, are included in the Companies Act of 2013.

A private firm may go public using one of the three approaches listed below:

1. Automatic conversion; 2. Active conversion. 3. Default conversion

When a private corporation violates the legal condition outlined in Section 2 of the Act, it loses its status as a private company and becomes a public company. The Tribunal may, however, provide remedy in the following circumstances: If the failure to comply was unintentional or mistaken, or Only on the request of the corporation or an interested party, if it is reasonable and equitable, can relief be granted.

**Conversion on purpose**

1. Article modification. Changing the Articles of Association so they no longer include the limitations and provisions of Section 2 and other provisions incompatible with the requirements of a public company enables a private firm to voluntarily become a public company:

2. A name change. A private corporation must adopt a specific resolution under Section 13 in order to alter the business name.

3. Make more people a member. If there are just seven members, attempts should be conducted to expand that number to at least seven.

4. Expand the board of directors. If there are just two directors, at least three more directors should be appointed.

**Filing paperwork with the ROC**

The following paperwork must be submitted with the ROC within 30 days of the resolution's passage:

1. Modified articles and modified memos

2. A duplicate of the unique resolution

3. A declaration that serves as a prospectus in place of one transformation of a sole proprietorship into a public or private enterprise One Person Company may, under certain circumstances, change its status from an individual to a private or public company:

**Beyond-limits growth in paid-up share capital and annual turnover**

If a one-person company's paid-up share capital surpasses 50 lakh rupees or its average annual revenue over the relevant time exceeds 2 crore rupees, it will lose its status as an OPC.One Person Company must transform into either a private company with a minimum of two members and two directors or a public company with a minimum of seven members and three directors in accordance with the provisions of Section 18 within six months of the date on which its paid-up share capital is increased beyond 50 lakh rupees or the last day of the relevant period during which its average annual turnover exceeds 2 crore rupees, as applicable.

**Modifications to MOA and AOA**

To give effect to the conversion and to make required adjustments incidental thereto, the One Person Company must amend its memorandum and articles by adopting a resolution in accordance with sub-section of section 122 of the Act.The One Person Company must notify the Registrar in Form No. INC.5 that it is no longer a One Person Company and that it must now convert into a private or public company because its paid-up share capital or average annual turnover has exceeded the threshold limit within a period of sixty days of the date that subrule becomes applicable.

**Penalty For Violation**

If One Person Company or any officer of the One Person Company violates the terms of these rules, One Person Company or any officer of the One Person Company shall be subject to a fine that may reach 10,000 rupees and an additional fine that may reach 1,000 rupees for each subsequent day that the violation persists. meeting the requirements of a private or public corporation A one-person company may convert to a private or public company by meeting the requirements of Section 18 of the Act for conversion, increasing the required minimum of members and directors to two or minimum of seven members and two or three directors, as the case may be, and maintaining the required minimum paid-up capital.

**Reduced annual turnover and paid-up share capital restrictions**

A private company that is not one that is registered under Section 8 of the Act and has a paid-up share capital of at least 50 lakh rupees or an average annual turnover of at least 2 crore rupees during the applicable period may convert to a one-person company by passing a special resolution at the general meeting.

**Obtaining a certificate of no objection**

The firm must get a written no objection certificate from members and creditors before adopting such a resolution. special resolution and application submissions to the Registrar of Companies Within thirty days after the day the special resolution was passed, the one-person business must submit a copy of the resolution in Form No. MGT-14 with the Registrar of Companies.

**Exclusive Benefits of a Private Company**

According to the Company Act of 2013, there are a number of rules and limitations that only apply to public corporations and not to private ones. The reason for this is that public corporations that receive money from the public need more safety measures than smaller companies with fewer members. Due to this, a private firm is granted several benefits by the law in the form of privileges and exemptions.

**Periods of Promotion**

The promotion process involves these four phases. Finding of an Idea An individual or group of people could have the notion to launch a new company or grow an existing one. For instance, one may come up with the notion of opening a cinema hall at a certain location. There could not be a cinema hall there, or the plan might be to undermine the dominance of one that is already there.

**Investigation**

Before investing any funds to take advantage of newly discovered business prospects, they must be fully explored. The individual who comes up with the concept could be highly

upbeat. He may be too enthusiastic or have other motives for his optimism. The study will be conducted to see if the appropriate amount of parcel of land for the Cinema is available or not, continuing our earlier depiction of a Cinema Hall. Whether the local government, such as the Delhi Development Authority, Delhi Municipal Corporation, etc., would provide the required permits to operate the cinema hall if the building is to be built in Delhi.

**Assemblage**

After determining if a company idea is profitable, measures will be made to implement the concept. This calls for the purchase of land, structures, equipment, patent rights, and other things. At this point, promoters team up with other individuals who serve as the new company's initial directors. The promoters afterwards engage into pre-incorporation contracts for the collection of the properties and assets required to operate the business.Registration or Company Incorporation: The promoters must do the following actions in order to register the company:

1. To draft the articles of association and memorandum of association.
2. To get an incorporation certificate.
3. To get a certificate of company start-up.

## CONCLUSION

In summary, in today's changing economic climate, private firm privileges including more flexibility, secrecy, control, and long-term strategic planning provide important benefits. These freedoms enable private businesses to take quick choices, maintain secrecy, concentrate on long-term objectives, and focus on certain market sectors with their goods. Private enterprises may position themselves for ongoing development and success by making proper use of these rights.

Despite these advantages, it's crucial to recognize any possible difficulties private enterprises can run against. Consideration must be given to aspects such limited access to financing, dependence on internal resources, and possible challenges in scaling up. Private businesses must overcome these obstacles by efficient financial management, smart alliances, and new development strategies.

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# CHAPTER 3

# CLASSIFICATION OF PROMOTER AND THEIR RIGHT: AN ANALYSIS

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**ABSTRACT**:

This paper explores the classification of promoters and their rights in the context of company law. It examines the role of promoters in the formation and initial stages of a company, their legal obligations, and the rights they possess. The paper analyzes the various categories of promoters, including active, professional, and nominal promoters, and discusses their respective responsibilities and liabilities. Additionally, it delves into the rights of promoters, such as the right to be reimbursed for expenses, the right to remuneration, and the right to promote and profit from the company. Through a comprehensive analysis of legal frameworks and case studies, this paper sheds light on the classification of promoters and their rights, providing valuable insights into the legal aspects of company formation. A person who does the essential preparatory work incidental to the creation of a corporation is known as a promoter. A person who initiates, completes, and goes through all essential and incidental preliminary steps with the goal of establishing an incorporated corporation is referred to by this comprehensive word.

**KEYWORDS**:

Disclosure, Duties, Fiduciary, Insider Trading, Legal Rights, Liability.

## INTRODUCTION

According to chronology, a company's promoters are the first individuals in charge of its operations. They are the ones that come up with the concept of starting a business with a specific goal in mind, get it off the ground, and take the required steps to incorporate it. Lord Bowen said that the word "promoter" is not a term of law but rather of business activities recognizable to the commercial world, through which a corporation is often brought into existence, in Whaley Bridge Calico Printing Co. Vs. Green Smith 5 QBD, 109. According to Lord Lindley, "We are of the view that the term has no particularly clear connotation. The word "promoter" as it relates to businesses implies effort put forth for the aim of establishing and launching a firm [1], [2].

### Promoters are who?

Depending on the role he had in the company's establishment, a registered company may function as a promoter. Whether a person is or is not a promoter of a business is an issue of fact. If they have taken promotional actions, even those who don't have significant roles may qualify. However, a person will not be a promoter if they are just hired in a professional or technical position, such as a lawyer, accountant, valuer, or business consultant. Additionally, it does not include those people acting in a professional position or those working to help a firm start.

However, if any such individual goes above and beyond the call of their profession and aids in any manner in the establishment of a firm or in the planning stages of the administration of its operations, he or she would be considered a promoter [3], [4].

**Different Promoters**

The following categories of promoters are possible:

Accidental Promoters: Some people are not paid advertising specialists. They attempt to make sense of ideas that sometimes come to them by mistake. They are referred to as unintentional promoters.

Promoters with experience: These promoters consider promotion to be their line of work. They often do the marketing job for numerous company endeavors. Professional promoters might be a single person, a partnership firm, a group of people, or even a business.

Financial Promoters: There are certain promoters who take on a firm's promotion, do their professional tasks, and then buy the whole share capital of the company they have just promoted. They provide the business confidence and financial predictability. They could then sell the shares for a profit [5], [6].

**What a Promoter Does**

Promoters are the ones that create a firm from scratch. They started a company; hence they are the founders. They must carry out a variety of tasks, including the following:

1. To develop the concept of forming a firm.

2. To evaluate the concept.

3. To inquire about the idea's viability with subject-matter specialists.

4. To identify potential candidates to sign the Memorandum of Association and serve as the company's first directors.

5. To choose the company's name, registered office location, office locations, purpose, capitalization level, and membership.

6. To draft and sign agreements with underwriters.

7. To pick who will serve as the bankers, auditors, brokers, and legal consultants.

In conclusion, it can be said that a promoter handles all tasks, from coming up with the concept in his head until the company's official launch. As a result, when the firm is established, the promoter steps away and allows it go on with its operations [7], [8].

**Promoters' Rights**

The following rights belong to promoters inside the business:

Right to obtain the Preliminary Expenses: Promoters have the authority to obtain the preliminary costs they expended during the company's incorporation. It should be kept in mind that the promoters are not permitted to sue the firm to recoup the upfront costs. Only if there is a contract between them and the company, which may happen after the company is established (i.e., after obtaining a certificate of incorporation and a certificate of beginning of operation), and the contract is accepted by the company, can they recover it. As a result, the firm after formation must have a legal contract with the promoters. Only then will they be able to recoup their initial costs. Right to Receive Proportionate Sums from Other Promoters: A corporation may sometimes have more than one promoter. If the corporation is still bound by its contract, it may pay all of the promoters' compensation in this situation. In such circumstance, other promoters are permitted to demand their fair share of co-promoters'

compensation. Right to Compensation: Promoters must put a lot of effort into promoting a business. They are entitled to compensation from the business they promote as payment for this. The payment might come in cash, in the form of commission, in the form of shares or debentures, etc. They shall get their compensation in accordance with the method of payment that has been chosen after reporting it to an independent board of direction [9], [10].

## DISCUSSION

### Liabilities of Promoters

The promoters have the following liabilities:

1. Promoters are the Company's Founders; hence they are subject to the following obligations: To report and Repay the Secret Profits: Promoters are required to report any profits they have received through transactions. Profit: A promoter has a responsibility not to make any unreported profits, either directly or indirectly, as a result of the need to fully disclose all relevant information. He must refund any hidden profits to the business if they are made.

In the case of Gluckstein v. Barnes A.C. 240, a syndicate paid £ 1,40,000 bought the Olympia Company with the intention of developing a business, then selling it to the new business. The syndicate marketed a new business and made a profit of £40,000 by selling the Olympia to it for £ 1,80,000. Before buying the Olympia, the syndicate bought its debentures at a discount, certain that they would be fully repaid if the transfer to the new firm really happened. The debentures were fully paid by the new firm, which led to a profit of £40,000 for the syndicate rather than the expected profit of £20,000 from the debentures. As a result of their incomplete disclosure, the promoters were ordered by the House of Lords to compensate the firm £20,000.

2. The company may sue the promoter for damages for breaching his fiduciary duty and recover from him any hidden profits either directly or indirectly if he fails to disclose all material facts, including any profit and his personal interest in a transaction with the company. It should be underlined that a constructive disclosure will not suffice; the disclosure must be actual and explicit in order to be effective. If the promoters don't comply, the business has the right to void the agreement and take legal action to recover the money paid. New Sambrero Phosphate Co. v. Erlanger, 3 A.C. 1218 illustrates the topic well.

E was the leader of a syndicate that bought an island with phosphate deposits. E advertised a business and appointed fake people to its board of directors. By signing a contract with the new firm, a nominee of the syndicate sold the property to E for double what he had initially paid. The shareholders meeting accepted the acquisition deal. However, no significant information was revealed during the conference. When the business filed for insolvency, the liquidator sued E to recoup the profit. The directors, according to E, were fully aware of the transaction. His argument that the disclosure should have been made to an impartial board of directors was denied by the court.

3. Preliminary contracts formed by a promoter are still subject to personal liability since, even after incorporation, they are not legally enforceable on the firm. The corporation cannot approve such contracts since it did not exist when they were created. If such contracts are either approved by the corporation or particularly enforced by the Court under the Specific Relief Act of 1963, the promoters may not be held accountable.

4. If a promoter was a party to the prospectus's release, he or she will be held accountable for any major fact omissions or misstatements that were made in it. If the promoter omitted

information or gave false information in the prospectus, he would be responsible for compensating anybody who lost money or had their property damaged as a result. Additionally, the promoter can be subject to criminal prosecution.

5. Liability During Winding-Up: Should the official liquidator submit an application during the winding-up processes, the Tribunal may hold the promoter accountable for any misdeeds or breaches of trust he may have done during the company's founding or promotion. The Tribunal may order a public examination of the promoter if the official liquidator has reported fraud to it in a report. If he is found guilty of fraudulent behavior during the winding-up of the company, the Court or Tribunal with the authority to wind up a company has the authority to suspend him for a period extending up to 5 years from becoming a director or from participating in the promotion, formation, or management of a company.

**Payment to the Promoter**

Unless there is a written agreement to the contrary, a promoter has no right to receive payment from the corporation for his services in advertising the company. A promoter often accepts payment for his services in one of the following ways:

Cash Payment: Paying with cash is the original and most common way to compensate promoters for their efforts.

Shares and Debentures: Allocating the promoter shares and debentures of the firm they have supported is the second way to compensate them.

Promotional services may also be compensated by commissions taken from the company's net earnings over a certain time period.Promoter may sell his own property to the firm at a profit in exchange for cash or fully paid shares as long as he discloses this. The prospectus has to include any compensation given to the promoters. Pre-incorporation or Preliminary Contracts: The promoters of a business often engage into pre-incorporation or preliminary contracts to obtain certain property or rights in the firm that has not yet been incorporated. Typically, the promoters sign these agreements on behalf of the newly created corporation. According to the law, "Two consenting parties are necessary to a contract, whereas the company, before incorporation, is not an entity."

A person is not permitted to serve as an agent for a person who does not exist, according to the law of agency. A pre-incorporation contract does not thus bind a firm. A lawyer was hired to draft the required paperwork and get the company's registration certificate. He spent the required money and paid the registration cost. Following registration, the corporation declined to pay the costs and services. The court ruled that since the corporation was not there when the expenditures were made, "it could not be sued in law for those expenses".

**Promoters' Position with Regard to Pre-Incorporation Contracts**

The promoters' stance on pre-incorporation contracts is as follows:

**Business not Bound by Pre-Incorporation Contracts**

When a business is formed, it is not bound by pre-incorporation contracts, even though it reaps the benefits of the agreement made on its behalf. Contracts formed before to a business's establishment cannot be enforced by the firm after it has been incorporated.

Natal Land and Colonization Co. is the key case in this area. Ltd. A.C. against Pauline Colliery Syndicate Ltd. 120. N. Co. signed into a deal to lease coal mining rights with A, who was acting as the syndicate's nominee. The syndicate sued N after it was registered. Co. for

precise compliance with the contract. It was decided that since the firm did not exist when the contract was signed, the syndicate was not entitled to the lease.

**Promoter Personal Liability**

The promoters are nevertheless held personally accountable for a contract entered into on the behalf of an unincorporated business.

The promoters are responsible for paying damages if they break the commitments made in the company's name since such a contract is considered to have been entered into personally by them.

**Ratification of a Pre-incorporation Contract**

A firm is not permitted to approve a pre-incorporation agreement signed on its behalf by promoters. As a result, it is not permitted to accept or ratify a contract that is said to have been established on its behalf before it really exists. Even while the adoption of the pre-incorporation contracts is listed as one of the company's objectives in its Memorandum and Articles, doing so will not result in a binding legal agreement between the firm and the other parties. In this situation, it is safer for the promoters working on behalf of the soon-to-be-formed corporation to stipulate in the contract that:

The promoters' obligation will terminate if the firm enters into a new contract in accordance with the pre-corporation. If the company does not enter into a new contract within a certain time frame, either party may cancel the agreement.

However, the Specific Relief Act of 1963 offers some assistance in this regard. According to Sections 15 and 19 of the Specific Relief Act, a contract that a company's promoters entered into before it was incorporated for the objectives of the business may be specially enforced by or against the company. The crucial need in this regard is that these contracts serve the company's objectives. Imperial Ice Manufacturing Co. thus demonstrates. 13 Mum v. Manchershaw L.R. 165 It was noted that these contracts should be for the business's operational needs, such as a contract for the provision of ice-making equipment.

**Organizing A Company**

The second step in the creation of a business is incorporation or registration. The firm may be formed by any seven or more people. A firm may be established by only one person. An association may create a limited liability corporation with or without restricted purpose. The most common kind of corporation is a company limited by shares. Lawful Purpose: A company's intended establishment must serve a legal purpose. It must not go against the country's basic laws.

**Documents to be Filed with Registrar**

It is advisable to find out from the Registrar of Companies if the proposed name of the company is permitted before a company is established.

Then, the following paperwork must be presented with the Registrar of Companies of the State where the business will have its registered office, suitably stamped, and with the required fees:

The following documents and information for registration must be filed with the registrar whose jurisdiction a company is proposed to have its registered office, namely: Memorandum and Articles: The company's Memorandum and Articles duly signed by all of the subscribers to the Memorandum in such a manner as may be prescribed.

**Declaration in Prescribed Form**

A declaration in the prescribed form that all requirements of this Act and the rules made thereunder with regard to registration and matters precedent or incidental thereto have been complied with by an advocate, a chartered accountant, a cost accountant, or company secretary in practice who is engaged in the formation of the company, and by a person named in the Articles as a director, manager, or secretary of the company.

**Affidavit from the Subscriber**

An affidavit from each of the subscribers to the Memorandum and from individuals named as the first directors, if any, in the Articles, stating that they have not been convicted of any crimes related to the promotion, formation, or management of any companies and that they have not been found responsible for any fraud, mismanagement, or breach of duty to any company under this Act or any previous company law during the five years prior.Mail should be sent to this address until the company has a registered office.

**Detail Particulars**

The particulars of name, including last name or family name, residential address, nationality, and such other particulars of every subscriber to the Memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed. Details of First Director: Details of the individuals listed in the company's articles as the first directors, including their names, surnames or family names, the Director Identification Number, residential address, nationality, and any other details, such as identification proof, that may be required. Details of First Directors' Interests: Details of the individuals listed in the company's articles as the first directors' interests. The Registrar shall register all ie documents and information referred to in that sub-section in the register and shall issue a certificate of incorporation in the prescribed form stating that the proposed company is incorporated under this Act on the basis of documents and information filed under this subsection. The Registrar shall assign the company a corporate identity number, which shall be a unique identifier for the company and which shall also be included in the certificate, on or before the date specified in the certificate of incorporation issued under subsection.

**Preservation of papers**

Until its dissolution under this Act, the firm must keep copies of all papers and information that were first submitted with the registrar at its registered office. Action for False Particulars: Section 447 may be invoked if someone provides any false or inaccurate information in any document filed with the Registrar in connection with the registration of a company, or omits any important information about which they are aware.

Without limiting the provisions of subsection, if it is established that a company was incorporated through the provision of any false or inaccurate information or representation, the omission of any material fact or information from any document or declaration filed or made for the purpose of incorporating such company, or through any fraudulent act, the promoters, the persons identified as the f

Without limiting the provisions of subsection, in the event that a company was formed through the provision of any false or inaccurate information or representation, the omission of any material fact or information from any document or declaration filed or made for the purpose of forming such a company, or through the use of any fraudulent act, the Tribunal may, upon application and upon finding that the circumstances warrant it, pass such orders.

1. Direct that the members' liability be limitless; or

2. Immediate deletion of the company's name from the list of registered businesses;

3. Adopt a resolution directing the company's dissolution; or

4. Pass any more orders it may judge appropriate:

5. As long as, prior to issuing any order under this sub-section:

6. A fair chance to be heard in the case must be provided to the firm; and

7. The transactions made by the corporation, including any contracts for obligations or payment of liabilities, will be taken into account by the tribunal.

**Consequences of Registration**

Such subscribers to the Memorandum and all other persons who may from time to time join the company shall be a body corporate by the name set forth in the Memorandum from the date of incorporation specified in the certificate of incorporation, capable of carrying out all the duties of an incorporated company under this Act, having perpetual succession, and having the right to purchase, hold, and dispose of property, both movable and immovable, tangible, and intangible.

**Beginning of business**

After incorporation, a firm cannot begin operating as either a private or public company. To start a company, these must get a further certificate called a certificate. The Registrar of Companies issues a certificate to start a business after the following requirements are met: A company with a share capital may not start a business or use its borrowing authority unless:

Every subscriber to the Memorandum has paid the value of the shares agreed to be taken by him on the date of making this declaration, according to a declaration filed by a director with the Registrar in the form and verified in the manner that may be prescribed. The company has also filed a verification of its registered office with the Registrar in accordance with subsection 12 of section 12. In the event that any failure to comply with the requirements of this section occurs, the company may be subject to a fine of up to 5,000 rupees, and each officer who is in default may be fined up to 2,000 rupees for each day that the failure to comply continues.

## CONCLUSION

In conclusion, A legal framework for comprehending the duties, obligations, and rights of those participating in the creation and promotion of a firm is provided by the categorization of promoters and their rights. Promoters may help a firm get off the ground successfully by acknowledging and respecting these rights, and prospective investors can make wise judgments about their investment by doing the same. In the early phases of a company's life cycle, openness, accountability, and fairness are encouraged by a clear knowledge of promoter rights.

Promoters and prospective investors should be aware of the duties and legal obligations that go along with their positions. Promoters have a fiduciary obligation to the firm and its shareholders, which obligates them to behave honestly and, in the company’s, best interests. They must comply with all applicable rules and regulations, provide complete and accurate information, and declare any possible conflicts of interest.

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# CHAPTER 4

# CONCEPTS FOR MEMORANDUM OF ASSOCIATION

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**ABSTRACT:**

The concept of the Memorandum of Association (MOA) in company law and its significance in the formation and governance of a company. The MOA is a fundamental legal document that defines the company's scope of activities, objectives, and rules of operation. This paper explores the essential components of an MOA, such as the company's name, registered office, object clause, capital clause, and liability clause. It analyzes the purpose and legal implications of these clauses and their impact on the company's legal capacity, contractual obligations, and relationship with its stakeholders. Through a comprehensive analysis of relevant statutes and case law, this paper sheds light on the importance of the MOA as a foundational document in company law. One of the fundamental papers that must be drafted by every business at the outset and submitted to the Registrar for registration is the memorandum of association. It lays out the company's bylaws and establishes the framework for the organization's structure.

**KEYWORDS:**

Capital, Clauses, Company Name, Directors, Liability, Limited liability, Members.

## INTRODUCTION

It outlines the company's operations' range and how it interacts with the outside environment. A company's operations and interactions with the outside world are governed by its memorandum of association. The preparation of a Memorandum of Association is the first stage in the foundation of a corporation. The Memorandum of Association of a Company, as initially drafted or as amended from time to time in accordance with any prior company legislation or of this Act, is referred to as a "Memorandum" in accordance with Section 2 of the Indian Company Act, 2013. It is a company's most crucial document. Because it outlines the organization's goals and places restrictions on its authority, it is known as the "Charter of the Company." This paperwork must be submitted in order for the firm to be registered [1], [2].

An Important Document In regards to the corporation, the Memorandum of Association is a crucial document. It includes the essential requirements that must be met before the firm may be formed. It outlines the company's operational region. In respect to outsiders, it also controls the company's external affairs. The aim is to make the enterprise's permissible scope known to shareholders and other stakeholders. It not only demonstrates the purpose for a company's foundation, but also its broadest range [2], [3].

### A Memorandum of Association's objectives

The Memorandum has two purposes. The potential shareholders must be aware of the area or purpose in which the company will use their funds, as well as the risk they are taking by investing. Any third parties dealing with the company must be certain of its objectives and that any contractual agreements they plan to enter into with it are consistent with those objectives. A company's memorandum must follow the specific formats outlined in Schedule I, Sections A, B, C, D, and E, depending on their applicability. Each subscriber must sign in

the presence of at least one witness and include their name, address, and any applicable employment [4], [5].

**Memorandum of Association's provisions**

**Clause of Name**

The prospective company's name must be included in the Memorandum's first sentence. A company's identity and emblem of existence are established by its name. Guidelines for Name: A business may choose any sui name as long as it adheres to the guidelines below: a bad name to avoid using: A firm cannot be formed using a name that the Central Government deems objectionable. In general, if a name is too close to another company's name or otherwise unfavorable, it will be rejected. misleading, i.e. implying that the firm is associated with a certain company or that it is a particular sort of affiliation when this is not the case. Injunction if Identical Name is Adopted: If a business registers with a name that is similar to another firm's name, the other company may ask the court for an injunction to prevent the new company from using the same name. This is because to the firm's goodwill and control over its usage; no other company may be registered under a name that is the same as it or even remotely similar enough to be intentionally misleading [6], [7].

A merely descriptive term with a clear meaning and widespread use will not be prohibited by an injunction. However, a simply descriptive term with a clear meaning and widespread use will not be subject to an order from the Court or Tribunal. A firm registered as Aerators Limited tried to prevent the establishment of another company using the name "Automatic Aerators Patents Limited" in the case of Aerators Ltd. Vs. Tollitt 2 Ch. 3191. Despite the fact that the patents and equipment of the two firms were different, the primary goal of both was the production of equipment for the immediate automated aeration of liquids. The Court did not issue an injunction. 'Limited' or 'Private Limited' as the Name's Last Word: If the firm is a public limited company, the final word of the name in the memorandum must be "Limited," and if it is a private limited business, the last word must be "Private Limited [8], [9]."

A company's name will be deemed improper if the term "Limited" is omitted from the name. The executives of the business that creates the contract are presumed to be personally accountable if the term "Limited" is omitted from the contract. The absence of the term "Limited" from a business name must have been intentional and not just an oversight. Observe the following situation: A bill of exchange made on a limited company in its legal name was properly accepted by two company directors in the case of Dermatine Co. Ltd. vs. Ashworth (T.L.R. 510). The term "Limited" was missed since the rubber stamp used to imprint the words of acceptance on the banknote was longer than the paper. Directors were not held personally accountable and the firm was held responsible for paying. It was a little mistake, and the harm that the Act was intended to prevent was nonexistent. Use of Certain Names Blocked: Any name or symbol listed in the Act's Schedule may not be used or registered by a firm, according to the Emblems and Names Act of 1950. The Schedule lists the names, emblems, and official seals of the World Health Organization, the International Civil Aviation Organization, the World Meteorological Organization, the United Nations Educational, Scientific, and Cultural Organization, the Indian National Flag, and the Central Government and State Governments. The name, insignia, or official seal of the President of India, the Governor of any State, or any affiliation with a local government, a corporation, or any organization established by the Government in accordance with any currently in effect legislation. Once a business is registered under a certain name, that name must be prominently displayed on all correspondence from that business, including letters, notifications, and checks, among other things. The name of the person who, in the event of

the subscriber's death, shall become a member of the company in the case of a one-person corporation. Penalty. A fine of up to 1,000 per day until the violation is remedied may be imposed on the corporation and any officer who fails to comply with this rule [10].

**Situation Clause**

The name of the State where the company's registered office will be located must be included in the second clause of the Memorandum. This establishes the company's domicile. It is necessary to provide the name of the provide where the company's registered office will be located. The Memorandum omits mentioning the actual address. However, within 15 days of incorporation or modification, whichever comes first, notification of its registered office and any changes therein must be sent to the Registrar. Typically, the Memorandum and the Notice of the Company's Registered Office are filed together at the time of registration. The aforesaid penalty will likewise be imposed in this instance for default.

Every company is required by Section 12 to: paint or affix its name and registered office address, and keep them painted or affixed, on the outside of each office or location where its business is conducted, in a conspicuous position, in legible letters, and if the characters employed are not those of the language or one of the languages commonly used in that locality, also in the characters of that language or one of those languages; have its name printed on money, promissory notes, bills of exchange, and any other documents that may be required, as well as having its name engraved in legible characters on its seal, if any, and having its name, registered office address, corporate identity number, phone number, fax number, e-mail address, and website address printed on all correspondence and official publications.

With the exception that, if a corporation has changed its name or names in the last two years, it must paint, attach, or print the previous name or names that have been altered in the past two years in accordance with clauses and: Furthermore, whenever the name of such a firm is printed, adhered, or engraved, the words "One Person Company" should be specified in brackets.

**The Object Clause**

A company's goals must be clearly mentioned in the memorandum since it may do anything that falls within or is related to those goals. The purpose clause limits and defines the company's authority, and once registered, it may only be changed in accordance with the Act. The Object Clause's Goal: The Memorandum's object clause serves two purposes: First and foremost, it safeguards investors by teaching them how to use their money. It guarantees that their money won't be put at danger in any venture that the Memorandum hasn't approved. Second, it safeguards the company's debtors and other customers as they may deduce the scope of the company's authority from it. Any action taken beyond the scope of the Memorandum's authority would be considered ultra vires. A company is free to pick its goals, but such goals cannot be illegal, unlawful, against to public policy, or in violation of the Companies Act, such as engaging in hostile trade, etc. the purpose for which the business is intended to be formed and any actions deemed essential to that purpose.

In Evans Vs. Brunner Mond & Co. 1 Ch. 359, a chemical manufacturing business sought to spend a significant amount of money supporting scientific education. Although it was shown that this Act would eventually be advantageous to the corporation, a shareholder protested on the grounds that it exceeded the company's authority. Holding true, the proposition was only ancillary to the goal of the business.

**Clause of Liability**

The liability of the members of the company, whether limited or unlimited, is stated in the liability clause, which also specifies: in the case of a company limited by shares, that the liability of its members is limited to the amount unpaid, if any, on the shares they hold; and in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute: to the assets of the company in the event that it is wound-up while he is a member or within one year

**Capitalization**

The amount of the share capital with which the company is to be registered as well as its split into shares of a defined amount must be stated in the company's memorandum. The amount of share capital with which the company is to be registered, its division into shares of a fixed amount, the number of shares to which the subscribers to the memorandum agree to subscribe, which shall not be less than one share, the number of shares each subscriber to the memorandum intends to take, d opposite his name, and, in the case of a one-person company, the name of the person who, in the event of the subscriber's death, shall be entitled to the subscriptions

**Clause VI: Subscription**

Despite not having a number in the Act, this provision is often included at the beginning of the Memorandum. "We the several persons, whose names, addresses and occupations are subscribed, are desirous of being formed into a company in accordance with this Memorandum of Association, and we each agree to take the number of shares in the capital of the company set opposite our respective names," reads the clause.

The subscription clause for "One Person Company" is as follows. In accordance with this Memorandum of Association, "I, whose name and address are given, am desirous of forming a company and agree to take all the shares in the capital of the company."

The people signing the Memorandum are ready to organize themselves into an organization, according to this provision. The signature of one subscriber cannot be attested by another. A subscriber must additionally purchase a minimum of one share. He should list the number of shares he has purchased next to his name. A minimum of seven people must sign the Memorandum in the event of a public firm.

## DISCUSSION

**Alteration In Memorandum of Association**

The Memorandum of Association is a company's founding document. It cannot be changed freely and shouldn't be. The procedure for amending the Memorandum of Association is outlined in Section 13 of this Act. Any change in a company's name shall be subject to the provisions of Section 4 and of Subsection 4 and shall not be effective unless approved in writing by the Central Government: PROVIDED, when a name change is made in accordance with subsection, the Registrar must enter the new name in the register of companies in place of the old name and issue a new certificate of incorporation bearing the new name. Only after the issuance of this certificate will the name change be final and effective.

**Clause for Change in Situation**

According to the guidelines of this Act and Section 13, a corporation may relocate its registered office. The Central Government must authorize the change on an application in the

format and manner specified by the Central Government before the registered office location may be changed from one State to another. The Central Government must respond to the application under subsection within sixty days and may make sure that the change has the support of the company's creditors, debenture holders, and other interested parties before issuing an order. It may also make sure that the company has made sufficient provisions for the timely repayment of all of its debts and obligations or that adequate security has been provided for such repayment. When a change to the Memorandum causes a company's registered office to move from one State to another, the company must file a certified copy of the order from the Central Government approving the change with the registrar of each State within the timeframe and in the manner prescribed, who will then register it. The registrar of the State where the registered office is being shifted to will then issue a new certificate.

**Modification to the Object Clause**

According to Section 13 of the Companies Act of 2013, a corporation may alter its purposes in order to advance the goals outlined in the Memorandum. A change must be done in compliance with the rules and the way specified. The corporation must adopt a special resolution and get the Central Government's permission before amending the purpose clause. Every modification to the Memorandum must be documented in every copy. A company that has raised money from the public through a prospectus and still has any unused money from the money so raised may not change the purposes for which it raised the money through a prospectus unless the company passes a special resolution, and the details of such resolution, as may be prescribed, shall also be published in the newspapers that are in circulation where the company's registered office is located.

Within 30 days after the date the special resolution was filed in accordance with clause of sub-section of this section, the Registrar must register any change to the Memorandum with regard to the company's purposes and certify the registration. Any modification made in compliance with this section must first be registered in accordance with its requirements before it may take effect. Any amendment to the Memorandum in the event of a business limited by guarantee without a share capital that purports to provide anybody the right to partake in the firm's divvy up profits other than as a member is invalid. For each copy of the Memorandum or Article that is published without this amendment, the corporation and any officer who is in breach will be fined $1,000.

**Revision of the Liability Clause**

Without their written approval, the members' responsibility cannot be deemed limitless. A Member shall not be required to acquire more shares of the Company by amendment to the Memorandum or the Articles. However, an organization may increase the monthly subscription without the written approval of its members by amending its Memorandum or Articles. Additionally, if the Article so provides, the responsibility of the directors, managing directors, or management may be declared limitless with their assent. The Company Law Tribunal's approval of a special resolution is required to restrict the shareholders' otherwise limitless liability. An unlimited corporation may also register itself as a limited company as an alternative. However, it won't have an impact on any commitments, debts, liabilities, or contracts established prior to that registration.

**Modification to the Capitalization**

A limited company with a share capital may change its memorandum in its general meeting, if permitted by its articles, to: increase its authorized share capital by any amount it deems

appropriate; consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares:

Convert all or any of its fully paid-up shares into stock and reconvert that stock into fully paid-up shares of any denomination; subdivide its shares, or any of them, into shares of smaller amounts than is fixed by the Memorandum, provided that no consolidation and division that results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner. Share capital will not be considered to have decreased as a result of the cancellation of shares under subsection.

When a company changes its share capital in one of the ways listed in Section 61's sub-section, when the government issues an order under Section 61's sub-section read in conjunction with Section 62's sub-section that increases a company's authorized capital, or when a company redeems any redeemable preference shares, notice must be given to the registrar.Within 30 days following any change, increase, or redemption, as the case may be, the company must submit a notification in the specified form with the Registrar together with an updated Memorandum. If a firm or an executive of the company who is in default violates the terms of subsection, it or he may be fined up to one thousand rupees per day for the duration of the default, or five lakh rupees, whichever is less.

**Philosophy of Ultra Vires**

A firm is capable of doing anything, including the following:

1. Permitted to be done under the 2013 Companies Act;

2. Essential to achieving its stated goal in the Memorandum; and

3. Reasonable and tangential to its goals.

Everything else is beyond the company's boundaries. Ultra and vires both imply "powers," which implies "beyond." When a firm acts in a "ultra vires" manner, it signifies that it is acting outside of its legal rights and responsibilities. Even if all of the business's shareholders agree to approve the transactions, any ultra vires activities by the company shall be completely invalid and never be confirmed and become legitimate. An act need not be unlawful in order to be deemed supra vires; it may be or may not be. By virtue of estoppel, passage of time, ratification, acquiescence, or delay, it cannot become extra vires. Future shareholders as well as the general public who do business with the firm are to be safeguarded by the guideline. The best example of this is Ashbury Rly. Iron & Carriage Company Ltd. Against Riche L.R. 7 H.L. 653, A business was established with the following goals:

1. Create, market, or rent out railroad wagons and carriages;

2. To conduct mechanical engineering and general contracting activities;

3. To buy, rent, operate, and sell mines, minerals, properties, and structures.

The business and Riche engaged into a deal for the financing of a railway line in Belgium. The validity of the contract was the issue at hand. The House of Lords ruled that the contract was invalid because it violated corporate policy and could not be upheld even with the eventual approval of all shareholders.The Ashbury case's application of the supra vires concept was upheld by the House of Lords in Attorney General v. Great Eastern Railway Co. Cas 473. According to a statement, the doctrine of ultra vires "ought to be reasonably and not

unreasonably, understood and applied, and whatever may fairly be regarded as incidental to or consequential upon those things which the legislature has authorised ought not be held by Judicial construction to be ultra vires." Take note of the following case:

Gas Light & Coke Co. v. Deuchar A. A gas firm was given the authority to create and sell residuals, produce and supply gas, and furnish any equipment and materials it judged necessary for those uses. After years of obtaining caustic soda, it made the decision to start producing its own caustic soda. Held, it did not violate the company's ultra vires.

The basic aspect of the idea of ultra vires is that even if a company's actions or those of its agents go beyond the bounds of its authority, it should not be held accountable since it is a corporate person. A business contract that is ultra vires is completely worthless and has no legal standing. However, there is nothing that prevents a business from defending its assets. The strongest argument for this claim is:

Countrywide Telephone Co. St. Peter Port Conss A.C. v. 317. In a certain location, a telephone company installed telephone cables. The Memorandum gave the business no authority to install cables there. They were killed by the defendants. Held, the business might file a lawsuit for wire damage.

The following categories may be used to categorize ultra-virulent acts:when an activity is taken or a transaction is made that, although lawful in and of itself, is not permitted by the Memorandum's purpose clause or by a law. It is said to be against business policy. Even the whole body of shareholders cannot approve a decision that is ultra vires the firm. A special resolution at a general meeting of shareholders may be used to approve an act that is ultra vires the directors, that is, beyond the purview and authority of the directors but intra vires the corporation. If an act violates the Articles, it may be approved by amending the Articles by a special resolution adopted by the membership.

**Ultra Vires Transactions' Effects**

Acts that are considered ultra vires are those that a company or its directors are not authorized to carry out. These acts have the following consequences: A company is not bound by ultra vires acts and cannot ratify them even if all of the company's shareholders agree to do so.Directors may be held personally liable for company money used in ultra vires transactions by any member of the company. This action may be brought against the directors of the business by any member of the company. Even if the misapplication of money by the directors is done in good faith or when it is not fraudulent, they are nevertheless personally accountable to the corporation for breach of trust.

From Sharpe Re 1 Ch. In the case number 154, the company's directors engaged in an extra vires conduct by paying dividends on shares using capital. The firm was subsequently dissolved. According to the ruling, the directors had to give the corporation its money back. Obtaining an injunction order from the court to stop work may be done by any member of the firm who believes that the corporation is about to act in violation of the law. Contracts that are Ultra Vires are Null and invalid: Any contract that a firm enters into that is Ultra Vires its Memorandum is null and invalid and cannot ever be approved.Directors are regarded as the company's agents and are thus liable for any breaches of the warranty of authority. They have to operate within the confines and authority of the business. They will be held personally responsible for such contracts and accountable for failing to uphold their obligations if it is shown that they persuaded someone to sign into a contract that violated the company's memorandum. They will have to make up for all of that person's losses.

In Weeks Vs. Propert, LR & C.P 427, the directors of a railway company that had used all of its borrowing capacity advertised for money to be loaned on debentures. 'W' gave £500 on the basis of the advertising and was given a debenture. The debenture was invalid, but "W" might still bring a claim against the directors for failing to uphold their authority. No Suit Can Be Filed: A business cannot sue somebody for acting in an ultra vires manner, and it also cannot be sued. Property Acquired via an Ultra Vires Transaction: A firm has the right to keep any property it has acquired via an ultra vires transaction and to defend it against harm from other parties. Torts committed by agents or employees in the course of ultra vires transactions are not the company's responsibility.

Exceptions to the Ultra Vires Doctrine

The following situations do not fall under the supra vires doctrine:

1. A company may approve an act that is intra vires the company but ultra vires the directors of that company.

2. If a company's articles of association are violated by an act, the articles may be changed to include the conduct within the company's authority.

3. The shareholders may approve an act if it is within the law but is carried out improperly.

4. If a person borrows money from a business according to a contract that violates the terms of the business, the business may file a lawsuit against the borrower to reclaim the money.

5. The rights deriving independently of the act that is ultra vires the firm are unaffected.

6. The lender who provided the money is replaced in place of creditors and as such he may reclaim the money if a corporation takes out an ultra vires loan and uses it to settle intra vires obligations.

7. The lender has the power to hold directors personally accountable for violating the implicit guarantee of authority if a corporation obtained an extra vires loan due to any misreading of the facts by the directors.

8. A firm may require a director who violates its rules by making a payment to reimburse it.

## CONCLUSION

In conclusion, the scope, goals, and regulations of a corporation are laid forth in the Memorandum of Association, which is a fundamental document in company law. It offers legal clarity and protects the company's, its shareholders', and other stakeholders' interests. The MOA acts as a contract, establishes the company's legal status, and directs its business practices.

Companies must carefully construct the MOA, making sure that it appropriately represents the company's goals and conforms with all applicable laws and regulations. The MOA also serves as a foundation for business contracts. It establishes the company's goals and regions of operation, enabling it to sign contracts and do business. The MOA's terms function as representations to third parties, and any acts the firm does must be consistent with those statements.

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# CHAPTER 5

# INVESTIGATING THE MODELS FOR ARTICLES OF ASSOCIATION

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**ABSTRACT**:

This paper examines the models of Articles of Association (AOA) and their significance in company law. The AOA is a key document that governs the internal affairs, management structure, and decision-making processes of a company. This paper explores different models of AOAs, including the statutory model articles, model articles provided by regulatory bodies, and bespoke articles tailored to the specific needs of the company. It analyzes the essential provisions typically found in AOAs, such as share capital, voting rights, directors' powers, dividend distribution, and amendment procedures. Additionally, it discusses the impact of these models on the company's operations, corporate governance, and shareholder rights. Through a comprehensive analysis of legal frameworks and case studies, this paper sheds light on the importance of selecting an appropriate model of AOA that aligns with the company's objectives and regulatory requirements.

**KEYWORDS**:

Registered Office, Share Capital, Shareholders, Signatories, Subscribers, Subscriptions.

## INTRODUCTION

The rules, regulations, and bylaws governing the internal administration of the company's operations are included in the Articles of Association. The goals and objectives outlined in the Memorandum of Association are intended to be carried out by them. The Indian Companies Act, 2013, Section 2 defines the Articles of Association as "the Articles of Association of Company as originally framed or as amended from time to time or applied in pursuance of any previous company law or of this Act." Since a corporation is an established entity, there must be laws and regulations governing how its internal affairs are managed and how business is conducted. It is crucial for a firm to have certain rules in place for handling interactions both with and among its members. Additionally, the company's rights and obligations as well as those of its members must be documented. The articles of association are a document that accomplish all of the aforementioned goals. Every organization that has been incorporated is required to have and abide by its articles of association, which constitute its internal rulebook. It is a clause in the organization's constitution that creates a contract between the members and the organization as well as between the members themselves. The rights and obligations of directors and shareholders both individually and collectively are also outlined in the articles [1], [2].

The Article must also include any specified things. With the caveat that nothing outlined in this subsection should be interpreted as preventing a corporation from incorporating any further provisions it may feel appropriate for its management in its articles. The Article of a Company shall be in the respective forms specified in F, G, H, I and J in Schedule I as may be applicable to such Company. The Article of a Company may contain provisions for entrenchment to the effect that specified provisions of the Articles may be altered only if conditions or procedures as that are more restrictive than those applicable in case of special resolution, are met or complied with [3], [4].

The Memorandum, which provides the essential requirements upon which alone a corporation is permitted to be established, is more significant than the Articles in terms of relevance. As a result, the Memorandum has power over them and is their superior. The 'Articles' play a role that is secondary to the Memorandum of Association, as was noted in Ashbury Railway Carriage & Iron Company Ltd. vs. Riche L. R.7 H.L. 653. They acknowledge the Memorandum of Association as the company's charter and accept it as such. The Articles go on to specify the governing body's responsibilities, rights, and powers with regard to the business as a whole as well as the manner and duration of any periodic modifications to the company's internal rules [5], [6].

It is important to take care while drafting a business's articles of incorporation to ensure that any restrictions do not exceed the authority that the organization has been granted by the Memorandum of Association. Additionally, they must not transgress any Companies Act rules. In the Peveril Gold Mines Ltd. Re Ch. 122 case, it was ruled that the Articles' contents should not contravene the Companies Act's rules [7], [8].

In addition to the aforementioned information, an un-limited company must state in its articles of association how many shares it will have and how much share capital, if any, it will have when it registers. The number of members with whom the company is to be registered must be disclosed in the articles of association for a company limited by guarantee. Additionally, the amount of the guarantee they have promised to provide in the event of a firm wind-up must be disclosed [9], [10].

## DISCUSSION

The following list of sample articles of association for different sorts of corporations is included in Schedule I of the corporations Act: F: Articles of Association for a company limited by shares. G: A corporation limited by guarantee and having a share capital's articles of association. H: The articles of association for a limited liability business without share capital. I: The articles of association for a firm with infinite assets and share capital. J: Non-share capital, limitless company's articles of association. Firms that are required to have their own Articles. The following corporations will each have unique articles:

1. Unlimited businesses.

2. Companies with limited liability.

3. Private businesses with a share capital.

The Memorandum's subscribers must sign the Articles, which must also be registered with the Memorandum.

According to Section 14 of the Indian Companies Act, 2013, a company may change its Articles, including changes that result in the conversion of a private company into a public company or a public company into a private company. The company will cease to be a private company as of the date of any alteration if its articles no longer contain the restrictions and limitations that must be included in the articles of a private company under this Act: Further, any alteration that results in the conversion of a public company into a private company shall not take effect without the approval of the Secretary of State. Every modification to the Articles made in accordance with this section must be registered with the Registrar within fifteen days of filing it with him or her, along with a printed copy of the altered Articles and a copy of the order of the Tribunal approving the modification as per subsection. Subject to the restrictions of this Act, any modification of the Articles recorded under subsection shall be legitimate as if it had always been there. Changes to a company's memorandum or articles

must be mentioned in each copy, in accordance with Section 15 of this Act: Every change made to a company's memorandum or articles must be acknowledged in each copy, if appropriate. Every official who is in violation of sub-section's requirements, as well as the firm, is subject to a fine of Rs. 1,000 for each copy of the memorandum or articles issued without the required adjustment.

**Limitations to the Change**

The restrictions for changing Articles are as follows:

No Alteration of the Articles May: No Alteration of the Articles may be in conflict with or beyond the restrictions of the Companies Act. Must Not Conflict with Memorandum: Any changes to the Articles must not go beyond the authority granted by the Memorandum or with its rules. If it does, it will be ultra vires, which means it is completely useless. Must Not Sanction Anything criminal: The modification may not be interpreted as endorsing any criminal activity. However, if it is unlawful and the Memorandum does not expressly forbid it, it may be deemed to be legitimate even if it changes the company's whole organizational structure.

Must be for the Company's advantage: The modification must legitimately be for the company's overall advantage. Gold Reefs of West Africa Ltd. v. Allen, Ch. It was noted in 656 that the power of change must be used in accordance with the normal legal and equitable rules that apply to all powers granted to majorities that allow them to bind minority. Must Not Increase Members' responsibility: Where the firm is a club or organization, the Articles may be changed to include a subscription clause or a higher rate of fee, but the modification must not in any way increase the responsibility of current members.

Change by Special Resolution: Only a special resolution as described by the Act may make the change. A special resolution should be used to correct any inaccuracy, including clerical ones, in the Articles. When a publicly traded corporation becomes a private company, the central government must approve the change. Only with the Central Government's approval may the Articles be changed in a way that results in a public business becoming a private corporation. Contract Breach: Even though changing the Articles would violate a contract, a corporation is nevertheless allowed to do so. However, the party who would be harmed by the change might sue for damages. Must not Lead to the Expulsion of a Member: It is unlawful and invalid for a company's directors to assume any authority to remove a member by changing the company's articles. Articles cannot be amended or corrected by the court, even if there is a typographical or drafting error that the court would correct in the event of any other contract. Only some clauses may be deemed supra vires by the court.

**Memorandum And Articles: Their Relation**

Memorandum is superior to the Articles. A firm cannot be granted powers by the Articles that are not granted by the Memorandum. This is so because the Memorandum's aim is to express the reason the business was founded, whilst the Articles specify how the internal administration of the company is to be conducted. The Memorandum may be explained or supplemented by the Articles, but it cannot be expanded or increased in scope. As far as the basic circumstances in the Memorandum are concerned, they cannot be clarified with the assistance of the Articles, and the provisions of the Memorandum cannot be amended or regulated by the Articles. Regarding this, Brown L. "The Memorandum contains the essential requirements upon which alone company is allowed to be incorporated," it was noticed. They are restrictions put in place for the interest of shareholders as well as creditors and the general public. The company's internal rules are included in the Articles.

**Legal Implications of The Association's Memorandum and Articles**

When the Memorandum and Articles are registered, they bind the company and its members to the same extent as if they had each been signed by the company and contained covenants on their parts to observe all of the provisions of the Memorandum and of the Articles, subject to the provisions of this Act. Any amount that a member owes the firm under the Memorandum or the Articles will be considered a debt. According to the aforementioned provisions of the Companies Act, the Memorandum of Association and the Articles of Association are legally binding on the business and its members once they are registered. These clauses have the effect of creating a contract between each member and the firm.

**Members of the Company**

The Memorandum and the Articles establish a contract between the Members and the Company. As a result, each member is obligated to abide by the Memorandum and the Articles of Incorporation as if they had all signed them in person. Trustees of Borland against Steel Brothers & Co. Ltd. 1 Ch 279, the amended articles of incorporation mandated that shares of any member who declares bankruptcy be sold to specific individuals at a reasonable price. B, a shareholder, declared bankruptcy, and his bankruptcy trustee asserted that he was not subject to the modified Articles. According to the ruling, the Articles were a private agreement between B and the other members, as well as his trustee, who were all bound by it. corporation to Members: A corporation and its members are both obligated to each other in the same way. Only in line with the Memorandum and the Articles may the Company use its rights against any Member. A member has the right to get an injunction prohibiting the corporation from acting in violation of the law. The Articles of W. in the matter of Wood v. Odessa Water Works' Co. 42, Ch, D 636. Company stipulated that the directors might declare a dividend to be paid to the members with the approval of the company at a general meeting. A resolution was adopted to issue debenture bonds to shareholders rather than paying dividends in cash. A member filed the lawsuit to prevent the board from acting on the resolution since it was against the company's bylaws. According to the ruling, the phrase "to be paid" refers to payment in cash, and a shareholder has the right to stop the corporation from implementing a resolution on the grounds that it violates the Articles. Member Inter Se: Members are obligated to one another, but nothing in these agreements establishes an explicit contract between them. To enforce the Articles, a member cannot file a lawsuit in his own name against another member. If not, there may be several lawsuits brought against a single defaulter, which would be ludicrous. However, if the at-fault member owns the majority of the shares, he will not be permitted to act on behalf of the firm. In this situation, another shareholder may file a lawsuit in his own name against him.

In Wettron v. Saffery A. C., Lord Herschell established this. 299. "It is true that the Articles serve as a binding agreement between each Member and the Company, but the Articles do not govern the Member's rights in and of themselves. In some cases, where the Articles seek to regulate the rights of shareholders in their capacity as members, they constitute a contract between two members and in which case contract can be directly enforced by a member against another without joining the company as a party. Such rights can only be conferred by or against a member through the company or through the liquidator.

**Corporation to the outsiders**

The corporation is not obligated to the outsiders, and neither are its members. This is true even if these papers include the names of the foreigners. Once again, even if a member is acting in a role different than that of a member, the Articles do not provide them any rights. Between the business and the outsiders, a separate contract must be signed.

Eley v. Proactive Govt. Life Security Ass. Co. EXD 88's articles of incorporation stated that E should serve as the company's solicitor for life and could only be fired for misconduct. E started working and joined the stock. After some time, the business fired him without making any accusations of wrongdoing. E filed a lawsuit against the corporation seeking damages for violating the Articles' rules. As a result, no action could be brought since the Articles did not represent a contract between the corporation and third parties.

**Constructive Notice of Articles and Memorandum**

The contents of the Memorandum and Articles are presumed to be known to anybody interacting with a firm from the outside. Constructive Notice of Memorandum and Articles is the name given to these papers once they have been registered with the Registrar and take on the status of public records. The Memorandum and Articles are available to everyone. Every individual who interacts with a business has a responsibility to examine these records and ensure that the firm has the authority to engage into the proposed contract. The legal effect of these constructive notices is that if a person transacts with a company in a way that is not inconsistent with the terms of the company's memorandum or bylaws, he must be deemed to have done so at his own risk and expense, and if he suffers any loss as a result of such a deal, he will be responsible for covering the loss himself.

Ram Murthi vs. Kolta Venkataswamy, 4 Comp. In Case 289, a company's Articles of Association included a provision requiring the managing director, secretary, and working director to sign all deeds and papers on the company's behalf. Only the secretary and a functioning director signed the mortgage deed. According to the ruling, even if the plaintiff acted in good faith and the money was used for the company's purposes, the mortgage could not be enforced since the illegality was evident on the face of the deed. As a result, the deed was invalid. Contrary to popular belief, the theory of constructive notice of the Memorandum and Articles is a negative one rather than a positive one. It is comparable to the estopple doctrine. It doesn't work against the business. It only works against a third party interacting with the firm. It prohibits him from claiming that he was unaware that the company's actions would be considered ultra vires under the Memorandum and Articles.

**The Indoor Management Doctrine**

There is one exception to the aforementioned law, even if the doctrine of constructive notice presumes that everybody engaging with the firm has read its memorandum and articles of association. The exception is that anyone doing business with the corporation are not required to inquire about the propriety of its internal procedures. Outsiders cannot be expected to verify that a firm abides by its internal rules, hence they are allowed to presume that the requirements of the company's articles of association have been completely respected by its executives. Consequently, the philosophy of indoor management attempts to protect outsiders against the firm rather than the company protecting itself against outsiders as the idea of constructive notice does.

The company's appropriate resolution must be obtained in order for the directors to borrow such amounts of money on bond, according to the Articles. Without the backing of such a decision, they granted Turquard a bond. It was decided that the loan bound the corporation. The plaintiff had a right to believe that the required resolution had been properly enacted. The restriction was adopted because it was impossible for outsiders to know what had taken place within the company's closed doors. Memorandum and Articles are open to the public, but not the minutes of director or shareholder meetings. Therefore, information about internal processes is private. The general idea behind the regulation is that individuals working with

limited liability businesses are not required to check the integrity of internal processes and will not be held accountable for irregularities they were unaware of.

Specifically, Laxmi Ratan Cotton Mills Ltd. J. K. Jute Mills Company v. 27 Ltd. Comp. It was determined in Case 660, in which the plaintiff sued the defendant firm for a loan of 1,50,000, that an act performed by a person working on the company's behalf is legal if it falls within the purported authority of that person. Whether the plaintiff has read the materials or not, it nevertheless binds the corporation. In this case, the defendant corporation argued that since the Board of Directors had not approved a resolution authorizing the loan, the transaction was not legally enforceable. A transaction entered into by the borrowing firm cannot be overturned just because such a resolution was not actually issued, the court said. The adoption of such a resolution is only a matter of internal administration and cannot be used to disprove a bona fide creditor's legitimate claim.

**Exceptions to the Indoor Management Doctrine**

The following exceptions apply to the indoor management doctrine:

If a person doing business with the firm has real or constructive knowledge of an irregularity about internal management, he is not eligible to get the advantage under the indoor management rule. Any alternative norm would "encourage ignorance and condone dereliction of duty" and is contrary to common sense. In the case of Devi Dutta Mal v. Standard Bank of India, A.I.R. Lah, 797, two directors agreed to a transfer of shares in a firm. One of these directors was improperly chosen. Due to the transferor himself, the other was eliminated. The transferor was aware of these details. The transfer was futile, it was held. In a different instance of Maward v. Patent Ivory Co. D. According to Section 156, a company's directors may borrow up to $1,000 without the shareholders' consent during a general meeting. However, for any sum above $1,000, they needed to have the shareholders' approval in a public meeting. Without the approval of the shareholders at a general meeting, the directors themselves gave the firm money that exceeded its borrowing capacity. Holding that the directors were aware of the internal irregularity; the corporation was only had to make a $ 1,000 payment.

Negligence: When a customer of a firm might have found the error if he had asked the right questions. He is ineligible to take advantage of the indoor management regulation. The rule's protection is also not applicable when the circumstances surrounding the contract are very suspicious and need further investigation. Anand Bihari Lal against Dinshaw & Co. was a legal dispute. The plaintiff in this case, A.I.R. Oudh 417, accepted a transfer of the company's assets from its accountant. As such a transaction seemed to be beyond the bounds of the accountant's power, it was held that the transfer was invalid.

Forgery: The idea of indoor management does not apply when activities performed in a company's name that are invalid from the start because they were forgeries. A corporation is never responsible for forgeries made by its executives. Ruben Vs. Great Fingall Consolidated Co. A.C. is the most significant case in this area. 439. A share certificate with the company's seal, the secretary's own signature, and a director's signature he had faked was issued. As held, the firm was not bound by the share certificate. The individual who received a loan based on the certificate did not have the right to be listed as the share's owner.

Lack of Article Knowledge: If a person wishes to be protected by the "indoor management" regulation, they need be familiar with the Articles. The rule is founded on the estoppel concept, and anybody who relied on the Articles may be protected. As a result, if a person enters into a contract with a corporation without being aware of its Articles of Association, he

or she cannot depend on those Articles to provide ostensible or seeming power to the company's representative with whom he or she transacted.

**Proposal and the Start of Business**

Every firm needs funds to conduct its operations. So, every business issues its own securities. However, public and private corporations cannot issue their securities in essentially the same manner or via the same channels. In the lines that follow, both sorts of corporations' methods for issuing securities are succinctly explained.A publicly traded corporation may do one or more of the following when issuing securities:

1. To make a "public offer," or to make a prospectus public.

2. Through means of private placement.

3. Through a legal problem.

4. Via the issuance of bonus securities, or by bonus issue.

It should be made clear that any listed business or firm with plans to list its securities on a recognized stock exchange is permitted to conduct a public offering of its securities. The Securities and Exchange Board of India Act, 1992, and the Rules and Regulations established thereunder for the issuing of Securities, should be complied with by the Company when making such an offer.

Any or all of the following methods may be used by a private corporation to issue securities:

1. Through means of private placement.

2. Through a legal problem.

3. Via the issuance of bonus securities, or a bonus issue.

The aforementioned explanation makes it evident that there is just one distinction between the two groups of corporations' methods for issuing securities. No private firm may offer securities using a prospectus, but all public corporations may. However, any of the other ways may be used by both private and public corporations to issue their securities. The fact that a private firm is not permitted to offer its securities through prospectus or to the general public also becomes obvious.

Private firms are thus exempt from the restrictions of the SEBI Act and the Rules and Regulations promulgated thereunder. Any document referred to or released as a prospectus is referred to as a prospectus, which includes red herring prospectuses, shelf prospectuses, notices, circulars, advertisements, and other documents that invite public offers for the subscription or acquisition of any securities of a body corporate. A prospectus is, to put it simply, any document that a corporation issues or describes as such in order to solicit proposals from the general public for the subscription or purchase of its shares. It should be emphasized that any document that is labeled or released as a prospectus, including a red herring prospectus, shelf-prospectus, notice, circular, advertising, or other document, falls within the definition of a prospectus. A corporation issues it to solicit public proposals for the subscription or purchase of its securities.

**Common Offer**

A prospectus-based public offering of securities is one that is offered to the general public. The term "public offer" is quite broad and encompasses the following types of offers:

1. Initial Public Offering.

2. Additional or subsequent public offer. The prospectus is used to make both of these public offerings.

3. Public offering of securities by an existing shareholder. A prospectus is also issued in order to make such an offer. Both the original public offering and a subsequent or follow-up public offer, or FPO, may apply.

1. Initial Public Offer (IPO): An IPO is when a privately held, unlisted firm issues new shares, or when its promoters first sell shares, they own to the general public. This opens the door for the company's securities to be listed on and traded on stock markets. Consequently, IPO refers to either of the following: An unlisted firm issuing its first batch of shares to the general public. Promoters of a firm making their first-ever offer to sell shares they already own.

2. An FPO, or further or follow-on public offer, is made by the promoters of a listed business following an IPO when they either issue new shares to the public or make an offer to sell their shareholdings to the public. Therefore, a subsequent public offering is any of the following: A listed company's fresh public issuance of securities at any point after an IPO. Any time after an IPO, the promoters of a listed business may offer to sell stock they own. Any time shares are offered publicly, a prospectus—also known as an offer documentis made available to the general public. It is the document that includes all pertinent information about the business, the promoters, the projects, the finances, the goals of the fundraising, the terms of the issue, etc. It is used to invite the public to subscribe for securities of a firm that the issuer is offering. A document soliciting the public to subscribe for shares of the firm must be released whenever a promoter or member offers to sell his or her ownership of securities. A legal word for such a document is "offer for sale," which is "deemed to be a prospectus." Sometimes, legal professionals refer to it as a "prospectus by implication.

## CONCLUSION

In summary, for businesses, choosing a suitable AOA model is crucial since it creates the foundation for internal operations, governance, and shareholder rights. Companies must carefully analyze their unique circumstances before choosing a model, whether it be statutory model articles, industry-specific models, or custom articles, to ensure that it is in line with their goals and legal requirements. Companies may build efficient governance procedures, safeguard shareholder rights, and assist the accomplishment of their strategic objectives by choosing the correct model and routinely assessing the AOA. Companies must carefully assess which AOA model best fits their needs, taking into consideration their operational goals, legal obligations, and preferred forms of governance. Companies may make educated judgments about their AOA by consulting legal counsel and carefully examining the models that are now available. In order to maintain alignment with the company's goals and compliance with applicable laws and regulations, it is also crucial to routinely evaluate and update the AOA as the business changes.

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# CHAPTER 6

# CONDITIONS FOR INCLUSION OF EXPERT'S CERTIFICATE: AN ANALYSIS

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**ABSTRACT**:

The conditions for the inclusion of an expert's certificate in various legal contexts. An expert's certificate is a document issued by a qualified professional in a specific field, providing an opinion or assessment based on their expertise and knowledge. This paper examines the requirements and considerations for including an expert's certificate as evidence in legal proceedings, contractual agreements, insurance claims, and other relevant scenarios. It analyzes factors such as the qualifications and credibility of the expert, the relevance and reliability of the certificate, and the procedural rules governing its admissibility. Through a comprehensive analysis of legal frameworks and case studies, this paper sheds light on the conditions that must be met for the inclusion of an expert's certificate and its potential impact on legal outcomes.A qualified expert witness must stay current in their area of study. While obtaining certification is beneficial, it does not replace the requirement for continued education and staying current with industry advances.

**KEYWORDS**:

Accreditation, Certification, Competence, Expertise, Expert's certificate, Inclusion Criteria.

## INTRODUCTION

### Contents of Prospectus

There is no model prospectus under the Companies Act of 2013 (the Act). It only specifies a prospectus's substance. Additionally, it stipulates that a prospectus must include any specified information [1], [2]. A prospectus that is to be published must include the information on the following things in accordance with the requirements of the Companies Act and the Rules enacted thereunder:

1. Every prospectus must have a date. The prospectus's date d is taken to be the day it was published.

2. Every prospectus must be signed by the individuals listed as directors of the business or as candidates to become directors, or by their properly appointed agents.

3. Information: The names and addresses of the company's registered office, company secretary, chief financial officer, auditors, legal counsel, bankers, trustees, if any, underwriters, and any other individuals as may be prescribed, must all be included in every prospectus that a company issues on its own behalf or on behalf of another company. dates for the issue's opening and closure [3], [4].

A statement on the issuance of allocation letters and reimbursements within the allotted period. The Board or the Committee authorized by the Board is required by the rules published by the Ministry of Corporate Affairs to declare in the prospectus that allotment letters will be issued or application money will be refunded within 15 days of the issue's closing, or within any shorter period that SEBI may specify. The application fee must be

returned to the applicants right away if this is not done. If the money is still not paid, the corporation will be required to pay the applicants interest for the length of the delay at a rate of 15% per year [5], [6].

A statement from the board of directors on the designated bank's separate bank account. All funds received from the issuance are to be deposited to this account, according to this announcement. Additionally, all financial information from the previous issue, including both used and unused funds, must be disclosed in the appropriate way. Details regarding the issue's financing. According to the rules announced by MCA, the prospectus must include the underwriters' names, addresses, phone numbers, fax numbers, and email addresses as well as the amount they have agreed to insure [7], [8].

Approval from the directors, auditors, bankers, experts, if any, and such other individuals as may be required. According to the rules published by MCA, the prospectus must also include the approval of the trustees, lawyers or advocates, merchant bankers, the issue's registrar, lenders, and specialists [9], [10].

The resolution's specifics and the issue's authority were therefore approved. Procedures and deadlines for the allocation and issuance of securities. The company's capital structure according to the rules. Principal goals of the public offer, the conditions of the current issuance, and any other information that may be required. The company's primary goals, current operations, location, and project execution timeframe. Minimum subscription amounts, premium payments, and non-cash share issuance terms. Information on the directors, such as when they were appointed, how much they were paid, and any other information that may be required about the nature and scope of their corporate interests. disclosures regarding the sources of the promoter's contribution in the way permitted by law.

The prospectus must also include the project's specifics listed below:

1. Management's view of project-specific risk considerations.

2. Time of gestation for the project.

3. The project's level of progress.

4. Project deadlines for completion.

5. Details of Litigation: The prospectus must also include information about any litigation or legal proceedings.

6. Reports: The following reports must also be included in every prospectus for the financial information's sake: reports from the company's auditors about its earnings, losses, assets, and liabilities, as well as any other necessary information. reports on earnings and losses for each of the five fiscal years that came before the fiscal year in which the prospectus was released. The reports of its subsidiaries are also required to be included in such reports. The reports must be submitted in the way that may be required. The assets and liabilities of the company's business as of the last date to which the accounts of the business were open and not more than 180 days before the prospectus' release were reported by the auditors in the prescribed manner for each of the five financial years that immediately preceded the issue. Information about the company or transaction that will directly or indirectly benefit from the sale of the securities.

7. A statement about the compliance with the terms of this Act must also be included in the prospectus. A declaration that nothing in the prospectus violates the terms of this Act, the

Securities Contracts Act, the SEBI Act, or the rules and regulations established thereunder must also be contained in it.

8. Any further Information: A prospectus must also include any further information and reports that may be required by law.

**Added Materials**

The prospectus must additionally contain a few other items, such as the following:

1. extra Information to Be Included in the Document Issued by the Issue House: An issue house's offer for sale must include the following extra information:The total amount of the consideration that the company has received or will receive in relation to the securities that are the subject of the offer. When and where the contract that the aforementioned securities have been or will be allocated under may be viewed.

2. The following information must be included on the front of every prospectus that is released: That a copy has been sent to the Registrar for registration. Indicate any papers that must be included with the copy that was distributed in accordance with this Section, or make reference to statements in the prospectus that include these documents.

3. Reproduction of requirements Relating to Personation for Acquisition of Securities: Every prospectus the firm issues, as well as every form of application for securities, must conspicuously replicate the requirements related to personation for acquisition of securities, among other things.

**Requirements for Expert's Certificate Inclusion**

A remark allegedly made by an expert must be included in a prospectus in the following circumstances. The expert cannot be someone who is now involved in, or has ever been interested in, the creation, development, or management of the firm. He has provided his written approval to the prospectus's release and hasn't changed his mind about it before a copy of the prospectus is sent to the Registrar for registration. In the prospectus, it has been stated that the aforementioned reality exists.

**Penalty for Contents Not Appearing in Prospectus**

The Company: The Company shall be penalised with a fine that shall not be less than'50,000 but which may increase to'3 lakh if a prospectus is published in violation of the regulations pertaining to contents of prospectus. Every Person Who Is a Party to the Issue: Anyone who knowingly participated in the release of such a prospectus is subject to a sentence of up to 3 years in jail, a fine of at least $50,000 but as much as $3 lakh, or both.

**Promotion of the prospectus**

There are occasions when a company's prospectus marketing is released in any way. However, it will be required to make the following points explicit in that memorandum:

1. The things.

2. Members' responsibility.

3. The quantity of the company's share capital.

4. The list of those who signed the memo.

5. The number of shares that signatories have purchased.

6. The company's capital structure.

Provisions Are Applied to Each Prospectus and Application Form

Any prospectus or form of application, whether published on or in connection with the creation of a business or afterwards, must comply with the aforementioned rules regarding prospectus content.

**Exceptions/Exemptions**

In the following situations, none of the aforementioned restrictions regarding the substance of a prospectus shall apply: Issuing to current members or holders of debentures of a firm. Whether or whether an applicant has the right to renounce the shares in favor of another person is irrelevant. To publish a prospectus or application form for shares or debt that are, or will be, identical in every way to shares or debt that have already been issued and are being traded on or quoted on a reputable stock exchange.

**Filing of a prospectus**

Only when it has been registered can a prospectus be released. The following are the major guidelines for prospectus registration:

1. Prospectus Preparation: A prospectus must be ready for registration. All the items listed in Section 26 and the Rules created thereunder should be included. It should also include the following reports, records, and declarations:

Consent of the issue's directors, auditors, bankers, and other designated parties. Reports from the company's auditors on its revenues, expenses, assets, liabilities, and other required items. reports on earnings and losses for each of the five fiscal years that came just before the fiscal year in which the prospectus was released, including similar reports from its subsidiaries. the assets and liabilities of the company's business as of the final date to which the accounts of the business were made up, as well as the profits and losses of the company's business for each of the five financial years that immediately before the issuance. a confirmation that the rules set out in this Act have been followed. a declaration that nothing in the prospectus violates the terms of this Act, the Securities Contracts Act, the SEBI Act, or the rules and regulations created in accordance with any of those laws.

2. Prospectus dating: A prospectus has to be dated. The prospectus's publishing date is determined by the date d in the document.

3. Every individual listed therein as a director or potential director of the firm must sign the copy of the prospectus that is to be presented for registration. Alternatively, it might be written and signed by his lawfully appointed agent.

4. The draft prospectus must have the following agencies' or authorities' approval in accordance with SEBI rules and regulations: the issue's lead manager. Every stock exchange where the company's securities are listed or are being considered for listing. the primary lending institution backing the bond.

5. SEBI reviews a prospectus to make sure the disclosures are adequate. In accordance with the MCA's directives, the Registrar is not permitted to register a prospectus prior to SEBI's review. If SEBI is pleased with the results of the examination, it will certify that the prospectus's contents do not violate any laws or other rules and regulations. However, SEBI disclaims all liability for the accuracy of any claims made or viewpoints expressed in the prospectus.

6. Delivery to the Registrar: The prospectus must now be sent to the Registrar for registration together with all necessary paperwork, approvals, and vetting certificates. It must be handed to the Registrar before the date of publication or earlier.

7. Prospectus registration: If all the requirements necessary for registration are followed and the prospectus is accompanied by the written approval of every person identified in the prospectus, the Registrar will register the prospectus. The registration must be completed before or on the day that it is published.

**Prospectus-related issues**

The following are the major guidelines for the public release of prospectuses:

1. Issue Only After Registration: Unless properly registered by the Registrar, no prospectus may be released to the general public. Thus, only properly registered prospectuses may be published.

2. The following information must be included on the front of every prospectus that is released: That a copy of the prospectus has been sent to the Registrar for registration. Indicate any papers that must be included with the copy that was distributed in accordance with this Section, or make reference to statements in the prospectus that include these documents.

3. A copy of the prospectus must be given to the Registrar no later than 90 days after that date in order for it to be issued. A prospectus is not considered to be legitimate if it is released more than 90 days after the date of registration.

4. Penalty for Issuing a Prospectus in Violation of These rules: If a prospectus is released in violation of the aforementioned rules, the corporation will be subject to a punishment that must not be less than $50,000 but may reach $30,000 instead. Additionally, anybody who knowingly participated in the release of such a prospectus may face a sentence of up to 3 years in jail, a fine of at least $50,000 but as much as $3 lakh, or a combination of the two.

5. Providing a Copy of the Prospectus Upon Request: If someone requests a copy of the prospectus, it must be sent to them prior to the subscription list and offer closure. A corporation will be subject to a fine of '50,000 for each violation of this clause if it commits any defaults.

**Changes to the Contract's Terms or the Objects**

A corporation that has obtained money from the public via a prospectus sometimes still has any unused funds. provided such a firm wants to change or modify the terms of any contracts mentioned in the prospectus or the things for which the prospectus was produced, it may do so provided it meets the following requirements:

**Special Resolution**

In order to implement this variant modification, the firm must approve a special resolution through postal poll. The following information must be included in the notification of the proposed special resolution being voted on via postal ballot:

1. The initial goal or focus of the problem.

2. The amount of funds collected.

3. The funds used to accomplish the goals of the firm as indicated in the prospectus.

4. The degree to which the suggested goals were achieved.

5. The portion of the money obtained via the prospectus that was not used.

6. Details of planned changes to contracts that are included in the prospectus or the items for which the prospectus was prepared.

7. The argument and basis for requesting variance.

8. The suggested time frame for completing the planned diverse goals.

9. The clause-by-clause specifics that were necessary in relation to the first suggested problem objectives.

10. The dangers associated with the novel things.

11. The additional pertinent data that is required for the members to make an educated choice about the suggested resolution.

**Publication of Resolution notification**

The corporation must publish an advertising including the shareholder resolution notification. It must be published in Form Number as well. PAS-1 in the papers published in the city where the company's registered office is located. The rationale for the modification must be stated explicitly. This advertising must be published at the same time as shareholders' postal ballot notifications are sent out. If the firm has a website, it must also be included there with the notification.

**Giving the Dissenting Shareholders the Opportunity to Exit**

The promoters and shareholders in charge of the firm must provide the dissenting shareholders the chance to withdraw their money from the securities they have invested in. The exit offer must be made under the terms and circumstances that the SEBI may specify, including pricing.

## DISCUSSION

**Types of prospectuses**

**Abridged prospectus**

An abbreviated prospectus is a memorandum that includes the key elements of a prospectus as may be defined by the SEBI through relevant rules. Abridged Prospectus to Be Accompanied with Application Form No application for the acquisition of any stocks of a firm may be submitted unless an abbreviated prospectus is included.

Exceptions: However, in the following circumstances, no one shall be obliged to provide a copy of the condensed prospectus together with the application form: When a person is legitimately invited to participate into an underwriting agreement for such securities when the form is provided in conjunction with such invitation. when it was issued in connection with securities that weren't made available to the public. Obtain a copy of the prospectus here: Upon request made by any individual prior to the subscription list and offer closure, a copy of the prospectus must be sent to him. Penalty: A corporation that fails to comply with this provision will be subject to fines of $50,000 for each violation. According to the SEBI Regulations, the Lead Merchant Banker is in charge of ensuring that the rules for the abbreviated prospectus are followed.

The process of allocating or agreeing to allocate a company's shares to an intermediary known as the "issuing house" is currently considered standard. The issuing house must then

make all or some of these securities available to the public through a specific document. An offer for sale of securities is a document like this one that is produced by an issuing firm. It will serve as and be regarded as a prospectus released by the company for all purposes. Here is a summary of the rules governing an issuing house's offer to sell securities.

**Deemed Prospectus**

Occasionally, a corporation may assign or agree to assign any of its securities to another firm or company with the intention of offering all or a portion of those securities for sale to the public. In this situation, any document used by the other business or firm to make the sale will be considered to be a prospectus published by the company. The following effects will occur because the offer document published by another corporation or firm is judged to be a prospectus. The document is subject to all provisions relating to the prospectus's contents. This document shall be subject to the same registration and issuance requirements as prospectuses. Any inaccuracy or omission of a crucial detail from the document will have the same consequences as a prospectus. The same rules that apply to those who authorize the release of a prospectus apply to those who authorize the release of a false or misleading document to the subscribers of securities.

**Presumption of Intention to Offer Securities to the Public**

Typically, the terms stating that securities must be sold to the public are included in the agreement with the issuing house. However, under the following circumstances, the intention to issue securities to the public will be inferred until the opposite is shown, absent any specific provision in the agreement: if the securities, or some of them, are made available for public purchase within six months following the allocation or agreement to distribute the securities. If the corporation has not yet received the whole amount due to it in relation to the securities at the time of the public offering.

**Further Points Should Be Made**

The terms and conditions outlined in Section 26 must be included in the offer for sale. In addition to this, the offer for sale should include the following details. The total amount of the consideration that the company has received or will receive in relation to the securities that are the subject of the offer. When and where the contract that the aforementioned securities have been or will be allocated under may be viewed.

**Offer for Sale Signature Requirements**

If the offer is being made by a business, two of the company's directors must sign the offer document; if the offer is being made by a firm, at least half of the partners must sign the offer document.

**Bookcase Prospectus**

For the convenience of a certain class or classes of corporations, such as public financial institutions, public sector banks, or scheduled banks, the requirements of shelf prospectus have been integrated into the Act. They will no longer be needed to create a prospectus for each offering of securities and submit it with the Registrar thanks to the regulations of shelf prospectus. This will help you save a ton of money and the time it takes to follow all the regulations.

A prospectus is referred to as a "shelf prospectus" if the securities or class of securities covered by it are released for subscription over a period of time in one or more issues without the release of another prospectus.

**Dispositions Associated with Shelf Prospectus**

The following conditions apply to shelf prospectuses:

**Any Class of Businesses May File**

At the time of the initial offering of securities, any class or classes of corporations may file a shelf prospectus with the Registrar. The SEBI has been given permission to establish rules for creating and submitting a shelf prospectus.

**Validity duration**

The shelf prospectus must be valid for a duration of not more than one year. The validity period will start on the opening day of the first offer of securities made pursuant to that prospectus.

**No Need to File Again within the Validity term**

A corporation that files a shelf prospectus is not needed to file another prospectus in connection with a subsequent or second offering of the securities made within the validity term of that prospectus.

**The filing of an information memorandum**

A firm submitting a shelf prospectus must also submit an information memorandum that includes the following information: All pertinent facts pertaining to newly establishedchanges in the financial situation that have taken place between the initial securities offer, the preceding securities offer, and the next securities offer. such other adjustments as may be required.

**Information Memorandum Filing Deadline**

The information memorandum must be submitted within the allotted time frame, but no later than the time that a second or subsequent offer of securities is made under the shelf prospectus.

**Applications for stocks Received Before Making Such Changes**

Through an information memorandum, a firm may sometimes accept applications for the allocation of stocks together with advance subscription fees before making any such modification. In this situation, the corporation must inform the applicants of the changes. If customers decide to withdraw their application, the firm must return all membership fees within 15 days of their request.Shelf Prospectus and Information Memorandum to be Considered Every time securities are offered; a prospectus is submitted with the appropriate regulatory authority. This memorandum will be regarded as a prospectus together with the shelf prospectus.

## CONCLUSION

In conclusion, a comprehensive evaluation of the expert's credentials, the certificate's applicability to the issue at hand, the validity of the expert's conclusions and methodology, and procedural compliance are all requirements for inclusion of an expert's certificate. An expert's certification may support claims or defenses, improve legal arguments, and help with fair and informed decision-making in a variety of legal circumstances by fulfilling certain requirements. The inclusion of an expert's certificate may significantly affect the results of judicial proceedings. It may give specialist information and viewpoints, explain complicated

technical or scientific topics, and support better informed decision-making. However, the final weight attributed to an expert's certificate relies on how the relevant legal authority or decision-maker perceives the expert's reliability, relevance, and admissibility.

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# CHAPTER 7

# RED HERRING PROSPECTUSAND THEIR ROLE IN INVESTOR DECISION-MAKING

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**ABSTRACT**:

The concept of a Red Herring Prospectus and its significance in the context of securities offerings. A Red Herring Prospectus is a preliminary document that provides information about a company and its proposed securities offering but contains certain omissions and disclosures. This paper examines the purpose and key components of a Red Herring Prospectus, including the company's business description, financial information, risk factors, and the process for subscribing to the securities. It analyzes the regulatory requirements and restrictions associated with Red Herring Prospectuses and their role in investor decision-making. Through a comprehensive analysis of legal frameworks and market practices, this paper sheds light on the importance of Red Herring Prospectuses in the securities offering process. The people who will subscribe for securities from the corporation place tremendous importance on those who release a prospectus to the public. The general public is encouraged to purchase securities in reliance on the claims made in the prospectus.

**KEYWORDS**:

Financial Statements, Initial Public Offering (IPO), Investment Risks, Legal Disclaimers, Offer for Sale (OFS), Price Range.

## INTRODUCTION

In recent years, the method of book building has been used to offer securities to the general public. The issuing corporation may submit a red herring prospectus to the Registrar during this procedure. A prospectus that lacks comprehensive information on the quantity or cost of the securities offered and the quantity of securities included therein is referred to as a red herring prospectus.

### Guidelines for Red Herring Prospectus

The following are the important terms pertaining to the red herring prospectus:

1. Publish Prior to the Issue of Prospectus: Before the release of a prospectus, a corporation planning to make an offer of securities may publish a red herring prospectus.

2. Filing with the Registrar: At least three days before the opening of the subscription list and the offer, a firm planning to publish a red herring prospectus must register it with the Registrar.

3. The same obligations that apply to the prospectus The same requirements that apply to a prospectus also apply to a red herring prospectus [1], [2].

4. Highlighting the Variations in Prospectus: Each firm is required to indicate any differences between a prospectus and a red herring prospectus as variations in the prospectus [3], [4].

5. Prospectus Filing with the Registrar and SEBI: A prospectus must be submitted with the Registrar and SEBI after the closure of the securities offer.

The following details must be included in the prospectus: the entire amount of funding received, whether in the form of loan or equity.

1. The securities' closing price.

2. Any additional information not included in the red herring prospectus.

3. The Golden Rule for Prospectus Framing

A prospectus is a document that a business releases to solicit public offers for the subscribing of shares or debentures. As a result, it is a crucial document. The firm's reputation as well as the relationship between the company and its members may be significantly impacted. Therefore, such a document must be entirely factual and up to date, without any significant facts being withheld or omitted. In summary, the "golden rule" for prospectus framing must be followed. Kindersely, VC stated the "golden rule" in New Brunswick etc. Co v. Muggeridge 3 LT 651. The golden legacy was used to describe this. The following sentences may be used to summarize the rule:

The corporation is consequently required to provide all information in the prospectus with scrupulous accuracy, as are the individuals who approve its release. They must not exclude any important information that might have an impact on the kind, scope, or caliber of the rights and benefits that the prospectus promises to subscribers [5], [6].

**False or Inaccurate Statement in Prospectus**

A statement that is deceptive in its form and context that has been included in a prospectus is referred to as a misrepresentation, untrue statement, or false statement. A prospectus will also be judged to include false information or to be misleading if anything that ought to be included is left out. A prospectus is referred to be a "misleading prospectus" under the following circumstances: When a statement in a prospectus is false in both the form and the context in which it is presented. when a prospectus leaves out information that is intended to deceive individuals who act on its basis [7], [8].

**Solutions or Repercussions of a Deceptive Prospectus**

A prospectus is deemed to be deceptive if it makes false or misleading claims or omits to provide any important information. A corporation will face a number of repercussions if it publishes a deceptive prospectus and subscribers subscribe for the company's shares on the basis of such prospectus [9], [10]. Subscribers who have been wronged and who have relied on this prospectus may seek redress from the following parties:

A. Legal action against the business.

B. Redress for directors, promoters, specialists, etc.

A. Recourse Against the Business

A corporation has legal obligations to the investors who bought securities from it under the influence of a deceptive prospectus. As a result, unhappy subscribers have the following legal options to pursue the company.

**Cancellation of the Agreement**

A person who purchases securities on the basis of a false prospectus may request that the contract be rescinded. The subscriber returns the securities assigned to him upon revocation and receives his money back plus interest. If the following criteria are met, the aggrieved

subscriber may use the right or remedy to withdraw the agreement: The corporation, or someone acting on its behalf, must have released the prospectus. A substantial information must have been left out of the prospectus or an inaccurate or deceptive statement must have been there. For instance, a company's prospectus noted that it had distributed dividends over the five years of the Great Recession. However, the fact that the dividends were paid from realized capital gainseven though there were large trading losses during those yearswas not made public. The court determined that the prospectus included significant inaccuracies.

The false statement must concern the important fact. Law should not be based on the fact. It shouldn't be considered a statement of opinion even. For instance, a company's prospectus claimed that two eminent businesspeople had consented to serve as directors of the corporation. In reality, they had just offered their assistance to the business. The Court decided that subscribers might cancel their contracts since the prospectus included factual errors. The prospectus' false assertion must have been taken into consideration and used by the subscriber. He must have felt pressured to purchase shares as a result. A person cannot cancel a contract if they subscribe for a company's stock without first reading its prospectus. The first holders of securities have the option to revoke their allocation. Even if he may have purchased based on the prospectus, a person who purchases shares on the open market has no recourse against the corporation. The power of revocation must be utilized within a reasonable amount of time and prior to the start of any actions to wind up the business. Loss of the right to rescind: The following situations result in the loss of the right to cancel a contract: if the subscriber accepts or supports the share purchase agreement. For instance, the subscriber is considered to have approved the contract if he tries to sell the authorized shares, collects dividends, makes calls, or attends the general meeting. if the subscriber does not exercise his right to rescission after having knowledge of the prospectus' error within a reasonable amount of time. In one instance, the applicant discovered the error in the brochure in July. But in December, he requested to cancel the agreement. The Court ruled that the five-month delay without explanation prevents him from requesting redress.

if the right of revocation is not used prior to the start of the company's winding-up procedures. However, if a subscriber has already begun the process to rescind the share contract, the issuance of the winding up order will not prohibit him from receiving the relief. when it becomes difficult for the parties to restore their prior positions or make compensation. when legal rather than factual information is being misrepresented. A prospectus could declare, for instance, that the shares would be offered at a 25% discount. No firm may offer shares at a discount; hence it is an inaccurate depiction of the law.

**When a subscriber reads the prospectus incorrectly**

**Damages Reparations**

Every subscriber who feels wronged has the option of filing a claim for reimbursement for any losses or damages he has suffered. The displeased subscribers will need to provide evidence of the following to be eligible for this remedy: that he subscribed for the company's stocks based on the false information in the prospectusthat the corporation or someone acting on its behalf issued the prospectus. that as a result of the deceptive prospectus, he has really experienced a loss or harm. he has returned the securities issued by the corporation, rescinding the contract for the acquisition of shares.

As a result, the only time a disgruntled subscriber has the option to seek compensation is when they cancel their agreement to buy shares. He is not permitted to keep the securities while also requesting reimbursement for losses. Before he may request the payment, he must cancel the agreement.

**Redress for Directors.**

The people who are accountable for misleading prospectus are listed in the Act. These are what they are:

1. Each and every director of the firm at the time the prospectus is released.

2. Anyone who has consented to serve as a director of the business and has permitted themselves to be so designated in the prospectus.

3. Every individual who promotes the business.

4. Everyone who has given their consent to the prospectus's release.

5. Every professional involved in or formerly interested in the creation, marketing, or administration of the organization.

The following two categories may be used to group together the responsibility of directors, promoters, specialists, etc.

1. Civil responsibility

2. Legal responsibility

**Civil Liability**

Every individual who purchased stocks based on the deceptive prospectus will be held legally liable, including the company's directors, promoters, experts, etc. To put it another way, any unhappy subscriber has the following legal options against the directors and others:

1. Compensation for false statements and omissions.

2. Unrestricted personal culpability for a false prospectus.

**Damages for Misrepresentation or Omission**

Any disgruntled investor in the company's stocks who purchased shares based on a deceptive prospectus has the right to hold every director, promoter, expert, etc., accountable and require them to make up for any losses or damages they caused. The subscriber must demonstrate the following facts in order to establish their claim for damages: Because based on the false prospectus, he subscribed for the company's stock. that as a result of the subscription, he has experienced loss or harm. Defenses on offer: If he can demonstrate the following facts, no one will be required to make up compensation: A director is not responsible if he can show that he revoked his permission to serve as a director before the prospectus was published and that it was published without his knowledge or approval. No one shall be responsible if they can demonstrate that the prospectus was released without their knowledge or agreement and that they immediately provided a reasonable public notice of that fact after becoming aware of the prospectus's release.

**Unlimited Personal Liability for Fraudulent Prospectus**

In certain cases, it may be shown that a prospectus was published with the aim to deceive potential investors or anybody else, or for any other fraudulent reason. Every director, promoter, expert, etc. in such a situation will be individually liable without any limit on responsibility. They will be held completely responsible for any and all losses or damages incurred by anybody who purchased securities based on the information in that prospectus.

Criminal Responsibility The following constitutes criminal responsibility for a deceptive prospectus: Liability/Penalty for Misstatement or False Statement in Prospectus: Section 447 applies to anybody who authorized the release of a deceptive prospectus that was published, disseminated, or distributed. Anyone found guilty of fraud is subject to a sentence of imprisonment that must not be less than six months but may not exceed ten years, as stated in Section 447. Along with this, he will also be subject to a fine that must be less than the amount involved in the fraud but may go up to three times that amount.The sentence cannot be less than three years in jail if the fraud in issue concerns the public interest.

**Defenses on offer**

If a person can demonstrate any of the following, they will not be subject to Section 447 liability.

1. That the statement or omission in question was unimportant.

2. That he had good cause to think the statement was truthful and that he did so at the time the prospectus was released.

3. That he had good cause to think that anything needed to be included or left out.

**DISCUSSION**

**Other Important Provisions**

Entities Entitled to Take Action/Remedies: According to the Act, certain parties have the right to file a lawsuit or seek redress against a firm or any other party responsible for publishing, distributing, or otherwise making a false or deceptive prospectus. Any of the following organizations may launch a lawsuit or take other legal action if they were harmed by any deceptive statement or the inclusion or absence of any information in the prospectus:

1. Any collection of people.

2. Any group of individuals.

3. Anyone at all.

Penalty for Deliberately Hiding Material Facts: In certain cases, a person willfully hides any relevant information or makes any statement, promise, or prediction that is false, fraudulent, or misleading. He will be subject to legal action under Section 447 if he does so with the intention of persuading another person to enter into, or to propose to engage into, any of the following agreements: Any contract involving the purchase, sale, subscription, or underwriting of securities. any deal that guarantees a profit for one party over another based on the yield on securities or changes in the value of securities. any arrangement with a bank or other financial institution regarding the acquisition of credit facilities.

Penalties for Personation in the Acquisition of Securities, etc. Any person who submits an application to a company in a fictitious name for the purpose of buying or subscribing for its securities, or who submits multiple applications to the same company under various names or variations of his name or surname for the same purpose, or who otherwise induces the company, directly or indirectly, to issue or register any transfer of securities to him or to any other person in a fictitious name

Prospectus Reproduction: Every prospectus a firm issue, as well as every application for securities, must conspicuously replicate the aforementioned clauses.

Gain Disgorgement: The Court may further order the forfeiture of any gains gained by the person who has been found guilty under this Section, as well as the seizure and sale of any securities they may have in their possession. The Investor Education and Protection Fund will receive the funds obtained via disgorgement or the sale of securities.

Procedure for the distribution, transmission, and transfer of shares, debentures, and share certificates vs. stock warrantA public corporation that wishes to solicit bids from the general public for the acquisition of its securities will release a prospectus. The applications are submitted in response to this request by potential investors in securities. These requests are in the form of forms sent to the business, which the business may accept or reject. The applicant's offer results in the public allocation of securities if the corporation accepts it. Every private firm may distribute securities after the issuance of an offer letter for the private placement of shares to individuals surpassing the required number of individuals, as well as any public company that chooses not to solicit the public for the subscription of its securities via a prospectus.

Definition of Since a share capital company is an artificial person, it is unable to produce its own capital; instead, it must be raised from other sources. These people are referred to as shareholders, and the sum they donated is referred to as share capital. Because there are so many shareholders, it is not possible to construct a capital account specifically for each of them. As a result, several capital contribution streams combine into one capital account known as the "Share Capital Account".

**Share Capital Types**

From an accounting standpoint, the company's share capital may be divided into the following categories:

1. Authorized Capital: The amount of share capital that a business is permitted to issue under its memorandum of association is known as authorized capital. The amount of capital that is allowed to be raised by the firm is set down in the memorandum of association. It is also known as registered or nominal capital. The Companies Act's process must be followed in order to raise or reduce the authorized capital. It should be noted that the corporation is not required to issue the whole amount of authorized capital at once. It may issue share capital depending on its needs, but in any event, it should not exceed the authorized capital.

2. Issued Capital: This refers to the portion of the authorized capital that has been made available for subscription to the general public, including the shares assigned to suppliers and signatories to the company's memorandum. 'Unissued capital' refers to authorized capital that is not made available for public subscription. Unissued capital could eventually be made available for public subscription.

3. Subscribed Capital: The portion of the issued capital that the general public has actually subscribed to. The issued capital and subscribed capital would be equal after the public had completely subscribed for all of the shares being made available for public purchase. Because the firm only allots the number of shares for which a subscription has been received, if the number of shares subscribed is fewer than what is offered, the subscribed capital and issued capital are eventually equal. If it is greater, the allocation will match the offer if it exceeds it. To put it another way, the oversubscription is not acknowledged in the books.

4. Capital that has been called up on the shares is that portion of the subscribed capital. The firm has the option to call all or a portion of the shares' face value. The called-up capital is Rs. 7 per share, for instance, if the face value of each share given is Rs. 10, but the firm has

only called up Rs. 7 per share. Its stockholders may be contacted to collect the remaining Rs. 3 as required.

5. Paid up Capital: This refers to the called-up capital that has already been paid for by the shareholders. The called-up capital equals the paid-up capital after the shareholders have covered the whole call amount. Amounts that have not been paid on calls by any of the shareholders are referred to as "calls in arrears." As a result, called-up capital less call-in arrears equals paid-up capital.

6. Uncalled Capital: The subscription capital that has not yet been withdrawn. As previously indicated, the corporation is entitled to collect this sum if more funds are required.

7. Reserve Capital: In the event that the firm is wound up, a part of its uncalled capital may be set aside. The corporation refers to this uncalled sum as "Reserve Capital." When a corporation is wound up, it is solely accessible to the creditors.

**Shares' Nature and Classes**

Shares are the units into which a company's whole share capital is split. A share is the fundamental unit of ownership interest in a firm and represents a portion of the share capital. Those who make financial contributions in the form of shares are known as shareholders. The Memorandum of Association specifies the amount of authorized capital as well as the number of shares into which it will be divided, but the Articles of Association of the company set forth the classes of shares into which the capital of the company shall be divided as well as each class's rights and obligations. A corporation may issue preference shares and equity shares of shares in accordance with Section 87 of The Companies Act.

**Preference Shares**

A preference share is defined as one that meets the requirements listed in Section 85 of The Companies Act of 1956. That it bears a preferred right to dividend payment, which must be made before any dividend is paid to equity owners, in the form of either a set sum payable to preference shareholders or a sum determined by a predetermined rate of the nominal value of each share. that with regards to capital, it now has or will soon possess the preferred right to the return of capital prior to any payments made to equity owners.

Despite the aforementioned two requirements, a preference share holder may be entitled to a full or partial portion of the company's surpluses, depending on what the company's memorandum or articles specify. As a result, there are participating and non-participating preference shares. These shares might also be redeemable or unredeemable, cumulative or non-cumulative.

**Equity Shares**

A share that is not a preference share is an equity share, as defined by Section 85 of The Companies Act, 1956. In other words, shares that do not have a preference in dividend payments or capital repayment are referred to as equity/ordinary shares.

After the Accounting for Share Capital 7 preference share holders' dividend rights have been satisfied, the equity shareholders are eligible to receive a portion of the company's distributive profits. According to the amount of earnings available for distribution, the dividend on equity shares is not set and may change from year to year. According to the norms and circumstances that may be imposed, the equity share capital may have voting rights, or voting, dividend, or other rights that are differential.

**Release of Shares**

A key feature of a company's capital is that, based on its changing financial needs, the money on its shares may be progressively collected in convenient installments over time. The first installment is paid in full at the time of application and is referred to as "application money." The second installment is due at the time of allotment, and the subsequent payments are referred to as "first call," "second call," etc. The last installment is prefixed with the term final. This does not, however, preclude a corporation from requesting the entire sum for shares at the time of application. The following crucial stages are included in the share issuing process:

**Prospectus release**

The corporation releases its prospectus to the general public first. A prospectus is a notice to the public that a new company has been established and that it requires money to operate. It offers comprehensive information on the business and the process used to gather funds from potential investors.

**Applications received**

Prospective investors who want to purchase shares of the company's stock must submit an application and application money to a designated bank as mentioned in the prospectus when the prospectus is made available to the public. After the prospectus was released, the business had 120 days to secure a minimum subscription. The application fee must be returned within 130 days of the day the prospectus was released if the business does not receive it within the allotted time. Otherwise, the firm cannot continue with the issuance of shares.

**Distribution of Shares**

After completing other legal requirements, the firm may continue with the allocation of shares if the required minimum subscription has been obtained. For individuals to whom shares have been allocated, letters of allocation are issued, while letters of sorrow are written for those to whom no allocation has been made. A legal agreement between the business and the applicants, who are now the firm's shareholders, is created when an allocation is made. A firm might choose to issue shares at par, at a premium, or at a discount. According to the terms and circumstances of the issuance, shares are to be issued at par when their issue price is precisely equal to their nominal value. The extra amount, known as premium, is issued when shares of a firm are issued beyond their nominal value. Shares issued at a discount are those that are issued at a price lower than the face value of the shares.

## CONCLUSION

In conclusion, A Red Herring Prospectus is a crucial document in the securities offering process that complies with legal requirements while giving prospective investors important information.

It promotes investor interest, provides important details about the firm and the offering, and describes how to take part in the offering. Investors may analyze the risks and benefits connected with the securities being offered by carefully reading and taking into account the details contained in a Red Herring Prospectus. By giving prospective investors useful information, Red Herring Prospectuses are essential to the process of issuing shares. They act as an overview of the business and the securities being sold, enabling potential investors to assess the investment opportunity and make well-informed choices. Before making an

investment choice, investors should be aware of the limits of a Red Herring Prospectus and do further due diligence.

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# CHAPTER 8

# EXPLORING THE ROLE OF CAPITAL OF THE COMPANY

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**ABSTRACT**:

The concept of allotment of shares and its significance in relation to the capital of a company. Allotment refers to the process of issuing shares to shareholders or subscribers in exchange for consideration, such as money, assets, or services. This paper explores the legal framework and requirements surrounding the allotment of shares, including the authority to allot shares, the procedures for allotment, and the implications of non-compliance. It analyzes the impact of allotment on the company's capital structure, shareholder rights, and the overall financial position of the company. Through a comprehensive analysis of company law and relevant case studies, this paper sheds light on the importance of proper allotment practices in maintaining transparency, compliance, and effective capital management. Allotment is the process of accepting a person's request to purchase shares of a firm. It should be highlighted that while the re-issuance of forfeited shares is funded by previously appropriated or allocated capital of the corporation, it is not an allocation of shares

**KEYWORDS**:

Leadership, Market Research, Mission Statement, Organizational Structure, Productivity, Quality Control.

## INTRODUCTION

The Company's Act does not define the word "allotment." Allotment simply refers to the allocation of a certain number of shares from the company's unallocated share capital to a specific individual or people.

The Supreme Court of India defined allocation as the appropriation of a certain number of shares from a company's previously unappropriated share capital to a person. "Allotment is generally neither more nor less than the company accepting the offer to take shares," said Justice Chitty[1], [2].

### Impact of Allocation

A contract is made between the corporation and the allottee upon share allocation. As a result, the firm is required to deliver the shares to the allotee, and the allotee is responsible for paying the outstanding balance on the shares as and when the company calls. However, the corporation may take ownership of his shares if he doesn't pay the allotment money or the calls made on them. He thus forfeits all of his membership privileges in the firm [3], [4].

### Mandatory Subscription

No public corporation that invites the public to subscribe for its securities may distribute shares until the minimum quantity specified in the prospectus has been subscribed. The idea of a minimum subscription has undergone a significant transformation.

The most recent notion is that the minimum subscription is the sum specified in the prospectus. A public business must obtain the minimum subscription amount on or before the issue's closing date in order to be qualified to distribute the securities [5], [6].

**Minimum Subscription Amount**

The minimum subscription amount that must be collected must be in proportion to the amount called on the application if it is not the whole issue price. It should be noted that the amount of shares allocated for certain groups of people and the amount of securities reserved for preferential allocation are omitted from the calculation of the net issue amount. The method for calculating the minimum quantity of subscription has been explicitly laid forth in the SEBI Regulations. These laws provide that a minimum subscription of 90% of the net issue amount must be received by the issuing business. However, in the event of an IPO, the minimum subscription amount must be subject to the distribution of a minimum quantity of specified securities. Exceptions: In the following circumstances, the minimum subscription rules do not apply: In the event that current firm employees make a purchase proposal. In the event that more shares are issued without the option to transfer them to another person [7], [8].

**Period of Money Reception**

According to the Companies Act, the minimum amount of subscription may be obtained within 30 days of the prospectus' release date or within any other time frame that the SEBI may specify. According to SEBI Regulations, an issuing business must obtain the minimum subscription amount on or before the issue's closing date. The SEBI Regulations take precedence over the Companies Act's regulations; hence the minimum subscription amount must be paid in compliance with their rules. The SEBI Regulations provide that a public offering must be available for a minimum of three working days and a maximum of 10 working days. Therefore, the required minimum subscription must be acquired by the company-set closing date for the offering [9], [10].

**Repercussions of Failure**

The following will happen if the issuing firm doesn't get the required quantity of subscriptions:

**No Allocation**

The issuing corporation cannot distribute the offered shares if the required minimum subscription amount is not collected in the allotted period.

**Subscription quantity Refund**

If the issuing firm does not get the required minimum quantity of subscriptions, it must refund the subscription fee within the allotted time frame.

**Penalty**

A firm may sometimes fail to follow the aforementioned rules. In this situation, the corporation and the defaulting officer are subject to a fine of $1,000 for each day the default persists, up to a maximum fine of $1 lakh, whichever is less.

**Personal Responsibility to Payback**

Sometimes a business doesn't get the minimal subscription payment and then doesn't reimburse it within the allotted period, which is 15 days after the problem closes.

In this scenario, the company's directors who are also its officers in default are jointly and severally responsible for paying back the money together with interest at a rate of 15% annually.

**Provisions or Limitations on Share Allotment**

The following two headings are general categories for the provisions pertaining to the allocation of shares:

1. General guidelines or limitations.

2. Restrictions outlined in the Companies Act.

**General Restrictions/Provisions**

The basic rules governing the distribution of shares are based on contract law. The standard rules of offer and acceptance of contract law apply to the allocation of shares since it is the corporation accepting a person's offer to purchase shares from them. These limitations and provisions are as follows:

Appropriate Authority: Share allocation must be done by a legitimate authority. The right person to distribute shares in a corporation is the Board of Directors. Shares may be distributed by resolution at its duly convened meeting. The committee of the Board of Directors may, however, also distribute the shares if the articles so permit. However, a Board allocation issued without the necessary power would be void. However, the firm may approve such an allocation. Because of the use of the indoor management or Turquand rule, it should be emphasized that the allocation of shares will be legitimate even if there was a flaw in the nomination of directors. Allotment made by a board that was improperly constituted is nonetheless considered legitimate.

In a Reasonable Amount of Time: The allocation must be completed in a timely manner. If allotment is unreasonably delayed, an application to take shares expires. According to a ruling, it is not appropriate to wait around six months between applying and receiving an allocation. The applicant may thus decline to accept such an allocation. But there have been some changes to both law and practice recently. According to the most recent SEBI regulations, businesses must, to the greatest extent feasible, allocate shares within 15 days after the public issue's conclusion. Directors will be required to pay the money plus interest at a rate of 15% per year if a firm fails to send out the allocation letters or refund orders within 15 days after the issue's conclusion.

Communication: The applicant must be informed of their allocation. The applicant cannot be bound by just having their name included in the shareholder register. When the applicant has been told about the allocation, it is considered to be a proper allocation. A formal allocation letter is not required, however. Just informing the applicant of the allocation is sufficient.

Posting a properly addressed and stamped letter of allocation completes and validates the postal communication. Even if the letter is lost or delayed in route, the validity of the message remains unaffected. By claiming that he didn't get the letter, an allottee cannot get rid of his allocation.

Absolute and Unconditional: The allocation has to be both unconditional and absolute. It must be compliant with the application's rules and guidelines. Any allocation granted without meeting the application's requirements is not legally enforceable against the applicant. Example: A individual requested 400 shares of a corporation on the understanding that he would be given the position of cashier at a new branch. The Court ruled that unless he was specifically assigned to be bound by the allocation, he was not.

An applicant is obligated by the allocation if he pledges the shares given to him without rejecting the allocation. He then forfeits his ability to refuse the allocation. Sometimes when

applying, the applicant includes a requirement that the firm must meet after the allocation. In this situation, the condition is not applicable, and the allocation is still valid.

Anta submitted a request for shares with the caveat that he would only pay further amounts after the business produced dividends. Despite the fact that the firm had paid the dividends while under liquidation, the court ruled that Anta was nonetheless obligated by the allocation.

Application to Stock Exchange Before Making Public Offer: Before making a public offer, every company must submit an application to one or more reputable stock exchanges in order to obtain authorization for the securities to be transacted there.

Including the Name of the Stock Exchange in the Prospectus: The prospectus must include the name(s) of one or more reputable stock exchanges where the securities will be traded.

Issuance of Application Form with Abbreviated Prospectus: Every application for the acquisition of any kind of corporate security must be supplied with an abbreviated prospectus. A copy of the prospectus will, however, also be provided upon request from any individual.

Application Money: The amount payable on application for each security must equal at least 5% of the nominal value of the security or any other amount that the SEBI may specify. According to SEBI Regulations, the minimum amount due on application for each security must not be less than 25% of the security's issue price. If a security is being offered for sale, the entire issue price must be paid when applying for each security. The application fee must be paid with a check or another form of payment.

Keeping Application Funds: All application funds received from the public for the purchase of securities must be stored in a separate bank account at a designated bank.

Minimum Amount/Subscription: The following prerequisites must be met before any securities offered to the public may be allocated: The minimum subscription amount specified in the prospectus must have been paid; the amounts due upon application must have been paid to and really received by the firm by check or other means; and the minimum subscription amount must have been paid.

Using Application Funds: All funds obtained via public applications may only be used for the following purposes: for adjusting against the securities or money allocated or the allocation. When the prospectus specifies a stock exchange (or stock exchanges) where the securities may be traded, such use is acceptable. for the purpose of reimbursing applicants' funds. When the corporation is unable to distribute shares for whatever reason, such usage is permitted.

Sanctions: If the firm fails to comply with the rules set out, it will be punished with a fine that cannot be less than '5 Iakh but may not exceed '50 Iakh. Additionally, any official of the firm who is in default may be sentenced to jail for a time that may last up to a year, a fine that must not be less than $50,000 but may reach $30,000, or a combination of the two.

Refund of Money if Minimum Amount Is Not Subscribed: On occasion, the minimum amount specified in the prospectus is not subscribed, and the amount due upon application is not received within 30 days of the prospectus's date of issue, or within any other time frame that the SEBI may specify. The SEBI Regulations establish a 15-day window for such money refunds. Therefore, the money paid as application money must be returned within 15 days after the issue's resolution. Only the bank account from which the subscription was paid will get the money being reimbursed.

Directors' Liability to Refund Money with Interest: The needed amount to be reimbursed in the event that the minimum subscription is not received is sometimes not paid out within 15 days of the issue's conclusion. In this scenario, the company's directors will be jointly and severally accountable for paying back the money plus interest at a rate of 15% annually.

Penalty for Failure to Refund Application Money: In the event that any failure is made in returning the application money, the company and its officer who is in default shall be liable to a penalty for each default of 1,000 for each day during which such failure continues, or'1 lakh, whichever is less.

Condition to Waive Compliance of Provisions invalid: Any condition that would ostensibly obligate or demand a securities applicant to waive compliance with any of the clauses 2, 3, or 6 or 8 above is null and invalid.

## DISCUSSION

### Return Of Allotment

According to the Act, every time a business with a share capital allots securities, it must submit a report of allotment with the Registrar in a manner as may be stipulated. According to the rules published by MCA, if a business allots any of its securities, the firm is required to submit a return of allotment in Form No. PAS-3 to the Registrar within 30 days of the transaction, together with the required fee. Additionally, Form No. PAS- 3 must have the following papers attached.

1. If shares are being distributed for cash, Form No. PAS-3 must include a list of the recipients. The list must include each allottee's name, address, profession (if any), and the quantity of securities assigned to them. The signature of Form No. PAS-3 must certify that the list is accurate and full in accordance with the company's records.

2. When Shares Are Allotted for payment Other Than Cash: A copy of the contract must be included to the form whenever Shares are allocated as completely or partially paid up for payment other than cash. It must have the proper stamp, in accordance with which the securities have been allocated. A contract for services or other remuneration, as well as any contract for sale if it relates to a property or asset, must also be attached.

3. If the Agreement for Sale, Allotment, or Service Is Not Reduced to Writing: If the Agreement for Sale, Allotment, or Service Is Not Reduced to Writing, the Company Shall Provide Complete Particulars of the Agreement. The same stamp duty that would have been due if the contract had been reduced to writing must be applied to it. Those specifics will be considered to constitute an instrument for purposes of the Indian Stamp Act.

4. Report of Valuer in Case Other Than Cash Consideration: As required by articles 2 and 3 above, a registered valuer's report must also be included with the contract.

5. Regarding Bonus Shares: If bonus shares are issued, a copy of the general meeting resolution allowing their issuance must be included to the form.

Report of the Valuer in the Event of Further Share Issue: A firm that is not a listed company will sometimes issue shares in accordance with the requirements for future issuance of shares. In this situation, the corporation must attach Form No. PAS with the registered valuer's valuation report.

Punishment: Failure to submit an allocation return to the Registrar results in a default. If this occurs, the corporation and the defaulting officer will be subject to fines of either $1 lakh or $1,000 for each day that the default persists, whichever is smaller.

**Securities Transmission and Securities Transfer**

According to Section 44, any member's shares, debentures, or other interests in a business are moveable property that may be transferred in the ways specified by the company's bylaws. The transfer and transmission of securities or interests of a member in the firm are covered under Section 56 of the Companies Act, 2013, which was passed in 2013. Requirement for filing a security transfer: The law states that a company is not required to register a transfer of its securities or a member's interest in a company if it does not have share capital unless a proper instrument of transfer, in the prescribed form, has been delivered to the company by the transferor or the transferee and is duly stamped, dated, and executed by or on behalf of the transferor and the transferee.

**Transfer instrument not delivered or lost**

The firm may register the transfer on such conditions as to indemnification as the Board may judge suitable in cases where the instrument of transfer has been lost or has not been supplied within the required time frame. When a corporation receives notification that a security right has been legally transferred from someone to another person, the power of the company to register is unaffected by the aforementioned rule. Transmission of securities on the application of a single transferor: When a single transferor makes an application for partially paid shares, the transfer cannot be registered unless the transferee waives any objections to the transfer within two weeks of receiving notice of the application from the company in a manner that may be prescribed. Delivering the certificate: Every corporation must give the certificates of any securities allocated, transferred, or communicated, unless forbidden by a legal requirement or a court order. Such a person shall be subject to a fine of not less than one lakh rupees but not less than one lakh rupees and a sentence of imprisonment of not less than one year but not less than three years. Refusal to register a transfer of securities and appeal against a refusal: Section 58 of the Companies Act of 2013 outlines the steps a business must take in the event that a transfer of securities is refused to be registered.

If a private company limited by shares declines to record the transfer or transmission of a member's right to any securities or interest in the company, the company must notify the transferor, the transferee, or the person providing the intimation of the transfer within thirty days of the date the transfer instrument or the intimation of the transfer was delivered to the company. Any member of a public corporation may freely transfer their securities or other interests, according to the terms of the agreement. The transferee may file an appeal with the Tribunal against the refusal within thirty days of the date of receipt of the notice, or, if the company has not sent a notice, within sixty days of the date on which the transfer instrument or intimation of transmission was delivered to the company, whichever comes first. If a public company refuses to register the transfer of securities within 30 days of the date the instrument of transfer or the intimation of transmission is delivered to the company without good reason, the transferee may appeal to the Tripartite Arbitration and Mediation Service within 60 days of the refusal, or within 90 days if no notice of the refusal has been received from the company. After hearing from the parties, the Tribunal may decide to dismiss the appeal, direct the company to register the transfer or transmission and require that it do so within ten days of receiving the order, or direct the register to be corrected with a corresponding order directing the company to pay any damages sustained by any aggrieved parties. A person who disobeys the Tribunal's order faces a sentence of at least one year in

prison and up to three years in jail as well as a fine of at least one lakh rupees and up to five lakh rupees. Correction of the member's register: The process for correcting the member list following a security transfer is outlined in Section 59 of the 2013 Companies Act. The clause reads as follows: Remedy to the aggrieved for not carrying the changes in the register of members: If the name of any person is entered in the register of members of a company without sufficient justification, is omitted from the register after being entered in it, or if a mistake is made or an unnecessary delay occurs in entering in the register, the fact that any person has become or ceased to be a member, the person aggrieved, or any member of the company,

**Order of the Tribunal**

The Tribunal may, after hearing from the parties to the appeal, direct that the transfer or transmission be registered by the company within ten days of receiving the order, dismiss the appeal, or direct rectification of the depository's or the register's records, in which case it may also order the company to pay any damages incurred by the party who was wronged. The requirements of this section shall not limit a security holder's ability to transfer their security, and any person purchasing such securities shall be granted voting rights unless the Tribunal has suspended such rights by order. The Tribunal may, upon application by the depository, company, depository participant, the holder of the securities, or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify it in cases where the transfer of securities is in violation of any provision of the Securities Contracts Act, 1956, the Securities and Exchange Board of India Act, 1992, this Act, or any other law currently in effect. Failure to follow the directive: The company shall be subject to a fine that shall not be less than one lakh rupees but which may extend to five lakh rupees for any failure to comply with the Tribunal's order under this section. Each officer of the company who is in default shall also be subject to a fine that shall not be less than one lakh rupees but which may extend to three lakh rupees or both.

**Transfer of shares**

The Company's Act has not yet defined "transmission of securities." A transfer is not a "transmission by operation of law." It describes situations in which a person obtains an interest in real estate by virtue of a legal provision, such as an inheritance or succession right, the bankruptcy or insanity of the holder of securities, or a purchase at a court-sale. As a result, the transfer of securities occurs when the registered holder passes away, is declared bankrupt, or, in the case of a corporation, enters liquidation. Because a dead person cannot own anything, his legal representatives become the proprietors of all of his possessions upon his passing. Similar to when someone is declared bankrupt, the Official Assignee or Official Receiver becomes the legal owner of all of their property. When a sole registered holder of securities dies, the legal representatives of that holder are the only ones with title to the securities in the eyes of the company, unless the holder had designated a nominee, in which case he would be entitled to the exclusion of all others.

According to Section 56 of the Companies Act of 2013, an automatic transfer of shares from a dead stockholder specified in the articles of incorporation is invalid and unlawful. Instead, a transfer of securities must be made by a formal instrument of transfer. Such a transfer does not constitute a transmission that occurs automatically under the law. Nothing in the sub-section of Section 56 of the Act shall limit the company's ability to register upon receiving notice that a right to securities has been transferred by operation of law from any person to whom such right has been transferred. Therefore, no instrument of transfer is necessary for this transfer; all that is needed is an application from the legal representative to the

corporation. Companies' bylaws often stipulate the procedures that must be followed when transferring shares. The method for transfer shall be governed by Regulations 23 to 27 of F of Schedule I to the Act in the absence of such a provision in the articles of the company. In accordance with these regulations, the legal representatives are entitled to the shares that the deceased member owned, and the company must accept any proof of succession that the Board of Directors may properly require, such as a succession certificate, letter of administrations, or probate.

Despite being the legitimate owner of the shares, he is not a member of the corporation. However, he is free to request membership registration. Instead, he may transfer the shares in the same way as the dead or bankrupt member may have instead of registering himself as a member. Additionally, the Board of Directors has the same option to refuse registration as they would have had in the event of a transfer of shares prior to a decedent's passing. However, if the corporation unreasonably declines to accept a transmission, the legal representative has access to the same remedies as in a transfer, namely, an appeal to the Tribunal under Section 58.

## CONCLUSION

In conclusion, A crucial step in managing a company's capital is the assignment of shares. Compliance with legal standards, openness, and efficient capital management are all ensured by proper allocation procedures.

Companies may maintain a balanced capital structure and promote shareholder confidence by abiding by legal requirements, taking shareholder rights into account, and matching allotment choices with strategic goals. Companies must carefully analyze the goal and timing of allocation in order to practice effective capital management. Decisions on allocations should be in line with the company's strategic goals, financial requirements, and market circumstances. Companies should evaluate their financing needs, capital requirements, and the effect of allocation on their entire financial condition.

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# CHAPTER 9

# SHARE CERTIFICATE AND SHARE WARRANT: AN ANALYSIS

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**ABSTRACT**:

The concept of allotment of shares and its significance in relation to the capital of a company. Allotment refers to the process of issuing shares to shareholders or subscribers in exchange for consideration, such as money, assets, or services. This paper explores the legal framework and requirements surrounding the allotment of shares, including the authority to allot shares, the procedures for allotment, and the implications of non-compliance. It analyzes the impact of allotment on the company's capital structure, shareholder rights, and the overall financial position of the company. Through a comprehensive analysis of company law and relevant case studies, this paper sheds light on the importance of proper allotment practices in maintaining transparency, compliance, and effective capital management. The company secretary distributes the letters of allocation to the appropriate members once the allotment committee has distributed the shares. The term "allotment letter" refers to a letter informing the applicant that he has been given a certain number of shares by the corporation.

**KEYWORDS**:

Allotment, Convertible Shares, Dividends, Equity Ownership, Face Value, Fully Paid Shares.

## INTRODUCTION

A share certificate is a document that a corporation issues to prove that the individual mentioned on the certificate really owns the shares of the company that are specified on the certificate. Following formation, firms must issue share certificates in accordance with the Indian firms Act [1], [2].Information required on a share certificate: Every share certificate issued in India must have the following information:

1. Name of issuing firm, CIN number, and registered office address are all required.
2. Owners of such shares by name
3. The member's Folio amount.
4. The amount of Shares covered by such Share Certificate
5. The sum paid on these shares
6. A different number of shares

The following timetable is used for share certificates: The firm must issue share certificates within two months after the date of organization following incorporation. If new or existing shareholders are given more shares, share certificates must be provided within two months after the date of allocation. The share certificates must be provided to transferees in cases involving the transfer of shares within a month of the company receiving the instrument of transfer [3], [4].

### Steps Involved in Issuing Share Certificates

1. Board meeting and share distribution: A board meeting is convened to discuss the distribution of shares. The allocation committee is a group of directors that the board of directors allocates. The decision to allocate shares would thereafter be made by the allocation committee. After the allotment committee submits its report about the allocation of shares,

the board approves it before passing the resolution allocating shares to the appropriate applicants. Until the final certificate is issued, this letter of allocation is regarded as the share certificate [5], [6].

2. Register of Members: Using the lists of applications received and the allocation sheets, the company secretary then creates a Register of Members. The shareholders' names and the specifics of the shares that have been assigned to them are included in the register of members [7], [8].

3. Preparing and Printing Share Certificates: According to the form recommended by the Articles of Association, the company secretary shall organize the share certificate's form. In accordance with the requirements of the applicable legislation, the secretary must have the form printed with all necessary information. With the aid of the application register and allocation sheets, the secretary must complete all the information on the share certificate. The share certificate must also have the signatures of two corporate directors, according to the secretary. The share certificate has to be signed by the secretary. The secretary must also make sure that each share certificate has the company's seal and revenue stamp attached. Once the certificates are in order, the board is called to action to adopt the resolution authorizing the issuance of share certificates [9], [10].

4. Share certificates are ready and will be issued in return for allocation letters and bankers receipts verifying payment of the allotted money, the company secretary must advise all shareholders of this. A public announcement needs to be made for the members' general knowledge. Allotment letters and share certificates are sent by registered mail to members who return them. The company's registered office or the agency designated for sending the share certificates will have the share certificates available for local shareholders to pick up personally if that is what they wish to do.

5. Remedy for violation: A company that violates the rules governing the issuance of share certificates will be subject to a fine that cannot be less than Rs. 25,000 but may reach Rs. 5,00,000, and each officer who violates the rules will be subject to a fine that cannot be less than Rs. 10,000 but may reach Rs. 1,00,000.

**Share Transfer Procedures: Physical Mode**

The transferability of shares is one of a company's distinguishing characteristics. One of a shareholder's privileges is the ability to transfer shares. A transfer of shares is not necessary if a company is limited by assurance and has no share capital since there are no shares to transfer.

Although there is a legal contract between the members and the corporation, share ownership may be transferred by delivery of possession. When shares are transferred, the transferee inherits the contractual connection, which requires a transfer instrument. An agreement to sell a share must be made first, followed by the completion of a deed of transfer, and lastly, registration of the transfer. In this article, we examine the approval and registration processes related to physical share transfers.

**Relocation Deed**

A share transfer deed is a transfer document that has to be signed by both the transferor and the transferee. The certificate pertaining to the transferred shares must also be given to the corporation together with the properly stamped share transfer document. The firm cannot accept any transfer instrument that is not compliant with these rules. Form "SH-4" is used to carry out share transfers in physical form.

**Acknowledgement**

Before the paperwork is examined, some corporations send a notification or acknowledgment of the instrument to the transferor who has filed a transfer with the company. A checklist for reviewing the transfer paperwork is often included in the notice of recognition, which typically takes the form of a letter. Some businesses have a policy of sending transfer receipts. When a single transferor applies for a transfer of shares that he has partially paid for, the business is not required to register the transfer until it has acknowledged the transferee and confirmed that the transferee has no objections to transferring the shares within two weeks after receiving the notification. The corporation is not required by law to notify the transferor when the transfer paperwork is filed by the transferee.

**Scrutiny**

Upon receiving all the transfer paperwork, it is important to check to make sure they are all present and correct. The inspection must be completed 3 to 5 days after the transfer paperwork are received. The papers should be returned to the transferee if they are not accepted. The papers will be returned if the transferor's signature in the transfer instrument does not match the specimen signature on file with the firm.

Every transfer of shares must be submitted for approval to the board of directors or appropriate committee. After approval, registration takes place. Everything should be authorized by the appropriate authority if it passes inspection and is accepted. The board must authorize any share transfers. If the company's bylaws allow it, the board may assign the authority to approve share transfers to a committee made up of individuals who may not be the board of directors.

**Registration**

The transferee must register their share transfer in order to become a member of the corporation. If a share transfer is not registered, the transfer is not complete. The transferee's acceptance of the shares is confirmed in a share transfer form. This is now a binding agreement with the business. The transferee's name is included in the member registry once the corporation accepts and registers the transfer, which qualifies his position as a member. The preservation of the transfer registry is not required by law.

## DISCUSSION

**Delivery of Share Certificate**

Transfer is only effective after the corporation registers those shares. Within one month after receiving the transfer-related corporate document, the firm must produce the share certificate. The appropriate name of the transferee must be written on the document of transfer.

**Equity Warrant**

A share warrant is a document that the business issues bearing its common seal and that certifies the bearer's ownership of the shares or stock stated therein. Share warrants are a kind of tradable property. They are transferrable by simple delivery without the need for transfer registrationrestrictions on the issuance of share warrants

The following requirements must be met before share warrants may be issued.

1. Share warrants may only be issued by publicly traded companies.

2. The Articles of Association must approve it.

3. The shares must be paid in full.

4. The Central Government's consent is required.

The following information must be entered by the firm together with the name of the member in its Register of Members at the time the share warrant is issued:

1. The fact that the share warrant was issued; 2. A list of the shares covered by the warrant, identifying each share by its number; and 3. The warrant's issuance date.

It is a negotiable instrument, and the ownership of the shares is transferred simply by delivery. Since the corporation cannot identify the shareholder or determine who is entitled to the dividends, coupons showing the dates on which the dividend will be paid by the company are attached to each warrant. The dividend might be paid to the individual who presents the proper coupon.

**Advantages of a Share Warrant**

1. By simple delivery of the warrant, the shares stated therein are transferrable. There is no need to register.

2. The instrument is a negotiable one. As a result, the title of the purchaser of the share warrant is superior to that of the transferor if they do so in good faith and without carelessness.

3. Share warrants are accepted by banks as collateral for loans.

4. By including dividend coupons with the share warrants, the corporation may make provisions for future dividend payments.

**Advantages of a Share Warrant**

In India, share warrants are not very common. It results from the following drawbacks:

1. The warrant's owner is not an employee of the business.

2. Because it is a bearer instrument, the holder is constantly at danger of misplacing the paper.

3. When printing and storing them in a secure location, the organization should exercise extreme caution.

4. Share warrants have extremely high stamp duties.

5. The Central Government's prior consent is necessary.

6. The number of shares specified therein does not equate to the minimum number of shares required for directorship.

**Administration of Company Law**

The following describes the current structure, which deals with company law administration, directly or indirectly, at different phases and provides for several administrative authorities:

1. Central government
2. The Business Law Board
3. National Accounting Standards Advisory Committee
4. India's Securities and Exchange Board

5. Official Administrator
6. Advisory Board
7. Courts.

**The Central Government**

The ultimate authority in charge of enforcing business law is the Central Government. It operates via the Ministry of Law, Justice, and Company Affairs' Department of Company Affairs. However, the day-to-day management of business law cannot be handled directly by the Central Government.

Therefore, it has granted the Company Law Board, which serves as the executive branch of the Department of Company Affairs, its authority. The Central Government has assigned powers to the Company Law Board, which it uses to carry out its duties under the Companies Act.

Except for the ability to choose a Public Trustee under Section 153A, Section 637 allows the Central Government to assign any of its powers or duties to another authority that may be named in the notice by publication in the Official Gazette. Each notice must be presented to both Houses of Parliament with a copy as soon as it is issued. Practically speaking, the business Law Board now oversees the daily administration of business law.

**Board of Company Law Administration's Bylaws**

The following is provided by Section 10E:

1. It enables the creation of the Board of Company Law Administration (CLB) by the Central Government.

2. The Company legislation Board must exercise and carry out any authority granted to it by or according to the Companies Act of 1956 or any other legislation. Furthermore, it must exercise and carry out any additional powers and duties granted to it by the Central Government under this Act or any other legislation, as specified in the Companies Act of 1956 or such other law, by announcement in the Official Gazette.

3. The Central Government must appoint the members of the CLB by publication of a notice in the Official Gazette, not to exceed a maximum of nine members.

4. The members of the CLB must meet the credentials and experience requirements.

5. The Central Government shall select one of the Board members as the Chairman of the CLB.

6. No action taken by the CLB shall be questioned only because of a flaw in its makeup or the occurrence of a vacancy on the CLB.

7. The CLB may create one or more benches out of its members and provide each bench the authority to carry out the duties and exercise the powers that may be indicated in the order. Every decision made or action taken by a bench when exercising this authority or carrying out these duties must be regarded as the decision or action, as appropriate, of the Board.

8. The CLB shall use its authority and perform its duties under the Act or any other legislation in accordance with its own judgment and in accordance with the principles of natural justice.

9. The CLB will have the authority to control how it operates.

**Appeals against the CLB's orders**

According to Section 10 F, anybody who feels wronged by a CLB decision or order has 60 days from the day the decision or order was communicated to him to submit an appeal to the high court on any legal issue related to the order. If the high court is convinced that the appellant was prevented from submitting the appeal within the specified term of 60 days by sufficient reason, the period of 60 days may be extended by a further period of not more than 60 days.

**National Accounting Standards Advisory Committee**

According to Section 210 A, the Central Government may establish the National Advisory Committee on Accounting Standards by publishing a notice in the Official Gazette. This committee's mandate is to advise the Central Government on the development and establishment of accounting policies and standards that will be adopted by companies or classes of companies under the Companies Act of 1956.

**The Indian Securities and Exchange Board**

According to Section 2(45B), the Central Government may create the Securities and Exchange Board of India (also known as SEBI) for the purpose of protecting investors in securities by publishing a notice in the Official Gazette.

**Authority of SEBI**

In accordance with Section 55A, SEBI is responsible for administering the provisions of Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116 to 122, 206, 206 A, and 207 as they relate to the issuance and transfer of securities and the non-payment of dividend in the case of: (i) Listed Public Companies; (ii) Those Public Companies which intend to list their securities on any recognized stock exchange in India.

According to Section 209A, all companies must make their financial records and other documents available for review by SEBI inspectors and others during regular business hours. However, an inspection may be conducted without providing the corporation or any of its officers with any prior notice. Additionally, an inspection may be conducted with regard to subjects covered by the sections mentioned in section 55A. Additionally, according to Section 621, a court may find a person guilty of an offense connected to the issuance, transfer, or non-payment of securities or a dividend upon receipt of a written complaint from a person authorized by SEBI.

According to Section 410, the Central Government may assemble this Committee of no more than five qualified individuals for the purpose of advising the Central Government and the Company Law Board on matters relating to the administration of the Companies Act, 1956, as may be referred to it by the Central Government or the Company Law Board. However, the Central Government is not required to form an advisory committee. Furthermore, even if a committee is established, neither the central government nor the company law board are required to follow its recommendations.

**Courts**

Section 2 defines "Court" as the following: (a) The Court having jurisdiction under this Act with respect to any matter relating to a company (other than any offence against the Act), as provided in s.10; (b) With respect to any offence against this Act, the Court of a Magistrate of the First Class or, as the case may be, a Presidency Magistrate, having jurisdiction to try such offence.

Section 10 of the Constitution specifies the following in relation to court jurisdiction:

1. The court with jurisdiction under this Act shall be: (a) The High Court with respect to the location of the company's registered office, unless jurisdiction has been delegated to any District Court or District Court subordinate to that High Court in accordance with (2) below; and (b) Where jurisdiction has been delegated, the District Court with respect to matters falling within the ambit of the j.

2. The Central Government may, by notification in the Official Gazette and subject to such restrictions, limitations, and conditions as it thinks fit, authorize any District Court to exercise all or any of the jurisdiction granted to the court by this Act, excluding the jurisdiction granted to the court by: (a) Sections 237, 391, 394, 395, and 397 to 407, both inclusive, in respect of companies generally; (b) Sections 237, 391 and 394 to 395 in respect of companies with

3. The location that served as the company's registered office for the longest period of time in the six months before the filing of the petition for winding up is referred to as the "registered office" for the purposes of jurisdiction to wind up corporations.

## CONCLUSION

In conclusion, Important tools for establishing ownership rights and simplifying the transfer of shares in a firm are share certificates and share warrants. These records show who owns shares, provide shareholders rights and responsibilities, and make it possible to manage shares effectively and transfer them.

Transparency, accountability, and the defense of shareholder rights are enhanced by abiding by legal requirements and keeping correct records of share certificates and share warrants. It is crucial for shareholders to store their share warrants or certificates in a secure location to guard against theft, loss, or unlawful transfers.

The proper steps should be taken to procure replacements or make repairs in the event of loss or damage.

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# CHAPTER 10

# EXPLORING THE MAIN CHARACTERISTICS OF COMPANY: A REVIEW STUDY

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**ABSTRACT**:

The characteristics of a company and their significance in defining its legal structure, operations, and relationships. It examines the fundamental features that distinguish a company from other forms of business entities, including legal personality, limited liability, perpetual succession, transferability of shares, and separate ownership and control. This paper analyzes the legal and practical implications of these characteristics, their impact on the rights and responsibilities of stakeholders, and their role in facilitating business activities and growth. Through a comprehensive analysis of company law and case studies, this paper sheds light on the key characteristics of a company and their importance in the business landscape. A corporation is a group of people united for a common purpose, such as doing business for profit or engaging in activities that benefit society, in the usual, non-technical meaning.

**KEYWORDS**:

Risk Management, Social Responsibility, Strategic Planning, Teamwork, Transparency, Value Proposition.

## INTRODUCTION

The term "company" is thus used to describe organizations established to conduct profitable business, to advance the arts, sciences, or education, or to serve charitable purposes. This group of people may or may not be organized legally. According to Section 3 of the Companies Act of 1956, a company is one that has been incorporated and registered under the Act or one that already exists and was incorporated and registered under a prior company legislation. This definition does not clearly convey the purpose and character of the firm. Additionally, S. 12 allows for the creation of other company kinds. These might be restricted by guarantee, limited by shares, or limitless businesses, among others. In India, the great majority of businesses have limited liability via shares [1], [2].

"An association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business; and who share the profit and loss (as the case may be) arising therefrom," is how Lord Lindley characterized the corporation. The common stock thus provided is represented in monetary terms and serves as the company's "capital." Members are those who contribute to it or to whom it belongs. individually member's "share" is the percentage of the capital to which they are individually entitled [3], [4]. The member may sell his stock in the firm, so resigning from membership and converting the buyer of his shares into a member. As a result, stock in a corporation may be transferred. Because shares are transferable, the business naturally possesses what is known as everlasting succession. The latter does not terminate with a member of a firm withdrawing or passing away. The company's existence is separate from the lives of its employees. Members may join and leave at any time, but the business remains in operation until it is disbanded. In his book The Principles of Modern Company Law, Gower, L.C.B. provides an intriguing illustration. He claims, "During the war, a hydrogen bomb murdered all the employees of one private firm while they were at a general meeting. However, the business managed to survive; a hydrogen

bomb could not have destroyed it. By detailing the attributes, a business obtains as a result of registration, Section 34(2) describes the impact of registration on a company. The section states: "From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, who may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable immediately of exercising all the powers of an incorporated company and having perpetual succession and a common seal, but with such liability on the part of the members to contribute any sums of money or other property as may be required by the certificate of incorporate [5], [6].

**Company Characteristics**

We may list the following distinctive qualities of a corporation based on the observations made above.

**Institutionalized Association**

According to the Companies Act, a business must be established or registered. A public corporation must have a minimum of 7, whereas a private firm must have a minimum of 2 (section 12). Additionally, it should be noted that an association of more than 10 people, in the case of a banking business, and more than 20 people, in the case of any other business, becomes an unlawful association under Section 11 if it is not registered as a company under the Companies Act or any other currently in effect statute [7], [8].

**Artificial Individual**

A corporation is referred to as artificial since it is founded with legal authorization and is not a living, breathing human being. However, because it is endowed with certain rights and duties, it is referred to as a person. Therefore, a corporation is an artificial person [9], [10].

**Distinct Legal Entity**

Company, as contrast to a partnership, is separate from the individuals that make it up. According to Section 34 (2), the association of individuals becomes a body corporate by the name stated in the memorandum upon registration. A company is at law a different person altogether from the subscribers, according to Lord Macnaghten in the well-known case of Salomon v. Salomon & Co. Ltd. (1897) AC 22. Even though it may be true that the business is exactly the same after incorporation, the same people manage it, and the same hands receive the profits, the company is at law neither the agent nor trustee for the subscribers. Additionally, the subscribers as members are not accountable in any way other than as specified by the Act. The following are the details of the infamous Salomon case:

Salomon had a successful leather company. He sold his firm to a corporation he, his wife, a daughter, and four sons founded for the amount of £30,000. The 20,000 shares of £1 each and the £10,000 in debentures issued in favor of Mr. Salomon, secured by a floating charge on the company's assets, met the acquisition price. The remaining stockholders each made a subscription for one share worth £1. In addition, Mr. Salomon served as the business's managing director. The business had problems nearly right away, finally went bankrupt, and started the winding-up process. The company's entire assets at the time of its dissolution were £6,050, compared to its liabilities, which were £10,000 secured by the debentures given to Mr. Salomon and £8,000 owed to unsecured trade creditors. The corporation was only acting as a fictitious name or agent for Salomon, according to the unsecured assorted creditors, who demanded payment for all of the company's assets, or £6,050. The corporation, which is in law a person entirely separate from its members, cannot be considered as Salomon's "alias,"

agent, or trustee, hence the claim of the trade creditors cannot be upheld. Additionally, the company's assets must be used to pay off the debentures since secured creditors have a precedence over unsecured creditors when receiving payment from the assets on which their debt is secured.

A firm was established in Lee v. Lee Air Farming Limited (1960) 3 All ER 429 PC with the aim of producing aerial top-dressing. The articles of incorporation named Lee, a licensed pilot who owned all but one of the company's shares, as the company's controlling director and chief pilot. Lee's widow filed a claim under the Workmen Compensation Act after he died while operating a corporate aircraft. Lee was not a "worker," according to the corporation, since one individual cannot be both a boss and an employee. Held: Lee and the business had a legal service agreement, and as a result, Lee was a worker. The claim of Mrs. Lee was accepted. The following are the case's facts in Bacha F. Guzdar v. The Commissioner of Income-Tax, Bombay:

Mrs. Guzdar, the complainant, got a specified sum as dividend on shares she owned in a tea firm. Agriculture income is excluded from paying income tax under the Indian Income-tax Act. Only 40% of a tea company's revenue is considered income from production and sale and is thus subject to tax since the company's income is partially agricultural. According to the plaintiff, the dividend income she receives should be considered agricultural revenue up to 60% of the time, much as in the case of a tea firm, since dividends paid to shareholders are considered corporate income. Held: The Supreme Court ruled that even if the company's revenue included certain agricultural components, Mrs. Guzdar could not classify the same money she received as a dividend as agricultural income.

**Small Liability**

Because the corporation is a different legal entity from its members, they are not responsible for its obligations. Consequently, the liability of members in a business limited by shares is capped at the nominal value of the shares they own. As a result, their obligation will be zero if the shares are completely paid up. However, corporations may be established with members' unlimited responsibility or with members' specific sum guarantees. In such circumstances, the members' obligation is not limited by the nominal or face value of the shares they own. Members of limited liability businesses are nonetheless responsible for all debts until the last penny is paid. Each member's responsibility in firms limited by guarantee is governed by the guarantee amount; in other words, he is only responsible for contributing up to the amount he has guaranteed.

## DISCUSSION

**Unlimited Liability of a Member of a Limited Liability Company**

In the following cases, a shareholder or member shall lose the privilege of limited liability:

Everyone who is a member during the time the company is operating with less than the required number of members after those six months and is aware of this fact shall be personally liable for the full amount of the debts contracted by the company if the number of members is reduced below the statutory minimum, which is 7 in the case of a public company and 2 in the case of a private company, and the company continues to operate during this period.

The court may hold those who were knowingly parties to the transaction personally liable without limitation for all or any of the debts or other liabilities of the company if it becomes

apparent during the winding-up process that any business of the company has been conducted with intent to defraud creditors.

**Separate Assets**

According to the legislation, shareholders are not an undertaking's co-owners. The Supreme Court of India eloquently articulated this distinct property theory in Bacha F. Guzdar v. The Commissioner of Income Tax, Bombay (Supra). According to the Supreme Court, "a shareholder is not a part owner of the company or its property; he is only granted certain rights by law, such as the right to vote or attend meetings and the right to receive dividends." Similarly, in R. F. Perumal vs H. John, it was noted that "no member may declare himself to be owner of the company's property throughout the course of the business or upon its dissolution. The statement "even where a shareholder held almost the entire share capital, he did not even have an insurable interest in the property of the company" was made in a different instance. Northern Assurance Co. v. Macaure is the case. Ltd., the situation was as follows: 'Macaure' owned all but one share in a wood firm. He had also given the business a significant advance. He personally insured the company's wood. His claim was denied due to a lack of insurable interest over the destruction of wood by fire. The insurance firm was found to be immune from liability by the court, which used the distinct legal entity concept.

**Shares' Transferability**

The transfer of member interests is made easier by the company form of organization, which separates business from its members. A company's shares may be transferred in the ways specified in its bylaws (section 82). A private business, however, may impose certain limitations on such a transfer of shares yet retain the freedom to do so.

**Continuous Existence**

Since a firm is an artificial person, it cannot become sick and does not have a set amount of time to live. The firm is unaffected by the demise, bankruptcy, or retirement of any of its members. Members may join and go, but a business may last forever. The adage "King is dead, long live the King" perfectly describes how companies are organized.

**Regular Seal**

A firm lacks a natural body since it is an artificial person. As a result, it must operate through its directors, officers, and other staff members. But only papers with its signature may be used to bind it. A company's common seal serves as its legal signature. When to use the company seal - The firm's articles of association allow the use of the company seal on papers. Apart from those documents, the company seal must be used on all formal documents, documents executed on stamp paper, powers of attorney, lease agreements, share certificates, debentures, debenture trust deeds, mortgage agreements, promissory notes, negotiable instruments (except checks), agreements of hypothecation, loan agreements with banks and financial institutions, employment contracts, guarantees provided by the company, and debenture trust deeds. A facsimile (exact replica) of the common seal may be preserved wherever a firm does business or engages in transactions outside of India. The name of the location where the seal will be used should also be on the seal. There must be power in the articles for such a purpose. To use the seal, a person must be duly authorized, who must sign his name, provide the name of the location, and state that he has been given permission by the relevant resolution. According to s.48, a business may appoint anybody as its attorney and authorize them to execute deeds on its behalf wherever in or outside of India by writing under their common seal, either generally or with regard to any specific concerns. A deed executed

by such an attorney on behalf of the company and with his seal, if needed, shall bind the company and have the same legal force as one executed with the company's common seal. Company may bring and respond to claims in its own name.

Another drawback of having a distinct legal organization is that the business may file a lawsuit or be sued on its own behalf if it is wronged in any way. In Rajendra Nath Dutta v. Shibendra Nath Mukherjee (1982) (52 Comp. Cas. 293 Cal.), a lease deed was signed by the company's directors without using the seal, and later the directors, not the company, filed a lawsuit to avoid the lease on the grounds that the defendants had fraudulently added a new term to the lease deed. It was decided that a director or managing director could not file a lawsuit unless the business did so to prevent a deed that was admittedly signed by a director and that the firm had also taken the rent. The corporation was not even a plaintiff in the action as stated in the plaint, which was instead put out by a few of the business's directors. The corporation, not the directors, was supposed to launch the lawsuit if it felt wronged. As a result, the lawsuit could not be maintained.

**Taking Off the Corporate Mask**

A firm is different from its constituent parts. It has its own legal identity. As a result, a barrier exists between a firm and its members, keeping them apart. It does sometimes become essential to remove this curtain, ignore the company's unique corporate entity, and learn the truth about the business. The court has the right to look into the company's actual operations, ownership, etc. Lifting or breaching the corporate veil is what this is known as. In other words, the Court looks into the company's actual financial situation. It has been noted that although a company may seem to be a separate legal entity, it really consists of a group of people who are the actual beneficial owners of all corporate assets.

The court thereby lifts the corporate veil when it disregards the firm and speaks directly to the management or members. It will rely on the underlying social, economic, and moral elements as they work in and through the company and will mainly be left to the Courts' discretion.

The following circumstances may cause the corporate veil to be lifted:

1. To look into the connections between the holding company and the subsidiary firm; to look into the number and names of the business's members;

2. To look into who really owns the company's shares and who holds the reins of power; to look into the company's legitimate goals;

3. To look into the majority's mismanagement and tyranny;

4. To look into the reputation of a business that trades with an enemy nation or whose managers are either controlled by foes or have lived in hostile territory;

5. To look at situations where there is a propensity to monopolize;

6. To look into any business activities that might be exploited to avoid paying taxes or engage in tax evasion;

7. To determine whether the business is representing its shareholders;

8. To look into the circumstances surrounding its formation with the intention of breaking the law, defrauding its creditors, or avoiding legitimate commitments.

(2004) 121 Comp., Bombay High Court v. According to Cas 314, the corporate veil may only be removed to the degree specified by law. Only individuals who want to utilize the 'business'

in an honest manner are able to benefit from incorporation. The legislation removes the corporate veil in cases of dishonest and fraudulent use of the incorporation facility and names the individuals (members) who are behind the scenes and accountable for the commission of fraud These are a few examples:

For the Protection of Revenue: When a business seems to have been founded only to evade or avoid paying taxes, the court may refuse to recognize the firm's distinct existence. D. was a wealthy guy who earned money via interest and dividends. He didn't want to pay surtax. He established four private corporations with him as the principal stakeholder for this reason. The corporations made investments, and anytime they got interest or dividend revenue, D sought for loans from the companies, which were quickly approved and never returned. The corporate veils of all the firms were removed in a judicial action, and their revenues were handled as if they were of class "D".

The shareholders will be held accountable for the company's actions in cases when it is acting as their agent. This agreement may be stated explicitly or it may be inferred from the circumstances of a specific situation. When a corporation has been established by specific individuals in order to escape their own legal contractual obligations, the court may proceed as if the company never existed. Example: A agreed to sell his company to B in exchange for a certain period of time during which he would not engage in any local competition. A founded a private company with majority shareholdings in breach of the contractual duty because she wanted to resume her business. The court ordered an injunction preventing "A" and his firm from moving further with the competitive business after B filed a lawsuit against "A" and the private corporation.

The court will pierce the corporate veil in such cases to reveal the fraudster if a business has been founded with fraudulent intent or is a "sham." In Delhi Development Authority v. Skipper Construction Company (P) Ltd. 4 SCALE 202, the skipper construction firm was found to have underpaid the DDA for the acquisition of a property. Instead, work got under way, and space was sold to different people. The two sons of the directors who ran businesses under their own names said that they were no longer together and that their businesses had nothing to do with their parents' assets. But they were unable to provide any convincing evidence to back up their assertion. According to this, the share transfer between the father and the sons must also be seen as a fraud. The director and members of his family had established a number of corporate organizations, but that did not stop the court from considering them all as a single company that belonged to and was under the control of the director and his family. Where a corporation is founded in violation of public interest or policy: Where the Court may uncover the corporate veil in order to assess the members' moral character. For instance, C Company was listed in London to promote tires made in Germany. The German citizens resident in Germany controlled the majority of C's shares. C firm sued D company for the recovery of trade debt during World War I. Germany was at war with England at the time, thus the D company claimed that C business was an enemy foreign corporation and that paying the loan amounted to trade with the enemy. The Court agreed with the defendants' argument.

Where instrument of incorporation is utilized for any unlawful or inappropriate purpose. The corporation gave S, the financial adviser of a financing public limited company, a loan of 15 lakhs to buy real estate in Delhi. S. also completed a pronote on the same. S used the loan money to fund three public limited businesses that he and his son had established. The money was then used by these businesses to buy real estate in New Delhi. The defendants were forbidden by the Delhi High Court from in any way alienating, transferring, disposing of, or encumbering the subject properties.

when there are less than the required number of members (two for a private company and seven for a public corporation), and the firm has been operating during this time for more than six months. Every individual who is a member of the company during the time it continues to operate in this manner beyond those six months and is aware of this fact will be jointly and severally accountable to the creditors for the repayment of the debts incurred by the company during that time. Such a member is subject to individual (direct) action from the company's creditors. The benefits of restricted liability and the independent legal entity are both forfeited. In order to satisfy their claims, creditors may appeal to shareholders rather than the firm itself (section 45).

When a prospectus makes a false statement that is materially false: If a prospectus makes a false statement that is materially false as to a fact, Ss. The promoters, directors, etc. are held personally accountable under sections 62 and 63 for both monetary damages as well as the possibility of prosecution for a fine as high as $50,000 or a sentence as long as two years, or for both. Unless the firm has already made the payment on the instrument, an official of a company who signs a negotiable document on its behalf without including the name of the company is personally accountable to the holder of the document. Companies with holdings and subsidiaries: Sections 212-213. The holding company and its subsidiaries are distinct legal entities in the sense of the law. When a company has subsidiaries at the end of its fiscal year, it may present a set of group accounts to its members in general meeting in addition to its own accounts. These group accounts will show the profit or loss made or suffered by the holding company and its subsidiaries collectively as well as their collective state of affairs at the end of the year;

The Court may, depending on the circumstances of a case, regard a subsidiary business as just a branch or department of one major activity held by the holding company. The Central Government may, where it deems advantageous, order the holding and subsidiary firms to synchronize their financial years. inquiry into related companies: Section 239 allows the Inspector assigned to look into the affairs of another connected business under the same management or group if it is essential for the acceptable completion of the inquiry into the affairs of a firm.According to Section 247, the distinct legal entity may be ignored when determining who owns a business.

This Section permits the Central Government to designate one or more Inspectors to look into and report on the membership of any firm in order to identify the actual parties with financial stakes in the business and those who control or significantly affect its policies.Business conducted with the intent to defraud creditors: If it becomes apparent during the winding up of a company that any business conducted by the company has been conducted with the intent to defraud creditors of the company, or any other persons, or for any fraudulent purpose, the court may, upon the application of the liquidator, or any creditor or contributory of the company, deem any persons who are knowingly parties to the carrying on of the business in the manner described above to be guilty of fraud.

**Company As Different from A Partnership**

A partnership is described as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all" under Section 4 of the Indian Partnership Act, 1932. Individual individuals in a partnership are referred to as "Partners," the group of partners is referred to as "a Firm," and the name under which the firm is operated is referred to as the "Firm's Name". The following are a partnership organization's fundamental traits:

1. An association of two people or more is referred to as a partnership. The maximum number of partners, however, is restricted under section 11 of the Companies Act of 1956 to ten for banking businesses and twenty for all other businesses.

2. An agreement between two or more people is required for the formation of a partnership.

3. The agreement has to relate to doing business.

4. The agreement must specify how the company will split earnings.

5. All of them must do business on their own behalf, or any one of them may do so. The concept of mutual agency is the foundation of the relationship. Each partner takes on the twin roles of principal and agent.

6. Each partner of the business has unlimited accountability for the obligations of the firm.

7. A partnership company does not have a separate legal existence from the individuals who make up the partnership.

8. A partnership agreement is founded on the parties' shared confidence and trust.

9. Without the approval of the other partners, no partner may transfer his ownership interest in a partnership to a third party.

10. Without the agreement of all partners, the nature of the partnership business cannot be changed.

In the following ways, a partnership firm may be differentiated from a company:

1. A partnership business does not exist independently of its members. Unlike its members, a firm is a separate legal entity.

2. A partnership is based on the concept of mutual agency, according to which each partner acts as the other partners' agent. A company member is not the other members' agent.

3. Members' responsibility: A partner's responsibility is limitless, which means that even his own assets are at risk for the firm's obligations. A member of a limited company has responsibility that is only as much as the outstanding balance on the shares he owns or the guarantee amount specified in the firm's memorandum of association.

4. Transfer of stake: Without the approval of the other partners, a partner cannot transfer his stake in the partnership. A member may freely transfer his shares in the firm, subject to the limitations set out in the articles.

5. Existence: Unless there is a written agreement to the contrary, the partnership is dissolved upon the death, retirement, or bankruptcy of a partner. A business, however, benefits from continuous succession. A company's continued existence is unaffected by a member's death, retirement, or bankruptcy.

6.Membership Requirements: Two people are needed as the bare minimum to start a partnership. Two people are necessary to start a private corporation, whereas seven people are needed to form a public one.

7. Maximum Membership: No more than twenty people may create a partnership. For a financial firm, the number is capped at 10. There is no maximum number of members in the case of a public business. A private business, however, is limited to fifty members.

8. Accounts audit: Unlike an audit of a company's accounts, the audit of a firm's accounts is not required.

9. Use of the Words "Limited" and "Private Limited" Not Allowed: According to Section 631, if any person or persons trade or carry on business under any name or title in which the words "Limited" or "Private Limited" are the last words, that person or each of these persons shall, unless duly incorporated as a public or a private company, as the case may be, be punishable with a fine that may extend to 500 for each day upon.

## CONCLUSION

In conclusion, A company's qualities, such as its legal identity, limited liability, perpetual succession, transferability of shares, and separation of ownership and control, influence how it is governed legally and how it does business.

These qualities support investor confidence, strengthen the basis for corporate operations, and encourage sustainability and development. Stakeholders may manage the complexity of a company's operations and help it succeed in the competitive business environment by understanding and valuing these traits. It is essential for stakeholders to comprehend a company's features in order to successfully engage in its activities, make wise choices, and defend their rights. Additionally, it is crucial for legal and regulatory compliance since these features specify the legal context in which an organization must function.

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# CHAPTER 11

# GOVERNANCE ARRANGEMENTS ASSOCIATED WITH DIFFERENT TYPE OF COMPANY

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**ABSTRACT**:

The different kinds of companies and their characteristics in the context of business entities. It examines various types of companies, including sole proprietorships, partnerships, limited liability companies (LLCs), corporations, and cooperatives. The paper analyzes the legal structures, ownership models, liability frameworks, and governance arrangements associated with each type of company. Additionally, it discusses the advantages, disadvantages, and suitability of different company types for specific business needs and objectives. Through a comprehensive analysis of company law and real-world examples, this paper sheds light on the diverse options available to entrepreneurs and business owners when choosing the most appropriate form of company for their ventures. A corporation that is established by a particular Act of the Legislature is referred to as a Statutory corporation, and it is subject to the rules of that Act.

**KEYWORDS**:

Accountability, Adaptability, Branding, Collaboration, Communication, Customer Service,

## INTRODUCTION

A subsidiary or holding company of a body corporate that is incorporated in a nation other than India shall be deemed to be a subsidiary or holding company of the body corporate within the meaning and for the purposes of this Act also, whether or not the requirements of this section (S. 4) are satisfied. For the purposes of this Act, a private company that is a subsidiary of a body corporate that is incorporated outside of India but that, if incorporated in India, would be a public company within the meaning of this Act, shall be deemed to be a subsidiary of a public company if that body corporate does not hold the entire share capital in that private company, whether alone or in conjunction with one or more other bodies corporate incorporated outside India [1], [2].

### Classification Based on Incorporation

Depending on how they were formed, companies may be divided into three groups. A corporation is referred to as a Chartered corporation and is governed by that charter if it was established by a royal charter. For instance, a Royal Charter was used to establish the East India Company. There are no such businesses in IndiaExamples of statutory businesses are the State Bank of India and the Industrial Finance Corporation of India. A business that is established via the registration of certain papers in accordance with the Companies Act of 1956 is referred to as a Registered business [3], [4].

### Using liability as a basis for classification

Members of a registered corporation are subject to either restricted or unlimited liability (section 12). It may be constrained by guarantees, shares, or both (i.e., guarantees and shares).

### Limited Liability Companies

A corporation limited by shares is a registered business whose memorandum of association limits the liability of its members to the amount, if any, remaining on the shares they each own. Throughout the life of the business or at the moment of winding up, the amount still owing on the shares may be called up at any time. A shareholder, however, may only be required to pay the outstanding balance on his shares. If there is no outstanding debt on the shares he acquired, his personal assets cannot be used to satisfy the company's obligations. Such a business is sometimes referred to as a Share Company [5], [6].

### Limited Liability Companies

A corporation limited by guarantee is one in which the members' liability is constrained by the memorandum to the amount that each member may agree to contribute to the company's assets in the case of its dissolution. 'Guarantee firm' is another name for such a business. The amount specified in the memorandum serves as a cap on the liabilities of guarantee company members. If the business's obligations exceed its assets at the time of winding up, the firm may only request the guaranteed amount from the members. A "guarantee company" that only offers guarantees without share capital. If necessary, the operating finances are acquired from sources such as fees, contributions, subsidies, endowments, grants, subscriptions, and the like. Such a business is often established to advance the fields of art, science, culture, charity, sports, or business, among other objectives [7], [8].

### Hybrid Businesses

A hybrid kind of corporation that combines aspects of the guarantee and the share company is a company limited by shares as well as by guarantee. In such a business, the initial capital is raised from the shareholders, and the regular operating capital is obtained from other sources like fees, charges, subscriptions, etc. Every member of such a company is subject to two types of liability: the guarantee, which may take effect during the company's dissolution, and the obligation to pay up to the nominal value of his share, which may take effect at any time during the company's existence or at the time of dissolution [9], [10].

### Unlimited Liability Companies

A business that has no cap on its members' liability is said to be infinite. In the case that such a corporation is wound up, its members are obligated to pay its debts to the fullest extent of their wealth. The creditors of the corporation, however, cannot hold the members accountable. The business is accountable to its creditors since it is a different legal entity from the individuals that make it up. If the creditors are unable to get payment from the firm, they may ask the court to wind up the business. The members will then be requested by the liquidator to contribute to the company's assets without restriction on their obligation for the settlement of the company's debts.

### Using the Number of Members to Classify

A firm may be categorized in the following ways from the perspective of the general public and based on the number of members:

### Public Company

Just two people need to subscribe their names to the Memorandum of Association in order to establish a private business. It refers to a corporation whose articles provide that it must have at least one lakh rupees in paid-up capital or such greater paid-up capital as may be required.

Limits the number of members to fifty, excluding employee-members and former employee-members; provided, however, that where two or more people jointly own one or more shares in a company, they are treated as a single member for the purposes of this definition; prohibits invitations to the public to subscribe to its shares and debentures; and forbids any acceptance of deposits from the public.

**Publicly Traded**

A public company is defined as one that meets the following criteria: 1. Is not a private company; 2. Has a minimum paid-up capital of 5 lakh rupees or a greater paid-up capital as may be required; 3. Is a private company that is a subsidiary of an unincorporated business.

There is no limit on the maximum number of members that a public corporation may have; nevertheless, Section 12 stipulates that there must be a minimum of seven members who must submit their names to the memorandum of association. A public firm has the option of inviting the general public to purchase shares of its stock. It must publish a prospectus if it chooses to encourage the public to subscribe to its share capital. It just has to file a statement in place of a prospectus with the Registrar of Companies at least three days before it may allot shares if it chooses not to allow the public to subscribe to its share capital and organizes the capital privately. The ability of members to transfer their shares is not restricted by the articles of such a corporation. Only public businesses' shares and debentures may be traded on a stock market, according to the Securities (Contracts) Regulation Act of 1956.

## DISCUSSION

**Distinction between Private and Public Company**

Following are the main points of distinction between a private and a public company. The minimum number of individuals required to start a private business is two, but the minimum need for a public corporation is seven. While there is no limit on the maximum number of members in the case of a public business, the maximum number of members for a private corporation cannot exceed fifty. The ability to transfer shares is limited in private companies, but it is unrestricted in public companies. A public corporation may encourage the general public to subscribe for its shares or debentures via a prospectus, while a private company is unable to do so. A private company may start doing business right away after getting its certificate of formation, while a public company must wait until it obtains a certificate from the Registrar authorizing it to do so. A public corporation must convene a statutory meeting and submit a statutory report to the Registrar, but a private company is not required to do so. A private company's directors are not needed to sign the memorandum of organization, register a formal approval with the Registrar, or engage into a contract for their qualifying shares. However, directors of a public company are required to sign the memorandum, register their written agreement to serve as directors with the Registrar, and engage into a contract for their qualifying shares.

A private company's board of directors may be chosen by a single resolution;however, this is not the case for public companies. In contrast to a public company, where at least two-thirds of the directors must retire by rotation, private company directors are not compelled to do so. In a private corporation, the number of directors may be expanded to any degree without the Central Government's consent; however, if a public company wants to have more than twelve directors, the Central Government's consent is required. In a private corporation, the quorum must consist of two members personally present, but in a public company, the quorum must consist of five members. There are no limitations on management compensation in a private corporation. In addition to the aforementioned benefits, a private corporation has several

unique rights. A public firm is not entitled to such benefits. Share warrants cannot be issued by a private corporation.

**Special Benefits and Exemptions for Private Companies**

A private corporation is entitled to a number of particular benefits that are not accessible to public companies. This is true because fewer individuals who are often members of the same family, group, or close acquaintances give money for private companies. There is thus little public interest in such matters. However, because a significant portion of the funding for public corporations comes from the general people, there are a variety of limits placed on them in order to protect their interests.The specific benefits that a private firm might have been as follows:

Even only two people may create a private firm. Without waiting for the required minimum subscription, a private corporation may continue with the share allocation (s. 69). This is because a private corporation is not compelled to make shares available to the general public. A prospectus is not necessary for a private firm to publish. As a result, it may distribute shares without releasing a prospectus or sending a statement in place of a prospectus to the Registrar. A private corporation is allowed to allocate new shares to outsiders and is not required to provide further issues of shares to the current owners. Since Ss, a private corporation is permitted to issue any kind of shares and permit unequal voting rights. It is not covered by Sections 85 through 89 of the Act. .A private firm may start operating as soon as it is incorporated. It is not required to have a membership index. The Registrar of Companies does not need a private company to have a statutory meeting or submit a statutory report.

Unless the articles specify a higher number, the quorum is just two members who are personally present at the meeting. In the case of a private corporation, if there are no more than seven people present, one person present in person or by proxy may demand a poll; if there are more than seven people present, two members present in person or by proxy may demand a poll. A private business is only required to have two directors at the very least. A single resolution may appoint all of the directors. The written approval of a private company's directors is not required in order for them to serve as directors or claim their qualifying share (Sections 264 and 266). Private business directors are not required to retire in succession (Section 255).

A private business is exempt from the application of Section 266's limitations on the appointment or advertising of directors. A particular notice of fourteen days is needed when a new director is to be appointed. Unless a private firm is a subsidiary of a public corporation, this law does not apply to them. Private company directors may vote on a contract in which they have a stake (s. 300). Private businesses are immune from constraints on executive compensation.

**A Private Company Losing Privileges**

According to Section 43, a private business would be considered as a public corporation and lose any rights or exemptions to which it would otherwise be entitled if it violates any of the three requirements specified in its Articles as per Section 3(1)(iii). The provision to s.43 states that the Central Government may release the company from these consequences upon application by the company or any other interested person if the violation of any of the three restrictions in the articles was unintentional or if the Central Government is satisfied that it is just and equitable to grant relief.A private company becoming a public company A private corporation may become a public company under Section 44. The steps are:

The requirements of Section 3(1)(iii) which are needed to be incorporated in the articles of a private business must be removed by a special resolution passed by the company in general meeting. The corporation transitions from being a private company to a public company on the day the resolution is approved. The corporation must submit the following documents to the Registrar within 30 days of the special resolution's passage: (i) a printed or typewritten copy of the special resolution; and

A declaration that serves as a prospectus in place of one.The corporation and any officer who is in default are subject to a fine of up to 5,000 for each day that the resolution, prospectus, or statement in place of prospectus were not filed on time. If there are less than seven members, action should be done to raise that number to at least seven, and if there are only two directors, action should be taken to raise that number to at least three. The term "Private" should be removed from the name before the phrase "Limited."

**Public company conversion to private company**

Except for a reference to s.31(1) in the preamble, the Act makes no explicit or direct provisions for the conversion of a public corporation into a private business. A public company that meets the requirements for private companies set forth in Section 3(1)(iii) may convert to a private company by following the steps outlined below: The company's general meeting must pass a special resolution to amend the articles to add the necessary restrictions, limitations, and prohibitions and to remove any language that is inconsistent with the restrictions. For instance, the ability of members to transfer their shares must be subject to particular limitations in a private business.Before "Limited," the term "Private" has to be included.

1. To change a public company's articles and turn it into a private business, the Central Government's consent must be acquired.

2. A printed copy of the amended articles must be submitted with the Registrar within one month of the date on which the order of approval was received.

3. A printed or typewritten copy of the special resolution must be submitted with the registrar within thirty days of it being passed.

**Using control-based classification**

On the basis of control, businesses may be categorized as follows:

1. Holding businesses

2. Subsidiary businesses

**Holding and Affiliated Businesses**

A firm is referred to be a holding company when it controls another company. The Subsidiary Company is the business over which control is exerted. A corporation is seen to be controlled by another if:

The make-up of its Board of Directors is under the jurisdiction of that other.The other company owns more than half of the nominal value of its equity share capital (in the event that a company had preference shareholders prior to the effective date of this Act who had voting rights equal to those of equity shareholders), which is required for control purposes. It is a division of a third business, which is a division of the controlling business. For instance, if company 'B' is a subsidiary of business 'A' and company 'C' is a subsidiary of company 'B,' then company 'C' must be a subsidiary of company 'A. Company "D" must be a subsidiary of

both Company "B" and Company "A" if Company "D" is a subsidiary of Company "C". Therefore, a firm must either control the make-up of the Board of Directors or possess more than half of the nominal value of another company's equity share capital in order to qualify as a holding company.

**Organization Governing Board of Directors Composition**

A company's board of directors is said to be controlled if it has the authority to name or remove the holders of the majority of its or all of its directorships without the approval or agreement of any other party. In the following circumstances, a company should be regarded to have the authority to nominate a person as a director of another company:

When the corporation must use this power of appointment in his favor in order to nominate someone to the position. when a person's appointment as a director or manager of, or to any other position or job inside the organization, inevitably follows from that appointment. when a person chosen by the firm or a division of it has a directorship. The following must not be taken into consideration when deciding whether a firm is a subsidiary of another:

Any shares owned or voting rights that may be exercised by the other business while acting in a fiduciary position are not considered to be its own.

Any shares owned or authority that a person may exercise over a company under the terms of that company's debentures or of a trust deed used to secure the issuance of any such debentures must be ignored. Any shares held or powers exercisable by a company or its subsidiary, other than as in clause (2) above, shall be treated as not held or exercisable by it if the regular course of business of that other company is lending money and the shares are held or powers are exercisable only as security.

However, shares owned or voting rights that may be exercised by any individual acting as the other company's nominee will be regarded as held or exercisable by the aforementioned business. As a result, the holding company will be considered to "hold" or "exercise" the shares owned or authority exercisable by a subsidiary. For instance, even though company 'A' has not made any direct investments and neither 'B' nor 'C' individually hold more than 50% of the equity share capital of company 'D,' if 'B' and 'C', subsidiaries of company 'A', collectively hold more than half of the equity share capital of company 'D,' then company 'D' shall be deemed to be a subsidiary of 'A'.

**Identification Based on Ownership**

Depending on who owns it, a firm may be:

1. Government enterprise

2. Non-Government organization

**Government Enterprise**

A government firm is one in which the central government, a state government, or a combination of the central government and one or more state governments holds at least 51% of the paid-up share capital, according to Section 617. Government Companies are subject to the same rules as other companies under the Companies Act, but under Section 620, the Central Government may order that certain rules do not apply to them or that they do so with the exceptions, modifications, and adaptations that may be specified by the Government. The Central Government, however, is unable to exclude the Government enterprises from the requirements of Ss. 619 and 619-A, which deal with such enterprises expressly.

According to Section 619, the Central Government must appoint or reappoint the auditor of a Government Company on the recommendation of the Comptroller and Auditor-General of India. The limits on the total number of audits that an auditor may conduct set out in Section 224 also apply to the audit of Government Companies. The Comptroller and Auditor General of India has the authority to specify how the accounts will be audited and to provide the auditor directions on any topic pertaining to the discharge of his duties. He has the authority to request that someone he has authorized undertake an additional test audit of the accounts. The controller and auditor general must get a copy of the audit report from the auditor of the Government Company in order for them to comment on it or add to it as they see appropriate. This information must be presented to the company's annual general meeting at the same time as the auditor's report and in the same format. According to Section 619-A, the Central Government is required to present an annual report on the operations and finances of each Government Company to both Houses of Parliament within three months of its annual general meeting, along with a copy of the audit report and any comments or supplements made by the Controller and Auditor General of India to the audit report. In cases when a State Government participates in a Government Company, the State Legislature must also be presented with this report. According to Section 619-B, a corporation in which the Central Government, any State Government, or any Government Corporation owns either alone or collectively not less than 51% of the paid-up share capital is also subject to the requirements of Section 619 as indicated above.

**Foreign Business**

A foreign corporation is a firm that was established in another nation but has operations in India. However, if one or more Indian citizens or one or more Indian bodies corporations hold at least 50% of the paid-up share capital (either equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, that company is required to abide by any Act provisions that may be prescribed with regard to the business it conducts in India. Every foreign business that opens an office in India is required by Section 592 to submit the following documents to the Registrar of Companies in New Delhi and the State where the office is located: (a) A certified copy of the company's memorandum and articles, or a certified translation of them if they are not in English; (b) The full address of the Registrar of Companies; and (c) A certified copy of the company's bylaws.

According to Section 593, the firm must submit a return of the adjustment to the Registrar of Companies within the required time frame if any of the aforementioned particulars change. Insofar as it relates to its operations in India, section 594 allows a foreign company to be subject to the rules regulating the books of account that must be maintained by a company under section 209. The main office in India is where the books of accounts must be maintained, and the Registrar must receive three copies of the balance sheet, profit and loss account, and other papers, together with a list in triplicate of all the locations where business is conducted in India. A foreign company is required by Section 595 to prominently display the name of the company, "limited" or "private limited" if it is a limited company, and the country in which it was incorporated on the outside of every office or place of business in India. This information must be displayed in both English and the local languages that are commonly spoken in the area where the office is located. These details must be included in the prospectus that was published in India.

Any process, notice, or other document must be served on a foreign company in accordance with Section 596. If it is directed to a person whose name has been given to the Registrar of Companies in accordance with Section 592, it is presumed to have been served. The

paperwork required by Section 592 must also be sent by the foreign firm to the Registrar of Companies in New Delhi, according to Section 597. If any of the aforementioned standards are not met, penalties are provided under Section 598. A punishment of up to 10,000 may be imposed on the corporation and any of its officers who are in default, and further fines of up to $1,000 may be imposed in the event that the default persists for more than one day. According to Section 599, a foreign corporation that violates the aforementioned clauses is forbidden from pursuing any contract via a lawsuit, set-off, or counterclaim, albeit it will still be accountable for whatever contracts it may have engaged into. The following sections are applicable to a foreign corporation under Section 600: Sections 124–145, 118, 209, 159–160, 209A, and 601-608.

A foreign business may be wound up under Section 584. No matter whether the foreign company has been dissolved or has ceased to exist under the laws of the country where it was incorporated, when a foreign company that has been conducting business in India stops doing so, it may be wound up as an unregistered company under Part X (Ss.582-590).

**One Man Business**

Almost the whole share capital of a corporation may be held by a member. Such a business is referred to as a "one-man company." Both private and public companies are susceptible to this. The company's additional member(s) may each only own one share. These additional members can just be dummies added to the group to meet the legal minimum membership criteria.

**Creating the Company**

Section 12 allows for the creation of firms without a share capital requirement. An organization without a share capital is an example of a guarantee corporation. However, since 2000, the idea of corporations without a share capital has been obsolete due to the implementation of the minimum paid up share capital requirement for both public and private firms. A business incorporated under Section 25 is not, however, needed to have the minimum number of paid-up shares.

**Unlawful Organization**

Any company association or partnership that conducts banking business with more than ten members or conducts any other business with more than twenty members with the acquisition of gain as its primary objective is deemed to be an illegal association by the Companies Act.

**The Drawbacks of An Illicit Association**

It is not permitted to sign any contracts or file lawsuits against other members or other parties. It is unable to incur any debts. It doesn't exist legally. It may, though, be registered at any moment and become lawful. Each member shall have unlimited personal liability for any obligations incurred in such enterprise. Every member will be subject to a fine that may reach $10,000. Under the Act, it cannot be dissolved. Regarding contribution or apportionment in relation to partnership operations and transactions, its members have no recourse against one another.

## CONCLUSION

In conclusion, the various company types provide a variety of possibilities for business owners and entrepreneurs to form their businesses in accordance with their unique requirements and goals. People may make wise judgments and create a legal framework that supports their business aims and goals by being aware of the features, benefits, and

drawbacks of each kind of company. When forming and running a corporation, it is crucial to get the advice of legal and financial experts to guarantee compliance with all applicable laws, rules, and taxes requirements. Changes in the company's structure and operational requirements may become necessary as a result of ongoing monitoring and assessment.

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# CHAPTER 12

# EXPLORATION OF THE FORMATION OF COMPANY: A COMPREHENSIVE REVIEW

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**ABSTRACT**:

The process and key considerations involved in the formation of a company. The formation of a company entails various legal and procedural steps, including selecting a business structure, registering the company, drafting necessary documents, and fulfilling regulatory requirements. This paper examines the significance of each step in the formation process, the legal implications of company registration, and the importance of compliance with applicable laws and regulations. It also discusses the considerations related to selecting a suitable business structure and the impact of formation decisions on liability, ownership, and governance. Through a comprehensive analysis of company law and practical examples, this paper sheds light on the essential aspects of company formation. The accountant who evaluates the assets of a firm to be acquired or the lawyer who forms the Articles are only providing the promoters with expert advice. However, he would be seen as a promoter if he went farther than this, for as by referring his client to a person who would be interested in buying shares in the proposed firm

**KEYWORDS**:

Financial Management, Flexibility, Innovation, Leadership, Market Research, Mission Statement.

## INTRODUCTION

A declaration that all requirements of this Act and the rules thereunder have been met in respect of registration and matters precedent and incidental thereto must be filed with the Registrar by an advocate of the Supreme Court or of a High Court, by an attorney or pleader qualified to appear before a High Court, by a person engaged in the formation of a company, or by a person named in the articles as a director, manager, or secretary of the company [1], [2].

### Beginning of a Company

For simplicity, the whole process of forming a corporation may be loosely split into three phases: promotion, registration, and flotation. The word "promotion" is used often to describe the first processes necessary to register and float a firm. Promoters are those who take on the responsibility of promotion. A person, syndicate, group, partnership, or business may be the promoter [3], [4].The ability to want the firm to exist and be willing to take actions, which may or may not include other peopleto make it happen is maybe the fundamental test of whether someone is a promoter. However, those who support the promoters by behaving professionally do not afterwards take on the role of promoters themselves [5], [6].

### Promoters have obligations and liabilities

Promoters have been defined as having a fiduciary relationship with the firm, which is a relationship based on trust and confidence. Because of this mutually beneficial connection, the promoter is required to fully disclose all relevant information pertaining to the company's

incorporation. He should not benefit secretly from the firm he promotes without the company's knowledge or approval, and if he does, the company may require him to account for it [7], [8].While making money is not against the law, making it secretly is. In the case of Gluckstein v. Barnes, a group of people organized a syndicate to purchase the property known as "Olympia" and sell it to a business that would later be established for the same reason. The former Olympia Company's discounted debentures were the first thing the Syndicate purchased. Then they paid £1,40,000 to purchase the business itself.

The debentures were fully redeemed with this self-provided capital, and a profit of £ 20,000 was realized on it. They supported a fresh business, selling Olympia to it for £1,80,000. The prospectus disclosed the £40,000 profit but not the £20,000 profit. Held: The promoters of the firm were obligated to pay the company the £20,000 hidden profit because they could not have disclosed it to the company on their own in their position as vendors to themselves in their capacity as directors of the buying company. To whom is the disclosure to be made? It was decided in Erlanger v. New Sombrera Phosphate Co. that the disclosure ought to be made to a qualified and impartial board of directors. He is not in compliance with this obligation if he informs the Board of Directors that some individuals are only his personal nominees or employees. The disclosure should be given to the whole group of people who are asked to become shareholders when it is not practicable to choose an independent Board of Directors. This may be done via the prospectus. Therefore, the promoters must see to it that "those who are induced by the promoters to join the company are disclosed the real truth [9], [10].

**Promoter's Obligations for Non-Disclosure**

The company may choose to rescind the agreement and recover the purchase price in cases where the promoter sold the company his own property, recover the profit made even if rescission is not requested or is not possible, or pursue damages for the promoter's breach of fiduciary duty. The discrepancy between the property's market worth and the contract price will serve as the basis for calculating damages.

**Promoter obligations under the Companies Act**

For the false representations made in the prospectus, the promoter is responsible to the recipient of the first share allocation. It is obvious that his responsibility does not extend to later allocators. For making such false assertions in the prospectus, he might additionally face up to a two-year jail sentence or a fine of up to $50,000 (Sections 62 and 63). The court may hold a promoter accountable for misfeasance or breach of trust during the company's winding up on an application brought by the official liquidator (section 543). In accordance with Sections 478 and 519, the court may also order a public examination of the promoter. If there are many promoters, they are each individually and collectively accountable. If one of them is sued and must pay damages, the other(s) may be held responsible. However, a promoter's passing does not absolve his estate of responsibility for misusing his fiduciary position.

In accordance with Section 12 of the Act, "any seven or more persons, or where the company to be formed will be a private company, two or more persons, associated for any lawful purpose, may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability." Therefore, in order to sign the memorandum of association, the promoters will need to gather at least two signatories for a private business or seven signatories for a public company. According to Section 33, in order to form a business, the Registrar of Companies of the State where the company's registered office will be located must receive the following three documents:

1. The company's memorandum

2. Any applicable articles

3. The contract, if any, that the business intends to sign with anybody it intends to employ as a managing or full-time director or manager.

In the event of a public corporation, seven people must sign the papers in (1) and (2); in the case of a private firm, just two people must sign the paperwork. The "Regulations for Management of a Company Limited by Shares" (provided in A of Schedule I to the Act, 1956) may be implemented if, as we will see later, a particular form of company does not need to draft its own Articles of Association. Along with the Memorandum and the Articles, Section 33 stipulates that a statement must also be submitted to the Registrar. It is referred to as a "Statutory Declaration of Compliance." It may be filed by a person designated in the articles of incorporation as a director, manager, or secretary of the company, or by an advocate of the Supreme Court or of a High Court, an attorney or pleader authorized to appear before a High Court, a company secretary, a chartered accountant who practices full-time in India, or any of these individuals. The declaration must attest to the fulfillment of all registration-related obligations set out in the Act and its implementing Rules.

The following must be followed in accordance with Section 266 prior to the articles' registration with the Registrar if the first directors are chosen by the articles. written authorization to act from those directors, signed by them or by an agent who has received proper written authorization; and unless he has already taken his qualification shares and paid for them, agreed to pay for them, or signed the Memorandum for a number of shares not less than the qualification shares, a written commitment from each such director to take from the firm and pay for his qualification shares (if any). The sole entity covered by Section 266 is a public business with a share capital.

**Floatation**

When a company has been registered and has obtained its certificate of incorporation, it is prepared for "floatation," which means it may go on with the capital necessary to start its operations and maintain them successfully. A private corporation is not allowed to invite the public to subscribe to its share capital, as we saw before under the "classification of companies" section. As a result, when a private business is established, the required capital is acquired via private negotiations with friends and family. The promoters of a public corporation may also organize the capital privately, just as they would for a private company, without inviting the general public to subscribe to its share capital. In this situation, the promoters want to use incorporation benefits that aren't accessible to private companies, such the ability to have an infinite number of members and provide members the unrestricted ability to transfer shares. However, a significant portion of publicly traded firms raise their initial capital by allowing the public to subscribe to their share capital. Every public corporation is required under Section 70 to perform one of the two actions listed below: If the public is to be solicited to subscribe to its capital, (i) a prospectus must be issued; otherwise, (ii) a "statement in lieu of prospectus" must be submitted if the capital has been secured privately. It has to be finished three days or more before allocation.

**The existence of the company name**

A corporation cannot be incorporated with a name that, in the eyes of the Central Government, is undesirable, according to Section 20. It is thus advised that promoters check with the Registrar of Companies to see whether the desired business name is available. Three

names in the order of priority should be submitted for this purpose.Although they are not necessary for registration, the following two papers are often given alongside the aforementioned ones.

1. The location of the company's registered office.

2. Specific information, if any, about the secretary, manager, and directors.

These two papers must be presented within 30 days of the company's registration.

## DISCUSSION

### Certificate of Incorporation/Consequences of Incorporation

The Registrar will, if satisfied, enter the name of the company on the Register of Companies maintained by him and will then issue a Certificate of Incorporation under his signature as a token of registration of the company on the date noted on it, after the aforementioned documents have been filed with the Registrar and the necessary fees have been paid. This document fulfills the same function for a corporation that a birth certificate does for a natural person in the event of a natural person. Upon registration, the company becomes a legal person separate from the individuals who have been its members since the day of incorporation stated in the certificate of incorporation, with rights and obligations similar to those of a natural person and the ability to enter into contracts.

The certificate of incorporation is irrefutable proof that all conditions of the Companies Act for registration, as well as things preparatory to and related thereto, have been met. Accordingly, the certificate would be conclusive and would not affect the status and existence of the company as a legal person even if the memorandum was discovered to have been materially altered after signature but before registration (Peel's case), signed by just one individual on behalf of all seven subscribers, or had signatories who were all infants.

This clause eliminates any lingering questions about events that occurred before, during, or in connection with the registration and were crucial to it. It also establishes the company's legitimacy as a legal entity. A guardian of the remaining five members, who were minors, and two adults both signed the memoranda in the Moosa v. Ebrahim case. However, the Registrar registered the business and provided an incorporation certificate. The certificate was deemed conclusive by the court in all respects. In another instance, Jubilee Cotton Mills Ltd. v. Lewis, the Registrar issued a certificate of incorporation on January 8th, although it was dated January 6th, the day he received the paperwork. The business distributed shares to Lewis on January 6. It was decided that the certificate was convincing proof that the business had been established on January 6th and that the allotment was valid despite having been made before the company had been incorporated. However, if an organization was formed with unlawful purposes, such purposes would not become lawful upon the issuance of the certificate. According to Section 36, the memorandum and articles of the company bind the company and its members to the same extent as if they had been signed by the company and the members individually and contained covenants on their parts to abide by all the terms of the memorandum and articles after registration.

### Preliminary contracts or pre-incorporation

A firm is an artificial person that is able to engage into contracts, as we've already explained. Before receiving the certificate of incorporation or after receiving the certificate of incorporation but before receiving the certificate to begin business, the promoters may

engage with third parties on behalf of the proposed firm. Therefore, the three circumstances in which contracts may be entered into in the case of a public corporation are as follows:

1. Agreements made before incorporation

2. Contracts made after formation but prior to getting the business license

3. Contracts made after receiving the authorization to start a company.

However, there are only two circumstances in the case of a private company: (i) contracts before formation; and (ii) contracts after incorporation. This is because it is not necessary to get the certificate to start doing business.

Pre-incorporation or preliminary contracts are those that promoters for the prospective business engage into before the firm is registered. A corporation is often established in order to buy an existing firm or other property. In such cases, the promoters sign agreements with the owners of the businesses or properties that the prospective firm would purchase. Since a person cannot enter into a contract before they are physically present and a business cannot exist legally before incorporation, a pre-incorporation contract can never bind the firm. But the Specific Relief Act of 1963's Sections 15(h) and 19(e) have offered some relief in this area. It states that a contract entered into by a company's promoters before its formation for the benefit of the business may be explicitly enforced by or against the company if the contract is supported by the provisions of the company's incorporation. However, in this situation, the business must have acknowledged the contract after being incorporated and informed the opposing party of its acceptance. The Act contemplates contracts for the creation and printing of the Memorandum and Articles, among other documents, for the rental of space and the hire of secretarial employees.

Promoter accountability with regard to pre-incorporation agreements. What a promoter's stance is in relation to preliminary contracts is a crucial issue that has to be addressed. What will the promoter who creates such a contract's legal position be if the business doesn't sign a new contract after incorporation and the contract isn't one justified for the purpose of the company's formation?

In the case of Phonogram Ltd v. Lane (1982) Q.B. 938, it was noted that even though everyone involved in the contract negotiations was aware that the business had not yet been formed, a contract signed before to the firm's incorporation might nevertheless have certain legal consequences. With the individuals who ostensibly enter into contracts on the company's behalf, the agreement is effective as a personal contract. In the event that commitments made in the company's name are not kept, promoters will be required to pay damages. Even though the contract specifically states that only the company's paid up capital should be responsible for performance, this must still be the case.

**Provisional Agreements**

Provisional contracts are those that a public company enters into after receiving its certificate of incorporation but before receiving its certificate to open for business. These agreements are not enforceable against the company until it is permitted to do business, at which point they will take effect automatically without further action from the firm.

The provisional contracts will not become binding on the firm if it is unable to receive the certificate to open for business, and no one may bring a claim based on them.A firm may only do those activities that are explicitly or imply authorized by its memorandum, as will be discussed later. Any transaction that has not received this approval is ultra vires (beyond the

scope of the powers) and is invalid from the start. The contract cannot be enforced by the corporation or the other party.

**Contract Types Used by Companies**

According to Section 46, a business may generally enter into contracts in the same manner as an individual. Therefore, a contract that must be in writing if it is between private parties may also be established on behalf of the firm. It must be signed by someone who is operating with the company's explicit or implicit consent. In the same way, such contracts may also be modified or terminated. Additionally, a verbal or written agreement made on behalf of the corporation by any person operating with explicit or implicit authority that would be enforceable if it were made between private parties. The same way might be used to modify or terminate such contracts. Every business established under the Act is obliged by section 147 to have a common seal with its name in visible letters because certain transactions must be under seal. A business may be given authority under section 50 of its articles to have an official seal for usage outside of India. In addition, there is a common seal.

**Articles of Association**

The term "Memorandum" is defined as "the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies' law or of this Act" (S.). 2(28). By signing their names to a memorandum of association and otherwise adhering to the requirements of this Act in regard to registration, any seven or more people, or where the company to be formed will be a private company, any two or more people, associated for any lawful purpose, may form an incorporated company, with or without limited liability.

**Meaning and Objectives of the Memorandum of Association**

A business's charter, or Memorandum of Association, outlines the essential requirements that must be met in order for the firm to be formed. It reveals the goals behind the establishment of the business as well as the absolute limit of what can be accomplished via its activities. Thus, it limits the company's authority while also defining it. Anything done outside of these bounds will be invalid and ultra vires (outside the company's authority). The memorandum has two purposes: first, it informs shareholders, creditors, and anyone else dealing with the firm about its authority and the scope of its actions. As a result, the prospective shareholder may learn more about the industry or purpose for which the firm will use his funds as well as the risk he assumes by making the investment. Additionally, everyone doing business with the firm, such a provider of products or money, will be aware of whether the transaction they wish to complete with the company is within the scope of those objectives or not.

**Structure and Contents**

According to Section 14, a company's memorandum must be in one of the Forms in Sections B, C, D, and E of Schedule I to the Act, or in Forms that are as close to those Forms as the circumstances permit. According to Section 15, the memorandum must be printed, separated into paragraphs, sequentially numbered, and attested by at least seven signatories (two in the case of a private firm). This witness must also authenticate the signatures. Each member is required to purchase at least one share and to indicate how many shares they have purchased next to their names. According to Section 13, a limited company's memorandum must include:

1. The business name, with the words "limited" in the case of a public company and "private limited" in the case of a private company as the last words;

2. The name of the state where the company's registered officer will be located;

3. 'Main objectives' and 'Other objects' listed separately as the company's goals;

4. The statement that the members' culpability is restrained;

5. A predetermined number of shares made up of the authorized share capital. These provisions in the memo are referred to as mandatory clauses.

**Name publication**

(i) paint or attach its name and the address of its registered office on the exterior of every office or place of business in a visible location, in letters that are clearly readable and in the language that is widely spoken in the area, and preserve the information painted or fastened.The Department of Company Affairs has said that failure to display the company's name in both English and the local language concurrently would result in insufficient compliance with the Section's requirements.The phrase "outside of every office" does not refer to the location of the office itself. The display outside the office room, even if it is within the building, is adequate where the office is located inside a complex.

(ii) have its name engraved on its seal in readable letters.

(iii) include the company's name and registered office address in legible letters on all business correspondence, bill heads, negotiable instruments, invoices, receipts, etc.

**Penalty**

A firm and any official who is in violation are subject to fines if they fail to paint or attach their names and the address of their registered office in the way specified. Additionally, every officer of a company or person acting on its behalf who signs or authorizes to be signed on the company's behalf any bill of exchange, hundi, promissory note, cheque, etc., where the company's name is not mentioned in the prescribed manner, shall be personally liable to the holder of such bill of exchange, hundi, promissory note, cheque, etc., for the amount thereof unless it is paid to the company. However, personal liability will not apply in the following circumstances: If the mistake was caused by the holder's own action, s.147(4) prohibits the holder of a negotiable instrument from enforcing personal liability against the officer in question. 'Limited' has unintentionally been left out. In this instance, a limited company's bill of exchange was approved. The company's rubber stamp was longer than the paper. The term "limited" did not show on the instrument as a consequence. Holding that the omission was neither intentional nor the result of negligence, the directors who accepted the bill of exchange were not held personally accountable. It was a glaring mistake of the most minor type, and the Act's intended harm was not present in this case.

**The Clause of Registered Office**

The name of the State in which the company's registered office will be located is specified in this clause. Every business must have a registered office, which establishes its domicile and serves as the location where the company's statutory records are often held, where notifications and other communications may be addressed, as well as where it is required to keep its accounts.

Within thirty days of the date of incorporation, the Registrar may receive notification of the precise location (address) of the registered office (section 146). Similar rules apply to publishing the firm's registered office under s.147 as they do for publishing the company name.

**The clause of objects**

The company's goals and the range of its operations are laid forth in the purposes clause. Any action taken by a corporation outside of its objectives is ultra vires and invalid, and it cannot even be approved by the approval of the whole shareholder body. However, a firm is permitted to take any action that is related to and necessary for achieving the stated goals without violating the law. A trading corporation thus has the implicit authority to draw, receive, and borrow money. The act's Section 13 read in conjunction with Sections "B," "C," "D," and "E," mandates that the firm break its objectives clause into three parts:

1. Principal goals that the firm will pursue after formation.

2. Items supplementary or auxiliary to achieving the primary goals; and

3. Other firm goals not covered in (a) and (b) above.

Upon receiving a certificate to start a business, a corporation may pursue any of the "main objects" listed. businesses (apart from trade businesses) whose purposes are not restricted to a single State must identify the State or States whose territory their objects extend in the Memorandum. However, no business specified under "other objects" may begin without first receiving the consent of shareholders by a special resolution adopted at a general meeting. If a special resolution is not adopted, the Central Government may, upon request from the Board of Directors, permit a corporation to start operations in the "other objects," provided that the number of votes voted in favor of the resolution outnumbers the number of votes cast against it, if any. The company's goals must not be against the law, immoral, or contrary to public policy or the Act. For instance, Section 77 forbids a firm from buying its own shares.

**The Clause of Liability**

The members' level of obligation is outlined in this section. If a firm has limited liability, it must specify that members' responsibility is constrained, whether via shares or a guarantee. This indicates that, in the case of a business limited by shares, a member may be required to pay the company any sum owed on the shares he owns at any moment. In the case of corporations limited by guarantee, this section will specify how much each member agrees to contribute to the company's assets in the event of the company's dissolution. This provision need not be included in the memorandum for an unlimited corporation. In actuality, the lack of this phrase in the agreement implies that the members' responsibility is uncapped. According to s.45, a limited company's members' liability may become limitless under specific situations.

**Capitalization Clause**

This paragraph specifies the share capital amount with which the business is registered as well as the method of its split into shares of fixed value, i.e., the total number of shares and the value of each share. If there are both equity and preference shares, then these two categories should be used to divide the capital.

**Clause of Association**

Every company has a clause that says, "We, the several persons whose names, addresses, and occupations are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we each agree to take the number of shares in the capital of the company set opposite our respective names," also known as a "association clause," "subscription clause," or "declaration of association." The names, residences, brief

descriptions, jobs, and amount of shares each subscriber has purchased are listed after that, followed by his signature with a witness' attestation.

**Modification of Memo**

According to Section 16, the Company may not modify the terms of the Memorandum except in the circumstances, manner, and to the extent expressly provided in the Act. Below is an explanation of these clauses.

**A Name Change**

According to Section 21, a corporation's name may be changed at any time with the written consent of the Central Government and by passing a special resolution at a general meeting of the company. However, if the name change solely entails the addition or deletion of the term "private" (i.e., when a public corporation becomes a private firm or vice versa), then the Central Government's consent is not required. A company may change its name by passing an ordinary resolution and obtaining the written approval of the Central Government if it was registered accidentally or otherwise with a name that is the same as or too closely resembles the name of an existing company.Within 30 days after the change, the Registrar of Companies must be informed of the name change. The Registrar will then substitute the new name for the old name on the registry and issue a new certificate of incorporation with the appropriate changes. The new certificate of incorporation is issued, and that is when the name change takes effect. The Registrar will also modify the company's memorandum of association if required. The business's rights and responsibilities are unaffected by the name change, and any legal actions that would have been brought by or against the company under its previous name may still be brought by or against the company under its new name.A printed or typewritten copy of the special resolution must be provided to the Registrar of Companies within 30 days of it being passed.

**Modification of Registered Office**

The process is determined by whether the change falls within the same registrar of companies' authority (section 146) or if it shifts to another registrar of companies within the same state (sections 146 and 17A). The corporation is free to move its registered office at any moment from one location to another within the same city, town, or village. It is sufficient if the Board of Directors passes a resolution. However, the Registrar must receive notification of the modification within 30 days after the change's date and must record it (Section 146). Change of registered office from one town, city, or village to another town, city, or village in the same state: In this case, the procedure is as follows: A special resolution must be passed at a general meeting of the shareholders; A regional director's confirmation must be obtained; A copy of the special resolution and regional director's confirmation must be filed with the within 30 days; Within 30 days after the removal of the registered office, notice of the new location must be given to all shareholders.

Change of registered office from one state to another: According to Section 17, the registered office may be changed from one state to another, and this change necessitates a change in the memorandum. The memorandum is not altered when the registered office is moved from one area in the same city to another or from one city to another in the same State. A specific resolution that must be approved by the Central Government may be used to move the registered office from one State to another. The Central Government will ensure sufficient notice has been given to all creditors and other parties whose interests are likely to be impacted by the change, including the Registrar of Companies and the Government of the State in which the registered office is located, before confirming the resolution. Additionally,

the Registrar, members, creditors, and other parties with an interest in the business will all get a chance to be heard by the Central Government. The resolution may be approved by the Central Government on the terms and circumstances it deems appropriate. In Zuari Agro Chemicals Ltd. v. F., it was made explicit. 44 Comp. S. Wadia and Others (1974). Cas. 465 that the corporation Law Board (now Central government) would not replace the collective knowledge or judgement of the corporation reflected in special resolution with its own wisdom or judgement. However, the company's application for modification might be scrutinized for legitimacy.

## CONCLUSION

In conclusion, Careful consideration of several issues and respect to legal regulations are necessary when forming a firm. Establishing a legally recognized and well-structured firm involves taking important actions such as choosing an acceptable business structure, registering the company, creating relevant paperwork, and making sure that all applicable laws are followed.

Entrepreneurs may build a strong foundation for their firm, safeguard their interests, and promote the efficient operation and expansion of the business by carefully following the formation process. In the creation process, adherence to relevant rules and regulations is crucial. Legal requirements for registration, taxes, licensing, permits, and continuing reporting and disclosure duties must be followed by businesses. Non-compliance may have negative effects on one's reputation as well as legal repercussions. Assuring compliance with legal requirements and reducing risks throughout the formation process requires seeking legal and professional counsel.

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# CHAPTER 13

# LOSS OF REVENUES OF STATE

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**ABSTRACT**:

The factors and consequences associated with the loss of revenues of a state. Loss of revenues refers to the reduction or decrease in the funds available to a government or state entity for public expenditure. This paper explores the various causes of revenue loss, including economic downturns, tax evasion, fiscal mismanagement, corruption, and external shocks. It analyzes the impacts of revenue loss on a state's ability to provide essential services, maintain infrastructure, and implement development programs. Additionally, it discusses strategies and policy measures that can be implemented to mitigate revenue loss and enhance fiscal sustainability. Through a comprehensive analysis of economic principles, case studies, and policy frameworks, this paper sheds light on the complexities and challenges associated with revenue loss and its implications for governance and public welfare.

**KEYWORDS**:

Budget Deficit, Corruption, Economic Downturn, Fiscal Mismanagement, Fraud, Government Expenditures.

## INTRODUCTION

In Orient Paper Mills Ltd. v. State, AIR (1957) Ori. 232, it was noted that a State has locus standi to object to a change in a company's registered office if its interests are impacted. As a result, the Orissa High Court denied to approve the move of registered office from Orissa to West Bengal, citing, among other reasons, the fact that under a federal constitution, each State has the right to preserve its income, making it necessary to take that interest into consideration. However, Justice Ray of the Bombay High Court ruled in Minerva Mills Ltd. v. Govt. of Maharashtra (1975) 45 Comp. Cas 1(Bom.) that the Company Law Board (now the Central government) cannot refuse confirmation on the grounds that the change would result in a State losing money or having negative effects on the State's overall economy. No local interests should be permitted to tip the scales in favor of shifting the registered office from one State to another in India. The issue of income loss to one State would need to be taken into account in the prospectus of overall revenues for the Republic of India. In Rank Film Distributors of India Ltd. v. Registrar of Companies, West Bengal, a similar opinion was given, stating that there is no legal authority for a State to object to the moving of the registered office from one State to another under Section 17. Within 30 days of the special resolution's passage, a printed or typewritten copy must be given to the Registrar under both sections 146 and 17.

Within three months, the Registrar of each State (the old State and the new state) shall receive a certified copy of the Central Government order. The modification will become worthless and ineffective at the end of the time period if it is not submitted within it. Within thirty days of the office relocation, the Registrar of the State where the office has been relocated must be notified of the new address of the registered office (s. 146). Only for certain reasons may a firm move its registered office from one State to another. These are covered in the section that follows (under "Alteration of Objects" - the justifications are common) in more detail [1], [2].

Modification of Items According to Section 17 of the Articles of Association, a corporation may, by special resolution, change its purposes or its registered office from one State to another if any of the following circumstances apply:

1. To do business more effectively and economically: In Dalmia Cement (Bharat) Ltd., In re (1964) 34 Comp. Cas. 729 (Mad.), the Court noted that it is up to the board to decide whether a corporation may operate more economically or effectively. The Court (now Central government) will not go behind it and hold an inquiry into whether the directors' opinion is well-founded or is justified if they believe that under the current conditions it will be convenient and advantageous to combine the new objects with the existing objects and if it appears that such a conclusion may be fairly reached. The Delhi High Court said that the firm must largely stay unchanged and that any additions, modifications, or adjustments should only be made to help the company run more effectively. A company's memorandum in Re, Scientific Poultry Breeders Association (1933) 3 Comp. Cas. 89 (CA) forbade paying compensation to the people who made up its governing body. It desired a change to the agreement that would allow it to award its governing body members compensation, which was permitted, for effective administration [3], [4].

2. To achieve its primary goal by novel or enhanced methods: For businesses founded after October 10, 1965, identifying the primary goal is simple since the Memorandum specifies it. For the earlier-registered corporations, however, one must consider both the memorandum and what has really been accomplished.

3. To increase or modify the locality in which a firm operates. For example, the India Mechanical Gold Extracting Company's operations were limited to the "Empire of India" in Re (1891) 3 Ch. 538. By eliminating these terms, it hoped to expand its activities. It was permitted to do so as long as the term "Indian" was removed from its name as well [5], [6].

4. To conduct some business that, given the current situation, may be easily or profitably merged with the company's activity: In reality, the majority of the changes proposed for the objectives clause are based on this justification. A business may diversify thanks to this provision. The way the clause operates broadens its application to any operation that may be profitably or readily merged with the present firm [7], [8].

5. To limit or abandon any of the objectives mentioned in the memorandum: The process outlined in s. 17 must be followed, even if just part of the object clause is being deleted.

6. To sell or dispose of the entire undertaking or any portion of it: A company may change its objectives in order to sell or dispose of any of its undertakings if it wishes to implement a cutback or retrenchment strategy, meaning that it believes it has either become too large or too diverse and that managing it has become difficult or unprofitable [9], [10].

7. To combine with any other business or group of people.

## DISCUSSION

### Procedure for Alteration of Objects

Within thirty days of its passage, a printed or typewritten copy of the special resolution must be submitted with the Registrar. Additionally, a petition to affirm the special resolution must be sent to the Central Government. The Central Government may approve the change in whole or in part after ascertaining that notice of the resolution was provided to everyone whose interests are likely to be impacted by it, including the Registrar and the State Government, and after hearing from them.

Within three months of the order's date, the Registrar must receive a certified copy of the central government order and a printed copy of the revised memorandum. The papers will be registered by the Registrar, who will then issue a certificate within a month that will serve as irrefutable proof that everything necessary has been done (section 18). The change and the order of the Central Government confirming the alteration shall, after the expiration of such period, become invalid and inoperative if the necessary papers are not submitted within the appropriate time (s.19).

**Changes to the Liability Clause (Section 38)**

A business member's responsibility cannot be raised without the member's written consent. However, the member's approval may be granted either before or after the modification. Increase in liability may occur in any number of ways, including by subscribing for more shares than he had on hand as of the day the adjustment was made. Even if the member does not expressly agree in writing to be bound by the modification, it will still be binding on him if the firm is a club or other similar organisation and the modification in the memorandum compels the member to pay recurring or periodic subscriptions or charges at a higher rate.

The liability of an unlimited liability business may be made restricted. Any debts, liabilities, commitments, or contracts made by or with the corporation before to the conversion will not be impacted by the change, nevertheless.

**Ultra Vires doctrine**

Any action taken by the business outside of its legal rights and powers is considered ultra vires, which is Latin for "beyond powers." It has been noted that the firm has a different legal existence from its members and is a separate body corporate. Therefore, the corporation is able to carry out independent activities. The company's actions are permitted by: The goals listed in the company's memorandum of association, with which it is registered. Any action taken by the company that is neither permitted by its purposes nor by the Companies Act is ultra vires the powers and authority of the company. purposes include incidental objects as well. A corporate act that exceeds its authority is invalid and cannot bind the organization. The act cannot be approved by the shareholders either because it is invalid.

In a landmark decision on the subject, it was determined that even the eventual approval of the whole body of shareholders could not ratify a contract that was ultra vires the firm. An ultra vires contract that is invalid from the start cannot be made valid by estoppel, the passage of time, ratification, consent, or delay. In this instance, the company's stated objectives included the manufacture and sale of railroad cars, wagons, and other railroad plants, as well as the lending and hiring of these items and the operation of general contractors and mechanical engineers. To fund the building of a railway line in Belgium, the business entered into a deal with Riche. When the business reneged on the contract, Riche filed a claim for damages, arguing that the term "general contractors" applied to the agreement and that a majority of the shareholders had approved it. It was noted in the case that the Memorandum of Association had two effects: a positive one in that it specifies the scope and extent of the company's capabilities and a negative one in that nothing shall be done outside of those bounds. Because it is specialized, the word "general contractors" cannot be used in such a broad sense. The company's agreement to fund the building of a railroad line went against its stated goals. The authority and extent of the Memorandum's aims could not be confirmed since the act was supra vires. Despite the directors' authorization to donate money to charities or other charitable causes, the payment was ruled to be outside of their authority. It was decided that the directors may only utilize business funds to promote charitable causes that would help them achieve their stated goals. Prior to this, Eastern Countries Rly had the

opinion that "no company can devote any part of its funds to an object which is neither essential nor incidental to the fulfillment of its object, no matter how advantageous that object may be." Acting beyond the scope of the company's directors' powers and outside the scope of the articles of incorporation but within the bounds of the memorandum is permitted. The directors' authority comes from:

1. Association Bylaws

2. Specific power is granted through resolutions.

3. Businesses Act.

The shareholders may approve a decision that violates the authority of the directors but not the corporation. The articles of incorporation may also be changed to ratify an act that is intra vires the memorandum but ultra vires the articles of incorporation. In other words, a conduct that violates business policy is invalid and cannot be approved. Even when an act violates the articles of incorporation and the authority of the directors, it is just unusual and may still be approved.

The harmed person is entitled to the following relief. Directors who violate an implicit assurance of power may be held accountable to third parties. Any member of the company has the right to obtain an injunction preventing the business from carrying out or continuing with an ultra vires act. A director may be required to return any payments made in violation of the law to the business. As was previously stated, a firm is only permitted to pursue the goals outlined in its memorandum. Activities of the corporation must carefully adhere to the goals stated in its memorandum; otherwise, they would be considered supra vires. Protecting the interests of shareholders and everyone else who does business with the corporation is the goal of ruling such an act to be extra vires. Regarding the theory of ultra vires, some important aspects to remember are: A corporation only exists for the purposes that are clearly declared in its objectives clause, as well as any purposes that are related to or logical consequences of those stated purposes.

Any action taken beyond the explicitly stated or implicit purposes is ultra vires.Acts that are supra vires are initially invalid. These actions do not bind the firm, and neither it nor the other contractual party may bring a lawsuit against them. Example: (1) A business with the following objectives: (i) to manufacture and sell railroad cars, wagons, and all other railroad equipment; (ii) to engage in general contracting and mechanical engineering work; (iii) to buy, lease, develop, and sell mines, minerals, land, and buildings; and (iv) to buy and sell as a merchant timber, coal, metals, and other materials. There was proof that the agreement had been approved by all the members when the corporation agreed to fund the building of a railroad bridge in Belgium. The business later renounced the arrangement and was held liable for breach of contract. In defense, the corporation denied having the ability to sign a contract that fell beyond the purview of its objectives clause. The other party filed a lawsuit seeking damages for contract violation. His arguments were that the contract in issue fit the definition of "general contractors" and was thus within the company's authority and that it was also approved by the majority of the shareholders.

It was decided that the phrase "general contractors" must be understood to refer broadly to those who make contracts related to the work of mechanical engineers. If the term "general contractors" were to be interpreted in this way, it would be permissible to enter into contracts of every description, including, for example, contracts for fire and marine insurance, and the memorandum, rather than mentioning the specific type of business, would essentially refer to conducting business of any kind at all, rendering it completely meaningless. The contract thus

went well beyond what was stated in the memorandum of association. .(2) The creation of costumes, dresses, and other similar items for the apparel industry was included in a company's objectives clause. However, it expanded its operations to include the production of veneered panels, and as a result, it accrued debt to three parties: the builders of the plant that produced the veneered panels, the suppliers of veneer, and the dealers in gasoline. The firm entered insolvency in the meantime and denied the three creditors' claim. In order to get their money back, the creditors filed lawsuits.

If a corporation is about to do an ultra vires conduct, its memberseven a single membercan request a court order of injunction prohibiting the firm from carrying out the ultra vires act. If the directors have gone beyond their jurisdiction and done something, the general body of shareholders may approve it, provided that the corporation is authorized to do so under its memorandum of association. The corporation may borrow money, but its bylaws provide that if the directors want to borrow more than $50,000, the company must first give its permission in a public meeting. However, the directors are permitted to issue up to 75,000 debentures without the shareholders' consent.

In spite of the fact that the act of the directors is ultra vires their authority, the company's general meeting has the authority to approve it. Any property obtained by a business via an ultra vires transaction may be safeguarded by the company against harm by other parties. Directors and other executives may be required to make up any losses the firm suffers as a result of an ultra vires act. Directors and other executives must personally answer to the third parties. Any money or property obtained via an ultra vires transaction that is accessible in cash or can be traced back to the original owner must be returned. When a firm takes out an ultra vires loan to pay off its intra vires obligations, the lender of the ultra vires loan replaces the creditor who has already been paid off and is now entitled to the money.

**An Explanation of the Doctrine of Ultra Vires' Effects and Exceptions**

According to its Memorandum of Association, this company's goals were to sell and provide the supplies needed to build railroads but not to actually build them. Here, the job was to build a railroad. Because it went against the memorandum of association, the directors' decision to engage into that contract was a clear violation of the Company Act of 1862. It was determined that this contract was ultra vires not just of the directors but of the whole company since it was of a kind not covered by the Memorandum of Association. As a result, even the eventual consent of the entire body of shareholders would not have the authority to ratify it. The resolution authorizing the release or amending the conditions under which releases may be issued in the articles of association may have been approved by the shareholders. It would have been more than adequate if they had approved of what had been done without the formality of a resolution. As a result, the contract that the firm entered into was not only voidable but also wholly null and void due to its breach of the Companies Act's ban. It cannot be ratified since it is precisely in the same situation as if no contract had ever been created.

If there had been a formal ratification, it would not have been able to give life to a contract that did not exist in and of itself; at most, it would have amounted to the shareholders endorsing the directors' actions, which, if done before the contract was signed, would not have made it valid as it does not pertain to an object covered by the memorandum of association. This theory was later clarified in the case of Attorney General v. Great Eastern Railway Co. The Ashbury Railway Carriage and Iron Company Ltd v. Riche principle was upheld in this case, but the House of Lords added that the doctrine of ultra vires "ought to be reasonable, and not unreasonable understood and applied, and whatever may fairly be

regarded as incidental to, or consequential upon, those things which the legislature has authorized, ought not to be held, by judicial construction, to be ultra vires." India's Life Insurance Corporation v. Lakshmanaswami Mudaliar. Even in India, it has been ruled that the firm has the authority to carry out both the objectives outlined in its memorandum's objects section and anything else that is deemed to be reasonably essential to accomplish those objectives. For instance, a business that had been given permission by its shareholders to buy property also had implicit permission to rent it out and, if required, sell it. The Supreme Court has made it clear that the company does, without a doubt, have the authority to carry out the purposes set forth in the objects clause of its memorandum, as well as anything that is conclusive to or incidental to those purposes. However, the company does not have the authority to go beyond the purposes or to take any action that does not have a reasonable proximate connection to the purposes or that only benefits the company indirectly or remotely.

In order to determine whether a specific act is ultra vires or not, the main purpose must be determined first, and then special powers to carry out that purpose must be sought. If the act is outside of the main purpose and the special powers expressly granted by the statute, the question of whether it is incidental to or consequential to another act should be asked. If it is discovered that a certain act:

Neither within the main purpose nor the special powers expressly given by the statute but incidental to or consequential upon the main purpose and a thing reasonably done for effectuating the main purpose, or neither within the main purpose nor the special powers expressly given by the statute.Corporate powers grew significantly as a result of the ultra vires concept. The idea still holds true for governmental bodies even if it is essentially irrelevant in contemporary private company law. A corporate act that exceeds its goals or authority is known as an ultra vires act. The original legal theory held that these actions were invalid. According to this method, a company could only perform things that were specified in its corporate charter and was only founded for certain objectives.

This initial perspective was unjust and unrealistic. It allowed a company to agree to the terms of a contract and then refuse to fulfill its commitments on the grounds that the agreement was illegal. A corporation's security of title to property in completely completed transactions was likewise compromised by the concept. The courts thus took the position that such actions were voidable rather than void, and that the circumstances should determine whether a corporate act should have any bearing on the law.A set of rules that forbade the use of the supra vires concept evolved throughout time. The application of the doctrine of estoppel, which forbade the defense of ultra vires when the transaction was fully performed by one party, and the prohibition against asserting ultra vires when both parties had fully performed the contract were among these principles. Shareholders' ability to ratify an ultra vires transaction were also included. The legislation further stipulated that a company could not claim that a tort committed by one of its agents was supra vires if the tort was committed while the agent was acting in the course of their job.

The ultra vires concept was used sporadically and inconsistently notwithstanding these principles. Modern corporate law has thus worked to eliminate the potential of supra vires actions. Most crucially, the articles of incorporation now include sections with numerous objectives and generic clauses that allow businesses to do any legal activity. Additionally, if a firm wants to expand its operations into other sectors, objectives provisions may now be simply changed. For instance, according to conventional ultra vires law, a business with the production of shoes as its exclusive purpose could not, by virtue of its charter, produce motorbikes. According to contemporary corporate law, either the company would update its

purposes clause to reflect the new enterprise or the purposes clause would be so broad as to let the firm to enter the motorbike industry.

The significance of the supra vires theory has also been significantly diminished by state regulations in practically every jurisdiction. The Revised Model Business Corporation Act, for instance, states in section 3.04(a) that "the validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act" There are three exceptions to this rule: by the corporation or its shareholders against the corporation's current or former officers or directors for exceeding their authority, by the attorney general of the state in a judicial proceeding, or by the corporation itself. State-created governments are public businesses that are regulated by municipal charters and other statutory authority awards. These delegations of power resemble the articles of incorporation of a private business. The extra vires principle has traditionally been used to limit a government entity's authority. Ultra vires is the legal term for violating the statutory restrictions.

An employee who is not authorized to act on behalf of a private business company may still bind the entity contractually if the employee would ordinarily be considered to have such capacity. However, with a government organization, it is often essential to demonstrate that the employee truly had the right to act in order to avoid a contract from becoming invalid as ultra vires. An ultra vires claim may be made by the government body in cases when a public servant oversteps her bounds.

**Ultra vires Doctrine critique**

Creditors' Interests: The theory does not give a creditor dealing with a corporation the right to assume that it would only act in accordance with the law. If he fails to inquire or, having inquired, comes to the incorrect conclusion, he runs the danger of suffering a loss from which other creditors could unintentionally profit. The notion could serve as a trap rather than a safeguard for the creditor. Even a careful creditor or other person engaging with a corporation may have negative impacts from the theory in certain cases since he may put a lot of time and attention into making sure a proposed transaction is within the bounds of the law.

The notion of ultra vires may, in principle, provide security by restricting the business and so prohibiting improper actions that might harm a company's solvency and capacity to repay. This does not really matter at all with creditors in real life. It is impracticable to depend on the objectives to place any restrictions on the operations that a company may carry out since memoranda of association are so lengthy, companies have the freedom to change their objects, and companies may operate via subsidiaries. However, in many instances, creditors will enforce such limits by inserting the relevant clauses in their agreements with the corporation.

Practically speaking, a lender of long-term money would often set terms to guarantee that the loan is used for a certain purpose and will examine the company's object clause. When a creditor loans short-term cash or advances that are repayable immediately, they are less likely to check the firm's purpose clause and are more likely to presume that, if the borrower is a trading corporation, the borrowing is within their legal rights. The articles of incorporation often specifically state that any infringement of the borrowing limit would not invalidate the borrowing, but the creditor giving money on any considerable scale will typically confirm whether or not there are any limits on the directors' borrowing powers in the articles.

There will often be a financing agreement that contains any limits on the company's actions that the lender deems sensible. Since the majority of contemporary memoranda of association permit a broad variety of purposes and since the business may always change its objects or

operate via subsidiaries, using the object provisions as a safeguard when such commercial documents are issued is more theoretical than practical. What is a creditor's position with respect to contesting the change made by the corporation is a crucial and significant topic in this regard.

This topic acquires a great deal of significance since creditors seem to be the group that has been most impacted by the legal mess in general. In this regard, the researcher holds the opinion that a creditor has no inherent rights and that all of his rights are merely contractual in nature. This belief is supported by the fact that if the ultra vires doctrine is repealed, the company's contractual capacity will be closer to that of a natural person. Furthermore, a creditor's involvement to prevent a firm from engaging in an ultra vires transaction is impractical since it is exceedingly challenging for a creditor to be aware of the transactions that a company is engaging in. Since the creditor has no practical way of knowing what the company is doing and his relationship with the company is more akin to a contract, the researcher does not believe there is any justification for allowing the creditor to object to the company's alteration of its object clause.

According to some critics, even if such a right is established, it would be completely ineffective for the reasons the researcher listed above. In reality, the commentators use the presence of such a right and its later revocation in December 1947 to support their argument, claiming that practical experience proved such a right to be unneeded and ineffectual. Can the creditors legally bind the corporation to prevent it from changing its goals in the future? is a crucial issue in this context. According to the researcher, the answer to this question will be "no" because, first of all, this will be a matter that should ideally be governed by the company's articles of association since those will govern the scope of the directors' authority to negotiate with creditors. Additionally, without the consent of the shareholders, the firm cannot commit itself to not exercising a power granted by the legislation.

Shareholders' Interests: Shareholders' interests are unquestionably adequately safeguarded by law and in principle. Practically speaking, memoranda of association are too prolix and intended to cover all imaginable transaction. The purpose of having an object clause is defeated by this, and members get no protection. Additionally, it fails to inform investors of a company's true business. What is the shareholder's recourse in this respect is another crucial question to ask. According to the study, there shouldn't ideally be a need for such protection since the law already offers shareholders sufficient security in this regardCLB approval. The researcher believes that this treatment may be unrealistic, and he or she will address this issue when discussing the practical components of the whole process of transformation.

The presumption that the MoA is available to the general public is outdated. As a result of India's rapid industrial development and widespread ownership, people who do business with the firm are often restricted to the areas within the authority of the Registrar of the Companies.

They may be entitled to obtain the necessary information via mail, but doing so would take time and would make business dealings less successful. The aforementioned notion of law may be appropriate in England since it is a smaller nation than India. Therefore, it is necessary to reconsider the presumption about the likelihood of automated examination at public registration.

It is not being argued that a firm does not need to outline its plans in advance. Clearly stating the business's lines of operation is necessary, but it serves little use to insist on separating the primary objectives from the ancillary objectives, particularly when the primary objectives include a wide range of activities.

**Law and the Insurance Sector**

Giving clients a portion of their compensation has been nearly common practice for Life Insurance Corporation salespeople throughout the years. Typically, they cover the customer's first quarter premium. Since it is a known fact that this behavior is prohibited, it is not up for debate. There are, however, conflicting opinions on whether or not this "rebating" should be illegal.

Despite the fact that they all agree that policing this practice is almost hard, the majority of life insurance firms advocate outlawing rebates. For all consumers to desist from rebating, there has to be a shift in knowledge, according to Ms. Suniti Ghoshal, Head-Corporate Communications, Aviva Life Insurance (previously, Dabur CGU Life Insurance). Since there is just one participant in this market, some actions have been taken without much scrutiny, according to Ms. Ghoshal in an email to Business Line.

Other insurance providers concur. "An agent uses incentives to accelerate his sales cycle. According to a Max New York Life Insurance spokeswoman, this expediting of the procedure often results in deception, which lowers the quality of the services provided. Another viewpoint on the same matter, however, is that there is no use in forbidding agent rebating since it is impossible to monitor in any manner. Advocates of this viewpoint point out that in the majority of nations, insurance firms are even permitted to give their clients credit for premium payments. A claim is only payable in India if and when the premium has been paid in full. Rebating may be thought of as a kind of unofficial credit given by the agency to the client.

The agent is paying out of his own money after all. Why is rebating only forbidden in the insurance sector although it is commonplace in all other sectors? Insurance providers, however, do not like it. According to Mr. Dilip Gazaaro, Head of Retail Sales at HDFC Standard Life, his organization did in fact fire an agent for rebating. According to Ms. Ghoshal, Financial Planning Advisers at Aviva are prepared to meet such requests. "They are able to explain to the client why he must compensate the agent for his services. A spokeswoman for Max New York Life expresses similar sentiments, saying that if a consumer can afford a high premium, he should also make sure that the guidance he gets and the services he uses for his policy are the finest in terms of quality and honesty. "We are also creating a code of conduct for the industry against such abuses. Others think that rebating should remain banned, notwithstanding how hard it is to manage. We have requested that the penalty for rebating be doubled from 500 to 10,000 at the Life Insurance Executive Council. Legalizing rebates, in the words of Mr. N. Raveendran, Director of Alegion Risk Management Services, which plans to transition into a general insurance broker, "would drive away the serious agents who do not typically give rebates." According to him, rebating would eventually end once society has developed to the point where it is prepared to pay for a good or service. After all, you don't always see the physician who costs the lowest fee. However, legalizing rebating would delay the coming of such a day.

## CONCLUSION

In conclusion, A state's financial stability and growth goals are severely hampered by income loss. Governments may reduce revenue loss, advance fiscal sustainability, and strive toward attaining equitable and sustainable development for their communities by putting into place effective policies, bolstering fiscal management, boosting transparency, and encouraging international cooperation. Collaboration with foreign partners and organizations may be very important in helping governments who are experiencing income loss. Governments may enhance governance, establish efficient policies to reduce revenue loss, and develop their

revenue management systems with the support of technical assistance, capacity building, and financial aid. Governments must emphasize long-term economic sustainability and create effective measures to deal with income loss. To maintain the state's financial stability, social growth, and general welfare of its population, proactive steps to improve income production, optimize spending, encourage good governance, and counteract illegal money flows are essential.

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# CHAPTER 14

# PROSPECTUS OF PRIVATE COMPANY: A COMPREHENSIVE REVIEW

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**ABSTRACT**:

The concept of a prospectus in the context of a private company and its significance in fundraising and investment activities. A prospectus is a document that provides information about a company to potential investors, enabling them to make informed investment decisions. This paper explores the key components and legal requirements of a prospectus for private companies, including the disclosure of financial information, business operations, risks, and management. It analyzes the purpose and regulatory framework surrounding prospectus issuance, as well as the exemptions and limitations that may apply to private companies. Through a comprehensive analysis of securities regulations and market practices, this paper sheds light on the role and importance of a prospectus in private company fundraising. Regulations that control how a corporation manages its internal affairs and how business is conducted are found in its bylaws and articles of organization. They specify the responsibilities, privileges, authorities, and authority of the shareholders, directors, and the company in each of their separate functions, as well as the manner and structure in which the company's operations must be conducted.

**KEYWORDS**:

Confidentiality, Directors' Report, Financial Statements, Fundraising, Legal Disclaimers, Private Placement.

## INTRODUCTION

A memorandum, articles of association, and prescribing regulations for the company must be registered with the memorandum in the case of a public company limited by shares and must be registered in the case of an unlimited company, a company limited by guarantee, or a private company limited by shares [1], [2].

### Articles of Association: Definition and Objectives

The articles of association of a business have legal effect with regard to the rights of the firm and its members as well as the members among themselves. Memorandum is their superior and has authority over them.

The memorandum of association, as we have seen before, sets out the scope and powers of the company, while the articles regulate how the business's aims are to be carried out. The memorandum cannot override the purposes stated in the memorandum of association. Additionally, changing a memorandum requires a complex process, while members may draft and change articles by adopting a special resolution. Beyond the memorandum, the company's activities are prohibited, but inside of it, the shareholders are free to enact whatever rules they see suitable for their own governance. The articles must not, however, contradict the memoranda. The articles of the company shall not include anything that is contrary to or contradictory to the requirements of the Companies Act (s.9), just as in the case of the memorandum [3], [4].

**Enrollment of Articles**

According to Section 26, a public company limited by shares may record articles of association that were signed by the memorandum's subscribers. However, if it fails to register its own articles, Schedule I's Articles specified in A automatically apply. Additionally, even if it registers its own articles, A will still automatically apply unless it has been omitted or changed. It is really conceivable for such a corporation to adopt articles in one of three ways: (i) completely adopting A; (ii) completely excluding A and laying down its own laws; or (iii) laying out its own articles and adopting a portion of A. The options (ii) and (iii) are often used, and partial adoption of option (A) offers special benefits for small businesses since it saves money on printing and because every provision of option (A) is unquestionably lawful. S.26 mandates the mandatory registration of the company's bylaws for companies limited by guarantee, unlimited liability companies, and private companies limited by shares. However, they are free to implement any suitable rules from A. In any instance, a company's articles must be: (i) printed; (ii) separated into paragraphs; and (iii) signed by the signatories to the memorandum in the presence of at least one witness who will confirm the signatures. Additionally, items must be marked with the appropriate stamp and submitted with the memorandum (section 3).

**Examination of Article Copies**

A copy of the articles of incorporation must be sent to a member within seven days of the member making the request, in exchange for payment of one rupee [5], [6]. If a corporation defaults, both the firm and each officer who is in default are subject to a fine of up to 50 (section 39).

**Changes to Articles**

A business may, by special resolution, amend or add to its articles, subject to the requirements of the Act and the terms of its memorandum, according to Section 31. Within 30 days after the special resolution's passage, a printed or typewritten copy of each special resolution amending the articles must be submitted with the Registrar. Because the ability to change by passing a special resolution is so crucial, a firm cannot in any way deny itself the ability to change its articles. Additionally, a special resolution of the general body of members may exercise the authority to change the number of members in the event of a company limited by guarantee without share capital as provided in the articles from time to time. Despite having the authority to amend its articles, a business may nonetheless use this authority with certain restrictions [7], [8].

The following are restrictions on the ability to change articles. The modification must not go beyond the memorandum's authority or clash with any of its other clauses. No clause of the Companies Act or any other legislation may be violated by the modification. For instance, Section 77 of the Companies Act prohibits companies from buying their own shares, and if a company's articles are changed to provide such a power, the authority is null and invalid. The modified articles must not include any content that is prohibited, in violation of public policy, or illegal. The change must be legitimate and in the best interests of the whole business. However, the change won't be detrimental just because it makes a shareholder's life difficult [9], [10].

A firm, for example, held a lien on all shares that were "not fully paid" for calls that were owed to the company. There was just one shareholder, A, and all of his shares were properly paid up. In addition, he had partially paid shares in the business. A died. By deleting the phrase "not fully paid up" from its articles of incorporation, the firm granted itself a lien on

all shares, whether or not they were fully paid up. A's legal representation contested the change on the grounds that it had retroactive effects.

(ii) By amending the articles, a firm gained the authority to seize shares owned by any member who conducted business against it. There was just one member operating a business against the firm at the time of the modification. He objected to the change.

The modification cannot be a majority deceit against the minority. The change would be detrimental if it served the majority of shareholders' interests rather than those of the corporation as a whole. To put it another way, an amendment to the articles cannot treat majority shareholders differently from minority owners in order to offer the former a benefit that the latter have been denied.

For instance, in the case of Brown v. British Abrasive Wheel Co. (1919), 1 Ch. 290, the majority that controlled 98 percent of the shares adopted a special resolution requiring shareholders to sell and transfer their shares to the nominee of holders of 9/10ths of the issued shares at a fair value upon their request. The modification was deemed unconstitutional because it represented minority oppression. Without their written approval, current members cannot be forced to acquire or subscribe for additional shares or make any other contributions to the share capital according to an amendment of the articles (section 38). A public corporation cannot be converted into a private business by changing its articles without the Central Government's consent (s. 31). By changing the terms of a contract, a firm cannot excuse a violation of its obligations to third parties. Only as of the date of revision will the new provision in the Articles of Association take effect.

**The Indoor Management Doctrine**

People who engage into contracts with the corporation are burdened by the theory of constructive notice since they are deemed to have read the papers even if they may not have done so. Contrarily, the theory of indoor management enables everyone who interacts with the firm to presume that the company's executives have adhered to the conditions of the articles. They are not required to inquire about the consistency of internal processes, in other words. It is not anticipated that an outsider would observe how the business adheres to its internal rules.

The articles of a business, for instance, gave the directors the authority to borrow on bond whatever quantities of money that the company's general meeting could sometimes decide to authorize borrowing. T received a bond from the directors without any such resolution's approval. The issue of the company's liability for the bond emerged. Exceptions: The following situations are exempt from the indoor management doctrine:

1. Any individual who has real or constructive knowledge of the lack of authority of the person operating on behalf of the firm is not protected by the regulation if they are aware of the irregularity. The directors of a firm were permitted to borrow up to 1,000 under the articles of incorporation. With the approval of the corporation at the annual general meeting, they might exceed the cap of 1,000. They took debentures and borrowed 3,500 from themselves without this permission. The business declined to provide the money. Held: Given that they were aware of the internal error, their debentures were valid only to the amount of $1,000.

2. No Knowledge of Articles: If a person did not read the memorandum and articles and did not depend on them, the rule cannot be applied in their favor. T worked as a director for the investment firm, for instance. He signed a contract with the Rama Corporation and accepted a

check from it while claiming to speak for the business. The Directors may assign one of them with authority under the company's articles of incorporation. Rama Corporation, however, never looked at the articles. Later, it was discovered that T was not given any authority by the company's directors. Plaintiffs used the indoor management rule as support. Held: They were unable to since they were unaware that the authority to delegate existed. .3. Transactions that are invalid or unlawful from the start, such as forgeries, are exempt from the rule. Example: In order to issue a share certificate without authorization, the secretary of a business faked the signatures of two of the directors who were needed under the articles of incorporation. The applicants insisted that they had the right to be registered as company members. Held: The certificate was invalid, and the holder of the share certificate was unable to apply the indoor management philosophy.

4. Negligence: If a corporate officer acts in a way that is beyond the scope of his authority, the person dealing with him is required to do the appropriate research and determine the officer's legitimacy. He cannot depend on the rule if he doesn't ask. Example: The only director and major shareholder of a business deposited checks made out to the business into his personal account. The bank ought to have done some research on the director's authority. Since the bank was under investigation, it was improper for it to depend on the director's purported authority.

**Constructive Notice of Articles and Memorandum**

According to Section 610, the memorandum and articles become public papers upon registration and may subsequently be examined by anybody for a small cost. Therefore, everyone considering making a contract with the firm has the means to learn about such powers and the amount to which they have been granted to the directors, and they are therefore assumed to be aware of them.

In other words, it is assumed that everyone who interacts with the organization has read and comprehended these papers. The 'Doctrine of Constructive Notice' refers to this. It is assumed that the person dealing with the corporation has "constructive notice" of the contents, even if he hasn't actually seen them.

(i) A company's articles of incorporation provide that two directors must sign a bill of exchange for it to be valid. One director alone may sign a bill of exchange. No claims under the bill may be made by the payee.

(ii) In the 1934 Supreme Court case Kotla Venkataswamy v. Ram Murthy, Mad. All corporate deeds and papers must be signed by the managing director, secretary, and working director, according to Article 579 of the company's bylaws. Only the working director and secretary's signatures were required to accept a mortgage deed. Held to be void, the deed.

(iii) In a same vein, if a person enters into a contract that exceeds the business's authority, he will not be able to enforce his rights against the firm.

**Articles and Memoranda: Relationship and Difference**

According to Section 36, the memorandum and articles, once registered, bind the company and its members in the same way as if each member had signed and sealed them and included a commitment on their part to abide by all of the provisions of the memorandum and articles.

Therefore, whatever stated in these contracts binds the company to the members, the members to the firm, and the members to one another. However, a company's members are not obligated to third parties. The following is a discussion of these connections:

**Company-bound Members**

The terms of the articles and memoranda must be followed by every member. For instance, if calls are not paid, a business has the power to place a lien on members' shares or to lose the shares altogether. Whatever is stated in the memorandum and articles is binding on every member. Example: A provision in a company's bylaws required that, in the event of a member's insolvency, his shares be sold to another party at a price set by the directors. A stockholder named "B" was declared insolvent. His bankruptcy trustee argued that he was not constrained by these clauses and should be free to sell the shares for their fair market value. It was decided that the trustee was bound by the articles since 'B' acquired shares in accordance with the provisions. Each member is obligated to abide by the covenants of the memorandum and articles, as well as any updates made in line with the Companies Act. The rules that apply to both the corporation and its stockholders are outlined in the articles of organization. Additionally, the shareholders are not permitted to make an agreement that conflicts with the company's articles of organization.

**Company obligated to Clients**

Similar to this, a company's articles of incorporation and memorandum bind it to its members. The firm is obligated to uphold the rights of each individual member as well as the "members as a body" as a whole. The members have the power to prevent a business from investing money in illegal activity. An individual member may force the corporation to uphold its duties to him, such as sending the meeting notices so he can vote at the meetings.

Member-to-member ties. As far as the rights and obligations resulting from the articles are concerned, the articles bind the members inter se, or one to another. It is well-established that the articles of association will have contractual effect regarding the rights of the business and its members as well as between the members themselves. Example: According to a company's bylaws, anytime a shareholder wanted to transfer their shares, they had to notify the directors of their plan and the directors had to accept the shares equally at fair market value. On the grounds that the Articles did not impose an enforceable responsibility upon them, the directors declined to accept the shares of a specific member. No, despite the fact that the articles reference the outsiders by name, the memorandum or articles do not provide them any contractual rights against the firm or its members.

The articles of a business, for instance, stated that Eley should serve as the company's solicitor for life and should not be fired unless there was misbehavior. Later, he also joined the business as a member. However, the corporation ended his employment as a solicitor after a couple of years. Being a member, he filed a lawsuit against the business for damages for breaching the agreement set out in the articles of association.

Yes, the articles of incorporation provide the company's directors its authority, and they must abide by whatever restrictions the articles may impose on their authority. Two parties may be impacted if they violate any article provisions: (1) the firm itself, and (2) third parties. The directors make themselves subject to legal action brought by the members if they violate the requirements of the articles. Members may, however, approve the director's action if they so choose. However, the directors are responsible for making up whatever losses the firm has experienced as a consequence of the breach of duty. Additionally, when directors violate the terms of the articles, it may also be detrimental to outsiders' interests. Following is an explanation of this case, Royal British Bank v. Turquand (1856) 119 ER 886. In accordance with their agreement, the plaintiffs paid a director of the defendant firm a check. The director may have been permitted to act in accordance with the company's bylaws, but she was not.

The items were unknown to the plaintiff. The plaintiff filed a claim against the business after the director stole the check. Is the business at fault?

**DISCUSSION**

Upon ceasing to be a private corporation, a prospectus or statement in place of a prospectus must be submitted. Every prospectus submitted in accordance with subsection (1) must include the information listed in Part I of Schedule II and the reports listed in Part II of that Schedule. These Parts I and II are subject to the rules in Part III of that Schedule.

Each statement in lieu of a prospectus submitted pursuant to subsection (1) shall be in the form and contain the information specified in Part I of Schedule IV, and in the cases mentioned in Part II of the Schedule, shall set forth the reports specified therein. The foregoing Parts I and II shall have the same effect as Part III of the Schedule, subject to the provisions therein. A prospectus is defined as "any document described or issued as prospectus and includes any notice, circular, advertisement or other document, inviting deposits from the public or inviting offers from the public for the subscription or purchase of, any shares in or debentures of a body corporate" in accordance with s.2(36). A prospectus is thus more than just an advertising; it may also be a circular or a notification. A document will be referred to be a prospectus if it meets the following criteria:

1. It seeks deposits or subscriptions to shares or debentures.

2. The public is extended the aforementioned invitation.

The following standards are established as to what qualifies as a public offer:

An invitation to the public must include an invitation to any segment of the public, whether they were chosen as customers of the person releasing the prospectus, as members or holders of the company's debentures, or in any other way. The learned court stated in Rattan Singh v. Moga Transport Co. Ltd. (1959) 20 Comp. Cas. 165 that the facts, the wording of the notice, and the specific circumstances of each case must all be considered before deciding whether an offer is made to the public. Justice Viscount Summer said in Nash v. Lynde (1929, A.C. 1585): "The 'public' is of course a generic phrase. There are no set numbers that must be used. Any number between two and infinity may be used; possibly even one, if he is supposed to be the first in a line of subscribers but cancels out all subsequent subscribers in the process. The important thing to remember is that whether or not the prospectus was delivered to him on behalf of the firm, everyone who brings their money and applies properly is eligible for the offer. The topic of considered prospectus should be covered in this context.

**Implication by Prospectus (Considered Prospectus)**

The purpose of Section 64 is to prevent the circumvention of the restrictions of Section 56 as stated above by making a selling offer of shares or debentures via the use of Issue Houses. Shares are allocated to an issue house as part of the procedure, and the issue house then publishes advertisements offering shares for sale. Since the advertising was not published by the corporation, it is not a prospectus and cannot be used to establish a violation of s.56's restrictions.

To combat this problem, Section 64 states that any materials that include an offer to sell shares or debentures fall within the definition of "prospectus" and are thus legally presumed to be prospectuses. Regarding these papers, all laws and legal principles pertaining to the information in prospectuses and the liabilities for representations and omissions therein will be applicable.

In addition, Section 64 states that unless the contrary is proven, an allotment of shares or debentures or an agreement to allot them shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public if one of the following conditions is met: the offer of the shares or debentures for sale to the public was made within six months of the allotment or agreement to allot; or at the time the offer was made,

If a document is regarded to be a prospectus, it must also include the information listed below in addition to what is needed by Section 56 for a prospectus:

The location and time at which the contract under which the aforementioned shares or debentures have been or will be assigned may be viewed. 1. The net amount of consideration the firm has received or will receive in relation to the shares or debentures to which the offer pertains.

The people making the public offer of sale are to be considered directors of the business for the purposes of registering a prospectus under s. 60. The documentation (i.e., considered prospectus) must be signed by at least two directors or, if applicable, half of the partners where the party making the offer is a corporation or partnership.

Situations in which a document conveying a purchase offer for shares or convertible debt is not considered to be a prospectus. Whether or not a document invites the public to subscribe determines whether it qualifies as a prospectus and contains an offer to sell shares or debentures. If the parameters of the offer or invitation are such that, notwithstanding its restricted distribution, they are available to any individual who so chooses to bring his money and apply for shares in response to the invitation, that is the primary test of whether it qualifies as a "public offer" or "public invitation." If the invitation or offer is thus broad, it qualifies as a "public offer." On the other hand, if an offer or invitation may only be accepted by the recipient and no one else, it will not be regarded as an offer or invitation to the general public.

Any segment of the public is included in the term "public" (s. 67). Thus, it may contain all of Delhi's licensed doctors, all of the city's High Court attorneys, and all of the country's English speakers.

What is not an offer to the public or what circumstances prevent a document containing an offer to sell shares or debt obligations from being considered a prospectus The document soliciting the purchase of shares or debentures of a firm, however, shall not be constituted an invitation to the public and, as a result, shall not be a prospectus under the following circumstances: A prospectus is not a document that a firm publishes to invite current members or holders of debentures to subscribe to shares or debentures by "right."

An invitation is not public if it cannot be predicted that it will make the shares or bonds accessible for subscription or purchase by parties other than those who are invited, either directly or indirectly. As a result, it will not be considered an invitation to the public if A accepts it, but B, who is a friend of A's, does not. B may want to subscribe, but the firm will not accept his offer since B was not asked to make it. No one else (even B) could have replied to the invitation made to A exclusively; A was the sole person for whom the invitation to subscribe to the shares was intended. On the other hand, it will serve as a public invitation for the corporation to accept his (B's) or anybody else's offer.

As a result, giving shares to a Kith and Kins director does not constitute a request for the general public to purchase shares. It is not a public offer when shares in a new business (let's say "B") are offered to shareholders of an existing company (let's say "A") in return for their

current shares of A. Manila Rail CO. v. Government Stock and Other Securities Investment Co., AC 81. When a company's management extends an invitation to a select group of individuals for subscription or purchase of shares or debentures by the recipients and the invitation or offer is not intended to be used directly or indirectly by other individuals, it is not considered to be a prospectus. In the case of Nash v. Lynd (1929) AC 158, the managing director sent a paper marked "strictly confidential" to a co-director, who then privately sent it to the director's close associates. The document included information about a planned share issuance. Because there had been no release to the public, the House of Lords ruled that it was not a prospectus.

Even if it is solely intended for individuals who receive it, a firm (other than a non-banking finance company or a public financial institution) may invite the general public to subscribe to its shares if it sends out the invitation to fifty or more people. As a result, if an invitation is sent to fifty or more people, a private placement of shares by such a corporation falls within the definition of a "public issue."

1. Overarching Information It must include details on things like: (i) The consent of the company's bankers, auditors, lawyers, managers involved in the problem, registrars involved in the issue, and specialists. If a professional opinion was consulted, it should be shared.

(ii) Any changes in directors or auditors during the last three years, if any, and the reasons for such changes.

(iii) The method and timetable for certificate distribution and issuance.

(iv) The names and addresses of the company secretary, the legal counsel, the issue's lead and co-managers, the auditors, the issue's bankers, and the issue's brokers.

(v) The issue's legal status and the specifics of the resolution adopted in response.

2. Financial Information: (i) A report by the business's auditors on (a) its earnings and losses (differentiating items of a non-recurring nature), assets, and liabilities, and (b) the rate at which the company paid dividends over the course of the previous five financial years. However, the report must include a statement if no accounts have been made up for any portion of the five-year period that ended three months prior to the prospectus' release. If the firm has subsidiaries, the report must also include the assets, liabilities, and combined earnings and losses of all subsidiaries, as well as how each one affects the company's shareholders.

(ii) A report on the business's profits and losses for the previous five financial years as well as its assets and liabilities on a date that cannot be more than 120 days prior to the prospectus' release date by the accountants (who must be qualified under the Act for the appointment as auditor of a company and who shall be named in the prospectus). If the proceeds from the sale of the shares or debentures will be used to directly fund the acquisition of any firm, then this report must be provided. If the proceeds of the issue are to be used to acquire shares of a body corporate so that it becomes a subsidiary of the purchasing firm, a comparable report on the finances of the body corporate by an accountant (who shall be listed in the prospectus) is required.

## CONCLUSION

In conclusion, a prospectus may be a useful tool in fundraising and investment operations, even if it is not legally needed for private enterprises. Private enterprises may attract investment, establish trust, and cultivate long-term relationships with stakeholders by

presenting prospective investors with thorough and honest information. The choice to create a prospectus should be supported by a thorough analysis of the company's requirements, legal responsibilities, and investor expectations. Private enterprises are not required to provide a prospectus, although doing so voluntarily may be advantageous to both the company and prospective investors. A well-written prospectus promotes investor trust, increases transparency, and helps capital raising efforts. When deciding whether to create and disseminate a prospectus, private enterprises should carefully consider their unique circumstances, investor expectations, and legal obligations.

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# CHAPTER 15

# AN OVERVIEW OF SHELF PROSPECTUS AND INFORMATION MEMORANDUM

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**ABSTRACT**:

The concepts of a shelf prospectus and an information memorandum and their significance in the context of securities offerings and fundraising activities. A shelf prospectus is a type of prospectus that allows a company to offer and sell securities in multiple tranches over a specified period without having to issue a new prospectus for each offering. An information memorandum, on the other hand, is a document that provides detailed information about a company to potential investors, typically used in private placement or non-public offerings. This paper explores the purpose, contents, legal requirements, and advantages of shelf prospectuses and information memoranda. It analyzes the differences between these two documents and their implications for companies and investors. Through a comprehensive analysis of securities regulations and market practices, this paper sheds light on the role and importance of shelf prospectuses and information memoranda in fundraising activities.

**KEYWORDS**:

Registration Statement, Restricted Offering, Risk Factors, Share Allotment, Shareholder Rights, Subscription Agreement.

## INTRODUCTION

In specific circumstances, a shelf-prospectus is allowed under Section 60A. "A prospectus issued by any financial institution or bank, for one or more issues of the securities or class of securities specified in that prospectus," is what is meant by a "shelf prospectus." Before issuing securities, every public financial institution, public sector bank, or scheduled bank whose primary purpose is financing must submit a shelf prospectus with the registrar. A corporation in this circumstance does not need to submit a new prospectus for each offering of securities made by it during a one-year window of validity. However, before making a second or subsequent offer of securities under the shelf prospectus, a company filing a shelf prospectus is required to file an Information Memorandum (as described in s. 60B below) on all material facts relating to new charges created and changes in the financial position that have occurred between the first offer of securities and previous offer of securities [1], [2].

At the time of the initial offering of securities, a shelf prospectus must be filed. This prospectus must be made available to the public and must be valid for a year starting on the opening date of the first issuance of securities [3], [4]. When a shelf prospectus and an update of information memorandum are submitted each time, a securities offer is made, the two documents together make up the prospectus. Information memos are covered by the following provisions in Section 60B:

Prior to submitting a prospectus, a public firm issuing securities may provide information memos to the general public. A corporation that solicits subscriptions via an information memorandum is required to submit a prospectus at least three days before the opening of the subscription lists and the offer as a red-herring prospectus. The same duties that apply to a prospectus also apply to information memos and red-herring prospectuses. The issuing

corporation must note any differences between the information memorandum and the red-herring prospectus. The individuals invited to subscribe to the issuance of securities must be personally informed of each modification made and noted under (iv).

If the issuing company or the underwriters to the issue have invited or received advance subscription in cash, post-dated checks, or stock investments, the company or such underwriters or bankers to the issue shall not encase such subscription moneys, post-dated checks, or stock investments before the date of opening of the issue, without specifically informing the potential subscribers of the variation and without offering an opportunity to purchase additional shares of the issue. Within seven days after the date of any notification of a modification, the applicant or potential subscriber may use his right to withdraw from the application. This withdrawal must be communicated in writing to the company and the underwriters [5], [6].

Any subscription request that the company, underwriters, or bankers act on without receiving sufficient information about any variations, the specifics of withdrawing the offer, or a chance to revoke postdated checks, stock investments, or stop payments for such payments, shall be void. In addition, the applicants are entitled to receive their original application and interest at a rate of 15% from the date of encashment until payment of realization, as well as a refund or return of their post-dated checks, stock investments, or subscription funds, as if the application had never been made [7], [8].

In the case of a listed public company, a final prospectus containing the total capital raised, whether in the form of debt or share capital, the closing price of the securities, and any additional information that was omitted from the red-herring prospectus must be filed with SEBI and the registrar, and in all other cases, only the registrar [9], [10].

**Prospectus Red Herring**

A prospectus that "does not have the complete particulars on the price of the securities offered and the quantum of securities offered" is referred to as a "red-herring prospectus."

**Short Prospectus**

According to Section 56(3), no application for shares or debentures of a corporation may be issued unless it is accompanied by a document known as a "Abridged Prospectus" that includes the principal characteristics of a prospectus as may be required. Therefore, a "abridged prospectus" should only be included to the application form rather than the entire prospectus.

Form 2-A has been established as a format for an abbreviated prospectus in order to provide fuller disclosure of information to potential investors so they may make an educated choice about investing in shares and debentures. It is also necessary for the share application form and the condensed prospectus to have the same printed number and to be separated by a perforated line. In light of this, the investor may separate the application form before delivering it to the business or the selected bankers.

**When the 'Abridged Prospectus' is not Required**

In the following situations, an abridged prospectus containing the required information per Form 2A is not required to be sent with the application forms: To engage into an underwriting agreement in the event of a genuine request to a person to purchase shares or debt securities.

When debentures or shares aren't made available to the public. when only current members and holders of corporate debt are offered rights, either with or without the option to renounce

them. When shares or bonds are issued that are identical in every way to those that have already been issued, traded, and quoted on a recognized stock exchange.

Penalty: Any individual who violates the aforementioned regulations will be subject to a fine that might reach $5,000. Furthermore, a subscriber for shares or debentures who has experienced loss due to the deletion from a prospectus that is required by section 56 may bring a claim for damages. The Act does not specifically state that directors must be accountable, although s.56 (4) seems to imply this.

## DISCUSSION

### Misstatements in Prospectus and their Consequences

S.65 (1) states that: (a) A statement included in a prospectus shall be deemed to be untrue if the statement is misleading in the form and context in which it is included; and (b) Where any matter is omitted from a prospectus that is intended to mislead, the prospectus shall be deemed, with respect to such omission, to be a prospectus in which an untrue statement is included. When referring to a prospectus, the word "included" refers to anything that is included in the prospectus itself, in any reports or memoranda that are attached to it, or by reference that is incorporated into it or published together with it. A corporation, for instance, released a prospectus. Every assertion made therein was precisely true. The rates of dividend payments for a number of years were mentioned in one of the announcements. However, dividends have been paid from realized capital gains rather than from trading earnings. This crucial information was kept a secret. Held: Lord Kylsant, the managing director and chairman, was found guilty of fraud since the prospectus was inaccurate in important details and he knew it.

If you have applied for shares in the firm and have been granted shares, you have legal recourse against the business and the people who issued the prospectus. However, neither a subscriber to the memorandum nor a purchase of shares on the open market have access to such rights. However, if a prospectus is published with the intention of persuading people to purchase shares on the open market, anyone who does so has the right to sue if the statements made in the prospectus are false or there is a significant omission from it. Both civil and criminal responsibility may result from making a false statement or omitting important information.

### In lieu of a prospectus, a statement

A public business must submit a statement in place of a prospectus with the Registrar at least three days prior to any issue of shares or debentures if it enters into a private agreement to raise money. A model Statement in Lieu of Prospectus is provided in Schedule III in accordance with Section 70, and a model Statement in Lieu of Prospectus is provided in Schedule IV in accordance with Section 44 when a private company is transformed into a public company. The allottee may avoid an allocation of shares or debentures made without submitting the Statement in lieu of Prospectus within two months of the statutory meeting, or, in the absence of such a meeting, within two months after the allocation. Additionally, any violation makes the corporation and each director responsible for a fine of up to 10,000. A promise of considerable contribution by certain people was included in a prospectus published by a corporation in an effort to get the public to subscribe. The complainant, who received 10 shares, claims there were substantial misrepresentations made. Determine the case.

**Brokerage and Underwriting Commissions**

When the issuing company or underwriters to the issue invite or receive advance subscription in cash, post-dated checks, or stock investments, the company or such underwriters or bankers to the issue shall not encase such subscription moneys, post-dated checks, or stock investments before the date of opening of the issue, without specifically informing the potential subscribers of the variation and without providing an opportunity for them to do so. Within seven days after the date of any notification of a modification, the applicant or potential subscriber may use his right to withdraw from the application. This withdrawal must be communicated in writing to the company and the underwriters.

Any subscription request that the company, underwriters, or bankers act on without receiving sufficient information about any variations, the specifics of withdrawing the offer, or a chance to revoke postdated checks, stock investments, or stop payments for such payments, shall be void. In addition, the applicants are entitled to receive their original application and interest at a rate of 15% from the date of encashment until payment of realization, as well as a refund or return of their post-dated checks, stock investments, or subscription funds, as if the application had never been made. Brokerage Agreements: A business may make brokerage agreements with brokers in addition to underwriters. A broker is a person who agrees to "place" sharesthat is, locate buyers for sharesin exchange for a predetermined brokerage. If the broker fails to place any shares, he is not personally responsible for taking them and is not entitled to any brokerage for shares that are not placed. On the other hand, the underwriter is required to purchase the shares that the public has not yet purchased and is entitled to the full amount of the agreed-upon commission. It should be emphasized that the articles must include a provision authorizing the payment of brokerage, that brokerage must be stated in the prospectus or statement in place of the prospectus, as applicable, and that the brokerage must be fair (section 76).

**Participation in a Company**

Any organization or business licensed under this section may have a firm as a member, but upon the firm's dissolution, the firm's participation in the association or company terminates. The Central Government may grant a license pursuant to Section 25 on the terms and subject to the regulations that it deems appropriate. These terms and regulations shall be binding upon the body to which the license is granted, and where the license is granted pursuant to Subsection (1), shall, as the Central Government may direct, be inserted in the memorandum or the articles, or partially in each.

The word "Limited" or the words "Private Limited" need not be a part of the name of a body to which a license has been granted, and, unless its bylaws state otherwise, such a body shall be exempt from such provisions of this Act as may be specified therein if the Central Government so directs and to the extent specified in the direction.

**Member-Meaning and Definition**

**Section 41 stipulates:**

1. The subscribers to a company's memorandum are assumed to have consented to become members of the company and, upon registration, will be included in the register of members as such.

2. Everyone else who signs a written agreement to join a business and has their name included in the register of members is considered to be a member of that company.

3. According to the Depository Act of 1996, any individual who owns equity share capital of a business and whose name is included as a beneficial owner in the depository's records is regarded to be a member of the relevant company.

Based on this, there are two requirements for someone to join a company:

1. the written agreement to purchase business shares; and

2. the entry of his name in the membership list.

Additionally, a person may join a firm through the depository system. As a result, an individual may decide to purchase shares of a business either as the subscriber at the time of its establishment or in any of the following ways:

1. by purchasing more or fresh shares in it;

2. when shares are transferred from an existing member;

3. Upon the purchase or acquisition of its shares (for instance, a takeover offer or the surrender of rights by an existing member); and

4. at acquisition of its shares by devolution (for instance, transfer of shares to a member's rightful heirs at death, upon bankruptcy, or upon merger or amalgamation according to a court order);

5. Upon the conversion of convertible debt obligations or loans in accordance with the conditions of the debt obligations' or loans' respective loan agreements.

The subscribers who agree to accept shares at the moment the company is formed and those who agree to take shares later vary fundamentally in that the former become members immediately upon the incorporation of the business, whilst the latter do not. The latter, although having consented to purchase shares, do not become members until their names are included in the company's membership record.

**Participant and shareholder**

When a business is limited by shares, the individuals whose names are entered on the register of members are the company's members. They may also be referred to as shareholders of the firm since they have been given shares and are legitimate owners of them. In such a circumstance, the words "member" and "shareholder" are used synonymously to refer to the same individual. Venkateshwara Real Estate Enterprises (P) Ltd. v. Srikanta Data (1990) 68 Comp. Cas. According to 216 (Kar), the term "member" as used in section 2(27) refers to a "shareholder" other than a person who is the bearer of a business share warrant. However, a member cannot be a shareholder in an unlimited company or a corporation limited by guarantee since these entities are not required to have a share capital. However, in the event that a firm has a share capital, there may sometimes be a difference maintained between a member and a shareholder. In other words, a person may be a shareholder and a member of a corporation with respect to the same set of shares. The following circumstances give rise to this distinction:

X belongs to a corporation limited by shares. It doesn't matter whether we call him a shareholder or a member since his name is included on the register of members because he is owning shares in his own right. The words "member" and "shareholder" may be used interchangeably in this circumstance. He will no longer be a shareholder under the following three circumstances, even if he will still be a member of the company:

(i) Shares are sold to Y by X. He completes a share transfer form and provides it to

Y. Additionally, he provides Y the share certificate that serves as proof of ownership. He obtains compensation from Y in exchange for the selling of shares. Due to the fact that X sold the shares and Y now owns the shares' property, X is no longer a shareholder. However, X's name remains on the list of members until the firm registers the transfer of shares in Y's favor. As a result, a person who buys shares on the open market may be a shareholder but does not automatically become a member. He doesn't really join the firm until his name is added to the membership register.

(ii) Upon Death: Y, X's legal agent, inherits all of X's assets, including his stock. The shareholder X has resigned. He doesn't exist; thus, he can't own the shares. Y is legally referred to as the shareholder since he is the one owning the shares in his own right. However, X is still listed as a member since his name is still on the membership list. However, X will no longer be a member after Y has his own name entered in the membership register.

(iii) Upon X Becoming Insolvent: Upon X becoming insolvent, ownership of all of his assets, including his stock, passes to the Official Receiver or Official Assignee. The shares are held on behalf of the Official Receiver or Assignee. X is still a member of the firm but is no longer a shareholder as a result.

The holder of a share warrant is a shareholder but not a member of the corporation since his name has been removed from the register of members (Section 115).Even though he is not given any shares, anybody who signs the memorandum of association automatically joins. The subscriber is a member of the firm but not a shareholder until shares are given to him.There will only be "members," not "shareholders," in the event of a company limited by guarantee with no share capital or an unlimited corporation with no share capital.

**Methods of Membership**

Any of the following methods may be used to join a firm as a member or shareholder:

1. By Signing the Memorandum of Association: Only by virtue of their signature on the memorandum are the subscribers to a company's memorandum considered to have consented to become members of the firm. The minute the company is established, a subscriber to the memorandum becomes a member; their names do not need to be included in the register of members.

Additionally, by signing the memorandum, each subscriber is believed to have agreed to become a shareholder with regard to the shares he purchased.

2. By Agreement and Registration: According to Section 41(2), "every other person who agrees in writing to become a member and whose name is entered in its register of members shall be a member of the company," with the exception of the subscribers to the memorandum. As a result, a person does not join the business until his name is properly included in the register of members, with the exception of the subscribers to the memorandum.

There are many reasons to register a person's name as a business member:

(i) After allocation and application.

By transfer, in (ii). The member may buy shares from another member via a gift, sale, or other arrangement.

By transmission, in (iii). In this case, a person becomes a shareholder when shares are transferred to him due to a company member's decease, insanity, or bankruptcy.

By estoppel, in (iv). This happens when someone pretends to be a member or willfully permits his name to stay on the register after really selling his shares. He will be responsible as a contributing, along with other true members, in the case of winding up. He may, however, avoid responsibility by submitting an s.155 application to have his name removed.

(v) By deciding to buy qualifying shares. A person in the same position as if he had subscribed to the memorandum for a comparable number is one who signs and delivers to the registrar a written promise to take from the business and pay for qualifying shares. As a result, he is also considered to have joined the firm automatically at incorporation. Any individual sui juris may join a corporation, provided that they abide by the terms of the memorandum and the articles, the memorandum, and the law. The following list of people's positions is in this regard:

**Minor**

A minor cannot be a member of a firm since they are legally incapable of entering into contracts, making any agreement they may have made to purchase shares null and invalid. If shares are granted to a minor in response to his application and his name is listed on the members' register without the business being aware that the applicant is a minor, the firm may revoke the grant of shares and remove the applicant's name from the register after learning of the minor's status. All monies collected from him in relation to the allocated shares must be returned by the corporation. The minor may also reject the allocation while still a minor, in which case he will get a refund of the money he contributed to the share allocation.

The minor has no obligation on the shares throughout his or her minority and cannot be considered a contributing at the time of winding up if his or her name remains on the register of members and neither party repudiates the allocation. Both the minor and the guardian cannot be included on the contributories list at the time of winding up if a father applies for shares on behalf of his minor kid as guardian and the firm registers the shares in the youngster's name.

If a juvenile's name accidentally ends up on a member list, he becomes a member, and he decides he no longer wants to be one, he must repudiate his obligation on the shares on the grounds that he is still a minor. The firm is not permitted to use a defense based on the estoppel principle that the minor had falsely represented his age or had earned dividends and other benefits as a member. He cannot, however, disavow his obligation to pay dividends and exercise his rights as a member of the firm after reaching majority. The corporation may refuse to register a minor as a member if shares that have been partially paid are transferred to him. If the business allowed the transfer while being unaware of the minority, it may now delete the name of the minor and replace it with the name of the transferor—even if the latter may have been unaware of the minority.

If a minor acquires fully paid shares by a transfer or transmission, his name may be added to the register of members for those shares. According to the court's ruling in Devan Singh v. Minerva Films Ltd. (AIR 1956 Punjab 106), there is no legal restriction on a minor purchasing share of a corporation (by means of transfer) as long as the shares are completely paid up and have no other obligations or liabilities connected to them.

**Company**

Being an artificial person and distinct legal entity, a business may join another company if its memorandum permits the acquisition of shares. This is nonetheless constrained by s. 42's rules. According to this section, a subsidiary company cannot be a member of its holding company, and any allotment or transfer of shares in a holding company to its subsidiary, or even to a nominee for such subsidiary, is void. However, a subsidiary company may: Hold shares in the holding company in the capacity of the personal representative of a deceased shareholder, or hold such shares as trustees, (except where the holding company or another subsidiary is beneficially interested unto the holding company or another subsidiary). As was already explained, a corporation cannot join itself since it cannot buy its own shares (section 77). However, a corporation may exercise its foremost lien on a member's shares as security for money due to the company or lose shares for failing to pay calls to obtain a beneficial interest in its own shares.

**Partner-Based Business**

A partnership firm cannot be included as a member in a company's register of members since it is an unincorporated association without a separate legal identity from the partners. However, partners may own shares in a firm as a component of the partnership property, either individually or in their joint names (as joint members). However, a partnership business may join an organization that is recognized as a non-profit organization under Section 25 of the Companies Act of 1956.

**An outsider**

A foreigner may engage into contracts and, as a result, buy shares of a firm under the Law of Contracts, although this is restricted by the terms of the Foreign Exchange Management Act of 1999 (FEMA). The foreigner's ability to vote at corporate meetings and his right to receive meeting notifications, among other rights, are suspended during the wartime when the nation in which he or she resides is at war with India.

**Indian President/State Governor**

The President of India or the Governor of a State may own shares in a government corporation in their respective names.

**1860 Societies Registration Act-registered organization**

A society that has been registered under the Societies Registration Act of 1860 is regarded as a "person" with a separate legal identity from the individuals who make up the organization. As a result, such a society may join a company in accordance with Section 41(2) of the Companies Act of 1956.

**Workers Union**

As a body corporate, a trade union that has been registered under the Trade Union Act of 1926 is able to sue and be sued as well as enter into agreements in its own name. Accordingly, a registered union may join under Section 41 of the Companies Act of 1956.

**Removal from Membership**

When a person no longer belongs to a corporation, for example. He transfers his shares to another person and the shares are registered in the name of the transferee; His shares are forfeited by the company for non-payment of calls; He surrenders his shares to the company and the latter accepts the surrender; His shares are sold by the company to enforce its lien and

the buyer of these shares is registered as a member; He dies and his legal heir gets his own name registered in the register of members or sells shares to a party who gets his name registered with the company; He is adjudged insolvent and the official receiver/official assignee either transfers the shares to a third party who gets registered as a member or disclaims shares; He was holder of redeemable preference shares which have now been redeemed by the company; He rescinds the contract of membership on the ground of fraud or misrepresentation; His shares are purchased either by another member of the company or by the company itself by an order of a court under s.402; He has got share warrants issued in exchange for share certificates of fully paid-up shares; and On the commencement of winding up (but he will be liable as a contributory and is also entitled to a share in the surplus assets, if any). A company may be a member of another firm, as was previously indicated. If the liquidator disclaims the shares in such a case, the membership will terminate and the shareholding company would be dissolved.

## CONCLUSION

When deciding whether to utilize a shelf prospectus or an information memorandum, companies should carefully analyze their unique circumstances and legal obligations. Shelf prospectuses may be useful for public corporations or issuers that often need to raise money since they provide a simplified procedure for future offerings. Information memos are a good option for private enterprises or issuers performing non-public offerings since they allow for more specialized and focused contact with possible investors. The legal and regulatory standards for shelf prospectuses and information memoranda must be followed by businesses. To maintain investor confidence and prevent legal ramifications, compliance with disclosure responsibilities, accuracy of information, and adherence to relevant securities legislation are necessary.

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# CHAPTER 16

# AN INVESTIGATION OF SHARE CAPITALITS SIGNIFICANCE

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**ABSTRACT**:

The concepts of shares and share capital and their significance in the context of company ownership and financing. Shares represent ownership interests in a company and are typically divided into units of equal value. Share capital refers to the total value of shares issued by a company and represents the initial capital investment made by shareholders.

This paper explores the types of shares, the process of issuing and transferring shares, and the implications of share capital for the financial structure of a company. It analyzes the rights and obligations associated with share ownership, such as voting rights, dividend entitlements, and liability.

Through a comprehensive analysis of company law and market practices, this paper sheds light on the importance of shares and share capital in corporate governance and financing. When fully paid-up shares are converted into stock, the fact that the stock has been issued against the member's name in the register of members must be recorded.

The firm has a responsibility to keep the membership record current.

**KEYWORDS**:

Allotment, Authorized Capital, Equity, Issued Shares, Nominal Value, Ordinary Shares.

## INTRODUCTION

There are many rights that a member of a corporation has in relation to the firm. These are granted to him either by the Act or the company's bylaws. Among a member's most crucial rights are within three months of the date of allocation, the certificate of shares held ready for distribution to him; if it had been incorrectly deleted or had not been entered, to have his name added to the list of members; to transfer shares in accordance with the Act's and the Articles' requirements; receiving meeting notifications, going to meetings, and casting your vote (in person or via proxy) at such meetings; to examine and get extracts from the registers of members and holders of debentures (section 163); to request and get copies of memoranda and articles upon payment of the applicable fees; to be given first dibs on any new shares issued by the corporation under Section 81. to take part in the selection of auditors and the election of directors; obtaining a copy of the profit and loss statement and balance sheet at least 21 days prior to the annual general meeting; seeking the revocation of any "variation of shareholders' rights" (s.106); to designate a beneficiary to whom his stock in the firm will revert upon his death (s. 109 A); requesting copies of the minutes of general meetings (section 196); to petition the court for an order of injunction preventing the directors from carrying out an ultra vires act; to participate in the removal of directors by passing an ordinary resolution (Section 284); to petition the court for prevention of mismanagement and oppression (Section 399); to petition the court for compulsory winding up;

Assisting in the passage of a special resolution for a voluntary or compelled winding up; to share in the company's excess assets, if any, when it is liquidated [1], [2]. To examine the following registers: (a) the register of investments not held in the company's name (section

49); (b) the register of charges and copies of instruments creating charges (section 144); (c) the register of members and an index thereof; (d) the register of holders of debentures and an index thereof; (e) the register of foreign members; (f) the register of contracts in which directors are interested; (g) the register of directors, managing director, manager, and secretary; (h

**Members' Responsibility**

The Act or the articles may impose additional duties and obligations on a member. Among the significant ones are.

Members are required to pay the full nominal value of their shares in cash if shares are not allocated for anything other than cash. When a member has partially paid-up shares and the business falls into liquidation, he is obligated as a contributing to pay, if requested, toward the firm's assets (section 429).If (i) at the start of the winding up, debts exist that were accrued while the person was a member and (ii) the contributories of the "A" list (i.e., present members) are unable to satisfy the contribution required from them in respect of their shares, the person may be included in the "B" list of contributories and be required to pay to the extent of the amount remaining unpaid on the shares that he held within one year prior to the start of the winding [3], [4]. As was previously indicated, even in the event of a limited liability business, the responsibility of the members becomes limitless and multiple (s. 45). All of the covenants in the articles bind a member to the company; for instance, the company may have a foremost lien on a member's shares for any sums owed to it by him. When a corporation limited by guarantee dissolves, the member could be requested to pay up to the amount of his guarantee.

**Members' List (Section 150)**

Every corporation is required to maintain a record of members typically at its registered office under Section 150 read with Section 168. The registration must have the following information: Each member's name, residence, and profession; the total number of shares each member has, identifying each share by its number and paid-up capital; the date of the register's entry; the day a member stopped being a member [5], [6].

A firm is not permitted to profit from its inability to keep the required register of members. Thus, if the register does not include the names of all shareholders as members, those shareholders who have been granted share certificates may exercise their rights as members, it was decided in N. Satyaprasad Rao and others vs. V.L.N Sastry and Others.Every corporation with more than 50 members must maintain an index of member names in accordance with Section 151, unless the register is in the form of an index. The register of members and the member index must both be stored in the same location. The membership list is available for free to members during business hours and for one rupee to non-members outside of those hours [7], [8].

The register may be closed at any time with seven days' notice by publication of an advertising in a newspaper distributed in the area where the company's registered office is located. The total number of days that it may be closed in a year cannot, however, go beyond 45 days. Additionally, it cannot be shut down for longer than 30 days at once. According to Section 157, a business with a share capital may maintain a branch register of members who live outside of India, known as a Foreign Register, if permitted by its Articles. The location of this register's storage must be disclosed to the registrar. The overseas register is treated as a component of the parent register of the firm and is subject to the same maintenance requirements [9], [10].

**Correction of the Member Register**

According to Section 111, the CLB may correct the members' register at the request of any aggrieved party, including a member, a transferor, a transferee, or the firm. The CLB may order the register to be corrected when: (i) the name of any person is entered in or omitted from the register of members of a company without good reason; or (ii) there is a mistake or needless delay in recording a person's termination as a member of the company.

In cases where the CLB has directed that the register be corrected, the correction must be made and notification of the correction must be submitted with the Registrar within 30 days after the CLB's directive. The annual return in question may only include information relating to individuals ceasing to be or becoming members, to shares transferred, or to changes in the number of shares held since the d. In order to avoid repetition of laborious particulars, notes appended to the annual return in Schedule V, it is provided that, where any of the five preceding returns has given full particulars as to past and present members and the shares held and transferred by them, the return in question may contain only that information. The list shall include the quantity of stock owned by each member instead of the number of shares thus converted that he previously held when any of the company's shares are converted into stock and notice of the conversion has been made to the registrar. the yearly return (section 161) being signed. A director and the manager or secretary of the company, or two directors of the company, one of whom must be the managing director when there is one, must sign the copy of the annual return that must be submitted with the registrar. The copy of such annual report must also have the signature of a secretary who works full-time for the firm whose shares are listed on a recognized stock market. If there is a failure to file the annual return, the firm and each officer responsible may be penalized up to 500 each day throughout the default period.

**DISCUSSION**

In the case of an unlimited corporation, the articles must specify the number of members and, if applicable, the amount of share capital with which the corporation is to be registered. The articles must specify how many members a business limited by guarantee must have in order to be registered. For any other private company, the articles must contain provisions relating to the matters specified in the said sub-clauses (b) and (c). For a private company with a share capital, the articles must contain provisions relating to the matters specified in sub-clauses (a), (b), and (c) of clause (iii) of sub-section (1) of section 3.

**Shares**

A share is described in Section 2(46) as "a share in the share capital of a company, and includes stock, except where a distinction between share and stock is express or implied." This definition falls short of capturing the actual significance of a share. Shares represent the following: the obligation of a shareholder to pay calls on shares until they are fully paid up; the interest of a shareholder in the company; the right to receive dividends, attend meetings, vote at meetings, and share in the company's surplus assets, if any; The ability of the shareholder to transfer the shares subject to the articles of association (For this purpose, section 82 classifies shares as movable property, transferable in the manner provided in the articles); Binding covenants on the part of the corporation as well as the shareholder, as specified in the articles of corporation. As a result, a shareholder's ownership of a company's share represents a range of rights and duties. A share, however, is not a negotiable asset. According to Section 83, each share of a corporation with a share capital must be identified by a unique number.

**Certificate vs Share**

'Share' and ‘share certificate' are synonymous in the eyes of the average person. Therefore, it is crucial to understand the precise distinctions between the two. A share is referred to be "a movable property, transferable in the manner provided by the articles of the company" under Section 82 in this context. However, Section 84 defines a "share certificate" as "a certificate, under the common seal of the Company, specifying any shares held by any Member." A share certificate is deemed to be prima facie proof of the member's ownership of the shares, according to Section 84. As a result, although a "share" symbolizes property, a "share certificate" provides proof of the member's ownership of that property. Each share has a unique number that differs from the share certificate number and is unique. A share certificate really has the potential to represent numerous shares, such as 50, 100, or even 1 lakh. As a result, even though each share certificate will only have one unique number, there will be as many different numbers for the shares that the share certificate attests to. As prima facie proof of ownership, the share certificate enables the shareholder to deal with his shares in the market more simply. He may sell his shares by immediately displaying the marke title. A share certificate also functions as an estoppel in relation to payment, preventing a genuine buyer of the shares from claiming that the sum specified as having been paid on the shares has not been paid. Anyone who is aware that a certificate's claims are untrue cannot, however, sue the corporation on the grounds of estoppel.

**Stock vs Share**

A company's share capital is split into a number of indivisible units, each having a predetermined value. Such a unit is known as a "share" for each one. A unit of 10 is thus referred to as a share of the firm if the share capital of the business is 5,00,000 split into 50,000 units of 10 each. The whole of a member's fully paid-up shares combined into a single fund of equal value may be referred to as stock. It is a group of shares bundled together. The'stock' is stated in terms of money rather than a specific number of shares. Any quantity of stock may be split into fractions, and those fractions can be transferred just like shares. These fractions lack distinguishing numerical identifiers, unlike shares. The shares cannot be issued initially by the corporation. If allowed by its articles and approved by the general meeting, a corporation limited by shares may convert all or some of its fully paid-up shares into stock. The quantity of stock possessed by each member after conversion into stock, as opposed to the number of shares, must be recorded in the register of members. The rights of the members are not in any way impacted by the conversion.

**Variety of Shares**

A share contains certain rights and is subject to certain duties, as was previously explained. All shares may be issued by a firm with the same rights and duties. To meet the demands of various kinds of investors, it may, however, issue several share types with various rights and obligations connected to them. The rights affixed to the various classes of shares in this situation are referred to as "class rights." The class rights are generally outlined in the company's articles of incorporation and typically pertain to voting, dividends, capital returns, or shares in the company's surplus assets (the latter two rights are accessible at the time of winding up).

The most typical share classes are:

1. Preference;

2. Equity or Common;

3. Founders' or deferred.

It is prohibited for public companies and private businesses that are subsidiaries of public companies to issue any other kind of shares save equity, preference, and cumulative convertible preference shares (CCPS). Additionally, according to its rules, SEBI has permitted businesses to issue various financial instruments. As a result, many businesses have given their promoters and directors convertible warrants that may be exchanged for shares whenever they want within 18 months of the warrants' issuance date.

**Favorite Share**

A preference share is one that grants holders of equity shares the following two rights:

1. a preference for dividends paid at a predetermined rate or at a defined amount,

2. a favourable position with respect to capital repayment upon wound up.

In contrast to the rights of equity owners, preference shareholders have precedence.

Shares that Participate and Do Not Participate

A preference share is referred to be a participating share if it has either one or both of the following rights:

1. To get additional profit sharing either before or after receiving a set rate of dividends on equity shares,

2. to take part in the company's excess assets as it is being wound up.

A preference share is referred to as a non-participating share if it does not possess any of these rights. Remember that unless clearly stated as participating, preference shares are always assumed to be non-participating.

**Preference Shares, Cumulative and Non-Cumulative**

A preference share is referred to as a cumulative preference share if it holds the right to receive dividend arrears from future earnings. As a result, dividends that aren't paid in a particular year or years build up and are distributed whenever earnings are available. A preference share is referred to as a non-cumulative or simple share if it does not include the opportunity to receive dividends in arrears. So, if there are no profits in a given year, neither the holders nor following years' unpaid dividend claims are valid. Remember that unless specifically stated as non-cumulative, preference shares are always assumed to be cumulative.

**Shares that are redeemable and non-redeemable**

Redeemable preference shares are those that, under the terms of the articles, may be exchanged for cash at the discretion of the board of directors (section 80). If a corporation meets the following criteria, it may issue redeemable preference shares:

1. Shares issued earlier cannot be converted into redeemable preference shares; such shares are to be issued as redeemable preference shares.

2. The articles must have the necessary authorization to issue redeemable preference shares;

3. Only once they have been paid in full are the shares redeemable;

4. Only one of the following two methods may be used to redeem the shares: (a) using corporate revenues that would otherwise be available for dividend; or (b) using the proceeds

of a fresh share issuance, not necessarily one that issued redeemable preference shares with the intention of being redeemed;

5. If a premium is due upon redemption, it must have been paid out of earnings or the securities premium account prior to the redemption of the shares;

6. When shares are redeemed using profits, the "Capital Redemption Reserve Account" must receive a transfer from earnings equivalent to the nominal value of the shares redeemed. The corporation has the option to redeem the redeemable preference shares at its discretion, at a defined date, or after a certain amount of time. However, the redemption of such shares will not be seen as a reduction in the company's nominal capital.

**Investable Preference Shares**

Any preference shares that are irredeemable or redeemable after ten years have passed from the date of issuance are not permitted to be issued by companies limited by shares. Additionally, the corporation may issue new shares up to the same nominal value after it has redeemed the shares or is about to do so, and it will be assumed that the preferred shares were never redeemed. In such a case, stamp duty is not due since it is not considered that the company's capital has risen. This benefit is only accessible if the redemption occurs within one month of the fresh issue's creation. The corporation and each officer who is in default if the requirements of s.80 are not followed shall be subject to a fine of up to 10,000.

**Share of Equity**

A share that is not a preference share is referred to as a "equity share" (s. 85). Dividend rates are not set in stone. The Board of Directors makes a dividend rate recommendation, which the members then vote on at the AGM. The BOD must adhere to all legal requirements, including those relating to depreciation, the transfer of a minimum amount to reserves, etc., before proposing a dividend on equity shares. Voting rights are proportional to the company's paid-up equity capital among equity shareholders. The Companies (Amendment) Act, 2000 replaced Section 86 with a new Section. It states that only two types of shares may make up the share capital of a corporation limited by shares, namely:

1. Equity Share Investment

(i) With the ability to vote or

(ii) With varied voting, dividend, or other rights in accordance with the rules and circumstances that may be established; and

2. Capital preference shares.

Public corporations were not permitted to issue equity shares with differentiated rights prior to the 2000 revision to the corporations Act. As a result, businesses are now able to offer stock shares without voting rights. These shares may, however, be issued in accordance with the guidelines established by the Department of Companies Affairs. The guidelines have been announced by the Department of Companies Affairs.

**Equity shareholders' privileges and powers**

The following rights and powers are specifically granted to equity shareholders: (Section 39) He may request a copy of the articles and memoranda. He has the right to accept offers to subscribe to future capital issues on a rights basis (Section 81).

The court may grant a request for the cancellation of the modification of shareholder rights from shareholders who own at least 10% of the issued shares but have not agreed to the resolution for the variation of rights (Section 107). He has the right to request that the CLB correct the members' register (s. 111). He is entitled to request extracts from and see any papers and records that the corporation is required to keep (Section 163). If a corporation fails to convene an AGM, he may appeal to the CLB to do so (section 167).

A corporate entity that is a member of a company may designate a representative to attend the company's general meeting (Section 187). He is entitled to see and request excerpts from the minutes of general meetings (Section 196). As soon as they are issued, fully paid-up bonus shares are his to receive (Section 205). A shareholder who is also a director may see the company's books of account during regular business hours (s. 209). According to Section 219, he is entitled to copies of the account and the auditor's report or description of noteworthy characteristics.

According to Section 235, 200 shareholders or shareholders with 10% of the voting power may request an inquiry of the company's operations. In accordance with Section 257, he may submit a notice to the firm announcing his or any other candidate's candidacy for the position of director to be chosen at the AGM.

He is permitted under Section 284 to provide special notice of a resolution to remove a director. Shareholders with significant holdings have the right to ask CLB to fire any management staff members who are incapable of doing their jobs. On the CLB's suggestion, the Central Government has the authority to fire management staff (Section 388). In the event of oppression or improper administration of the company's business, he may petition to the CLB for remedy (sections 397 and 398). He has the right to file a complaint with the registrar and CLB over any violation of the Companies Act of 1956.

**Convertible Preference Shares in Cumulative Form (CCPS)**

By decree dated August 19, 1985, the government authorized public limited businesses to issue cumulative convertible preference shares, a different class of shares.

The following are the directives provided in this respect by the Ministry of Finance:

1. Application: The rules will apply to public limited corporations who want to generate money by issuing CCPS.

2. The following should be the aims of the issuing of the aforementioned instrument: (a) Establishing new projects; (b) Extending or Diversifying Existing Projects; (c) Typical Capital Expenditures for Modernization; and (d) Working Capital Requirements.

3. The number of CCPS issued cannot be more than the number of equity shares made available to the public for subscription. The amount of issuance would, however, need to be authorized by banks or financial institutions in the event of projects receiving financial institution assistance.

4. Terms of Issue: These are the CCPS's terms of issue:

(i) For the purposes of determining the debt equity ratio as may be necessary, CCPSs would be considered an equity issue.

(ii) As determined by the firm and authorized by SEBI, the full issuance of CCPSs would be convertible into equity shares between the end of 3 years and 5 years.

(iii) The conversion of the CCP shares into equity would be considered to have occurred during the process of redeeming the preference shares using the proceeds of a new share issuance made specifically for that purpose.

(iv) A 10% preference dividend would be paid on CCP shares.

(v) This new instrument would not be subject to the criteria for preference shares respecting the ratio of 1:3 as between preference shares and equity shares.

(vi) The right to receive dividend arrears, if any, on preference shares up to the conversion date will pass to the holder of the equity shares upon conversion of the preference shares into equity shares. When the firm is profitable and able to issue a dividend, the holder of equity shares is entitled to receive the arrears of that dividend.

(vii) The aforementioned CCP share would have voting rights under the Companies Act, which is applicable to preference shares.

(viii) At the conclusion of the five-year period, the aforementioned preference shares must be converted into equity shares; they are not redeemable at any time.

5. Denomination: Each CCP share will typically have a face value of 100.

6. Listing: CCP shares must be listed on one or more national stock exchanges.

7. Resolution of the General Body and the Company's Articles of organization: A provision for the issuance of CCPSs should be included in the company's articles of organization. Additionally, the business must include with the application to SEBI a certified copy of the validly adopted special resolution in this respect under Section 81 (1A) of the Companies Act. In addition to authorizing the issuance of CCP shares, this resolution must mandate the conversion of the preferred shares between the third and fifth years, if applicable.

## CONCLUSION

In conclusion, the fundamental components of corporate ownership and finance are shares and share capital. They reflect the financial structure of the organization, provide ownership rights and duties to shareholders, and have an impact on corporate governance. Shareholders, business management, and investors all need to understand the many kinds of shares, how shares are issued and transferred, and the ramifications of share capital. Effective corporate governance, financial stability, and sustainable growth are all influenced by how shares and share capital are managed and used. Shareholders use their voting rights to choose directors, approve significant decisions, and shape the company's direction, hence shares and share capital are essential to corporate governance. Shareholder equity also serves as a proxy for the business's financial strength, which affects its capability to raise money, make investments, and seize development opportunities.

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# CHAPTER 17

# EXAMINING THE CHARACTERISTICS DEFERRED OR FOUNDERS SHARES

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**ABSTRACT**:

The concept of deferred or founders' shares and their significance in company ownership structures. Deferred or founders' shares are a type of share class that carries certain restrictions or preferential rights compared to other classes of shares. These shares are often issued to founders, early investors, or key stakeholders of a company to provide specific benefits or control over the company's operations. This paper examines the characteristics, benefits, and potential drawbacks of deferred or founders' shares. It analyzes the implications of such shares on voting rights, dividend entitlements, and decision-making within the company. Through a comprehensive analysis of company law and market practices, this paper sheds light on the role and importance of deferred or founders' shares in establishing ownership control and aligning interests within a company.

**KEYWORDS**:

Subscribed Capital, Treasury Shares, Uncalled Capital, Unissued Shares, Voting Rights, Warrant.

## INTRODUCTION

Shares of a sort different from those mentioned above may be issued by a pure private corporation (section 90). As a result, it may issue so-called delayed shares. Deferred shares are sometimes referred to as founders' shares since they are typically owned by the company's promoters and directors.

They often have a lower value, like one rupee apiece. However, they often have the same voting rights as equity shares, even if the latter may have larger nominal values, such $10 per share. When it comes to the distribution of dividends to holders of these shares, the articles often provide that the dividend on these shares will be determined by the earnings left over after dividends on the preference and equity shares have been declared. As a result, the promoters, founders, and directors of such a firm have a very direct stake in its success since bigger dividend payments are correlated with better corporate profitability. But keep in mind that the private firm will need to change its capital structure and keep solely equity share capital and preference share capital (including CCPs), if any, when it becomes a public company [1], [2].

### Non-voting Shares

The phrase "non-voting shares" refers to shares without voting powers. These are considered to be entirely new classes of shares, which may be issued without voting rights but with extra dividends instead. Under Section 86 of the Companies (Amendment) Act of 2000, this kind of equity share issuance was permitted [3], [4].

Equity Shares in Sweat

The Companies (Amendment) Act of 1999 permitted the issuance of sweat equity shares as long as certain requirements were met. For this reason, a new Section 79A was added. The

regulations are If the following criteria are met, a corporation may issue sweat equity shares of a class of shares that have already been issued, notwithstanding anything else in s. 79: (a) A special resolution passed by the company's general meeting authorizes the issuance of sweat equity shares; (b) The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued; (c) At least one year has passed at the time of the issue from the date the company was permitted to begin operations; (d) The sweat equity shares are being issued; The sweat equity shares may be issued in compliance with any regulations that may be specified in the event of a firm whose shares are not listed on any recognized stock market. The term "a company" as used in this section refers to any company that has been incorporated, constituted, and registered in accordance with this Act, including any subsidiary companies that have been established abroad. The term "sweat equity shares" refers to equity shares that a firm issues to its workers or directors at a discount or in exchange for anything other than cash in exchange for their expertise, the provision of intellectual property rights, or the addition of value, under any name. However, these sweat equity shares are subject to all the restrictions, limits, and prohibitions that apply to equity shares [5], [6].

**Bonus Stock**

If the articles of incorporation permit it, a firm may transfer capitalized amounts from the profit and loss account or reserve account to the share capital by issuing fully paid-up shares to the members. These shares, which are often referred to as bonus shares, are given out free of charge to the company's current members [7], [8].

The issuing of bonus shares is governed by both the Companies Act of 1956 and the corresponding SEBI recommendations. The following is included in SEBI's 2000 Bonus Shares Issue Guidelines: Any public or right problem must be at least a year old before a bonus issue may be created.

Only free reserves created from actual earnings or share premiums acquired in cash may be used to fund bonus issues. Revaluing fixed assets leaves behind reserves that cannot be capitalized. It is not possible to declare a bonus issue in place of a dividend [9], [10].

If there are any existing partially paid shares, they must be completely fully paid up before the bonus issue may be made. The company has sufficient grounds to believe that it has not defaulted in respect of the payment of the employees' statutory dues, such as provident fund contributions, gratuities, bonuses, etc. The company has not defaulted in paying interest or principal on fixed deposits, interest on existing debentures, or principal or redemption thereof.

A corporation that announces its bonus issue after the BOD approves it must put the recommendations into action within six months of the approval date and will not be able to reverse its decision. There should be a provision in the company's articles for capitalization of reserves, etc., and if there isn't, the company must adopt a resolution at its general body meeting to include such a provision. If the subscribed and paid-up capital exceeds the authorized share capital, bonus shares will be issued as a result, and the company's general body meeting will adopt a resolution to increase the authorized share capital. No corporation may issue any bonus shares while FCDs or PCDs are being converted unless the holders of those FCDs or PCDs also get a corresponding advantage. by holding back shares in proportion to the convertible fraction of FCDs or PCDs. The shares that have been reserved may be issued under the same conditions as the bonus issues were made when the debentures are converted.

## Change in Capital

Altering anything is adding to, removing from, or changing something that already exists. Similar to this, altering the capital clause refers to changing the company's current capital structure. This may be necessary on multiple occasions, such as when the company undergoes a capital restructuring or when it needs to raise additional funds but the Authorized Share Capital of the Company forbids it from doing so due to the limited capital specified there. It becomes necessary to change its many components at different times and on different occasions in ways including expansion, subdivision, reclassification, consolidation, conversion, cancellation, reduction, and many more. Most people mistakenly believe that changing the capital only involves changing the authorized share capital, however this is not true at all as changes may be done at several stages, for as by simply raising the paid-up capital.

The Memorandum of Association of the Company and/or the Articles of Association of the Company, which make up the company's charter, do not need to be modified if changes are made to any other clauses; instead, they can be made with the approval of the board of directors or shareholders, depending on the circumstances. However, a thorough process, as described below, must be performed if the Authorized Share Capital is to be changed:

1. Earlier Phase: At this point, the internal approval, or that of management, is granted by either approving a Board Resolution with a simple majority at a legally called Board Meeting or by publication. When such agreement is reached, an appropriate notice informing all of the company's shareholders of the upcoming general meeting with the stated purpose is delivered to them. The Notice and the relevant Explanatory Statement must be attached.

2. Conducting the Meeting and obtaining the Shareholders' Consent: After a suitable notice is delivered, the next step is to call the Meeting, which may only be done if a sufficient Quorum is present. The shareholders' consent must be obtained at the meeting by passing an ordinary resolution or a special resolution, depending on the circumstances. For example, an ordinary resolution is needed to increase, consolidate, divide, convert, or cancel share capital under Section 94 of the Companies Act of 1956. However, a special resolution is needed to reduce share capital under Section 100 of the same Act.

3. Procedures for the consent granted: Once the consent of the shareholders is granted, and in the case of a reduction in share capital, the court's approval is also obtained, then the necessary changes to the Memorandum of Association of the Company and, if necessary, the Articles of Association of the Company, are to be made. An announcement to the Registrar of Companies is made by filing the E-form 5, E-form 23, and E-form 21 as may be required in accordance with the circumstances. In the event of an increase, stamp duty must also be paid in accordance with the applicable State Stamp Act. The aforementioned E-Forms must be submitted to the relevant Registrar of Companies.

4. Approval of the aforementioned Change: If a change is to be made, just notifying the Registrar of Companies is insufficient. The relevant Registrar of Companies must approve the form. As a result, it is always recommended to monitor the progress of the submitted E-form.

## DISCUSSION

## Share Capital

It refers to a firm's capital, the sum obtained by the issuance of shares by a corporation, or the capital expressed in terms of a certain number of rupees split into shares of a certain quantity. As was already indicated, a public corporation and its subsidiary are only permitted to issue

equity and preference shares. Preference share capital and equity share capital are the only two types of share capital that such a firm may issue in the form of preference shares and equity shares. There are five possible uses for the terms "preference share capital" and "equity share capital":

1. Nominal, Authorized, or Registered Capital: This refers to the amount listed in the memorandum as the share capital of a business that is intended to be registered. This is the maximum amount of capital that it is permitted to raise via the issuance of shares, on which it is required to pay stamp duty. As we'll see later, the authorised capital may be expanded by adopting an ordinary resolution after the initial amount has been used up through the issuance of shares.

2. Issued Capital: This refers to the portion of the company's authorized capital that has been made available for subscription. The issued capital is either the same as the authorized capital or less.

3. Subscribed Capital: This is the part of the company's issued capital that has been taken up by buyers of its shares. The subscribed capital is either equal to, or less than, the capital that was issued.

4. Called-up Capital: The corporation is not permitted to call up all of the shares' face value. The entire amount called up on the subscribed shares is represented by the called-up capital as a result. The sum of the capital that was called up may be more than, less than, or equal to the capital that was subscribed.

As a result, uncalled capital is the whole number of shares subscribed for but not called up, and owners are still obligated to pay the amounts as and when called. In the event that the business is wound up, however, the firm may reserve all or a portion of the uncalled capital, which may then be called. The uncalled capital is referred to as Reserve Capital or Reserve Liability for this purpose when a specific resolution is enacted (s.99).

5. Capital Paid-Up: The sum of money paid up on the shares subscribed is known as paid-up capital.

**Changes to Share Capital**

According to Section 94, a company limited by share capital may, if the articles permit it, change the terms of its memorandum regarding capital in the following ways: 1. To increase its authorised share capital by an amount it deems expedient by issuing new shares; 2. To consolidate and divide all or any of its shares into shares of larger amount than its existing shares; 3. To convert all or any of its fully paid-up shares into ordinary shares.

5. To cancel any shares that, as of the resolution's passage date, had not been acquired or promised to be acquired by anybody.

Here is a detailed explanation of these clauses:

1. An increase in the permissible share capital If the bylaws permit it, a corporation limited by shares may adopt an ordinary resolution to raise the authorized share capital. An announcement of the increase in share capital must be sent to the Registrar within 30 days after the resolution's adoption. Upon receiving the notification, the Registrar must record the increase and make any required amendments to the company's articles of incorporation, memorandum, or both. If the notification is not filed on time, the corporation and any officer who is in default are subject to fines of up to $500 every day that the failure persists (Section 97).

2. Combining and dividing shares: Combining shares of different denominations is known as consolidation. One share of 100 is created, for instance, by combining 10 shares of 10 each. The reverse of consolidation is subdividing shares, when one share of 100 is split into 10 shares of 10 each. After a resolution has been approved, a copy of the resolution must be sent to the Registrar within 30 days.

3. Exchange of Shares for Stock and the reverse: Stock is only a collection of fully paid-up Shares, and it is transferable in any amount or portion. A share, however, may only be transferred as a whole; it cannot be divided into smaller pieces. A share of ten, for instance, may only be transferred in its whole; it cannot be transferred in pieces. However, if 10 fully paid shares of 10 each are transformed into 100 shares of stock, the stockholder may also transfer shares worth, say, 17. If a company's articles permit such a conversion, Section 94 gives it the authority to convert its fully paid-up shares into stock by adopting a resolution in general meeting. Within thirty days following the passage of the resolution identifying the shares thus converted, a notification must be sent to the Registrar. It should be emphasized that stock cannot initially be issued. Before converting shares into stock, they must first be issued and completely paid up. By approving a resolution at general meeting, stock may also be converted back into fully paid-up shares. Shareholders get stock certificates when their shares are changed into stock. Instead of the number of shares, the quantity of stock is recorded alongside a member's name in the Register of Members. A shareholder is just as much a part of the business as a shareholder.

4. A decrease in share capital: Occasionally, shares are issued but never allocated because they are not claimed by the general public. According to Section 94, a company may, if its articles permit it, cancel shares by resolution in general meeting that have not been taken or agreed to be taken by anyone as of the resolution's passing, and reduce the share capital by the amount of the shares that were so cancelled. This is different from a decrease in capital since it represents decline of capital.

**Under certain Conditions, the Authorized Share Capital increases**

When an order is issued according to s. 81(4), section 94A gives the Central Government the authority to administratively enhance the authorized capital of a firm. According to Section 81(4), if a company has received debentures from the government or loans from the government, the Central Government may, if it believes it is in the public interest to do so, by order, direct that all or a portion of those debentures or loans be converted into shares of that company. Even if the conditions of the loans or the debentures at issue do not include a clause allowing for the possibility of such conversion, such an order may nonetheless be issued. As a result, the Central Government has the authority to administratively raise the company's nominal capital.

Additionally, when a public financial institution proposes to convert debentures or loans (with a conversion option) issued to or given to the company, when the financial institution requests that the Central Government issue orders for the increase of the authorized share capital of the company, the nominal share capital of the company shall also be increased. The order of the Central Government will have the effect of changing the conditions stated in the company's memorandum and increasing the nominal share capital by an amount equal to the value of the shares into which the debentures or loans, or a portion thereof, have been converted.

The Central Government shall transmit a copy of such an order to the Registrar and to the company in the event that the memorandum of a company is revised as described above. The company must submit a return to the Registrar regarding the increase in share capital within

30 days of receiving the order in the prescribed form. The Registrar will then, after receiving the order and return, make the necessary changes to the company's memorandum.

**Decrease in Share Capital**

The lowering of share capital is outlined in Sections 100 through 105. A company limited by shares may lower its share capital by special resolution, which must be approved by the court, if it is permitted to do so under its articles of incorporation:

1. By decreasing or wiping off the members' obligation for uncalled capital, for example, by treating a share of 10 on which 5 are paid as a share of 5 completely paid-up. The shareholder is released from responsibility for the uncalled capital in this manner. 2. By paying off or returning capital that is excessive compared to the needs of the firm, for example, if a share is completely paid up at 10, decrease it to 5, and then return 5 to the shareholder.

3. Pay down paid-up capital with the knowledge that it may be called up again. For instance, if a share of stock is completely paid-up and worth 10, 2.50 of that share may be returned to the shareholder with the understanding that the firm might call it up again if required. approach (1) and this approach are therefore different in that the latter does not erase the uncalled responsibility; 4. A mixture of the aforementioned ways.

5. Write off or cancel capital that has been lost or is not supported by accessible assets, for example, a fully paid-up share of 10 is supported by 7.50 in assets. In this case, a write-off of 2.50 per share might bring realism back into the company's balance sheet. The most popular way of capital reduction is this one. The balance sheet's assets section may also contain fictional goodwill, preliminarily incurred costs, discounts on the issuance of shares and debentures, and other items. Depending on how beneficial they are, these assets are either cancelled or have their worth decreased. Share capital on the liability side is thus decreased.

**Procedure for Capital Reduction**

The corporation must file a petition with the court to have the special resolution for the capital reduction confirmed when it is passed in accordance with section 101. The creditors have the right to object if the proposed decrease in share capital would result in (i) a reduction in the amount of unpaid capital owed; (ii) the payment of any paid-up share capital to any shareholder; or (iii) any other situation, if the court so orders. The court chooses a list of these individuals so that the creditors may raise objections. If any creditor opposes, it is best to either get his payment or acquire his assent to the planned decrease. The court may, however, appropriate the whole amount or the amount set by the court without the approval of a creditor on the corporation providing security for payment of the debt or claim.

According to Section 102, the court may affirm the reduction if it is satisfied that either the creditors who are entitled to object have agreed to it or that their obligations have been paid or secured. Additionally, it may stipulate that for a certain time, the words "and reduced" be added to the firm's name and that the corporation publicize the justifications for the reduction as well as the factors that contributed to it.

The court's order must be registered with the Registrar, according to Section 103. Additionally, the corporation must provide minutes detailing any changes to the share capital. The decrease in share capital only becomes effective when the court's ruling has been registered with the Registrar, not before. A Certificate of Registration, which the Registrar will issue, will serve as irrefutable proof that the Act's criteria have been met and that the share capital is currently as stated in the minutes. The capital phrase in the memorandum that corresponds to the recorded minutes is regarded to have been replaced, modifying the

memorandum in accordance with section 40. Therefore, the copies of the memoranda that will be released later must adhere to the provisions.

According to Section 104, the members are no longer responsible for calls in relation to the amount by which the nominal value of their shares has been lowered after the reduction of capital. Every member is obligated to contribute toward the payment of that debt at the time the court order and minutes are registered if a creditor who has the right to object to the reduction of share capital is not included among the creditors.

A violation of Section 105 can result in up to a year in prison, a fine, or both if an officer of the company intentionally withholds the identity of a creditor who has the right to object to the reduction or falsely represents the type or amount of a claim or debt.

## CONCLUSION

In conclusion, Founders and early investors might be rewarded and encouraged via deferred or founders' shares, aligning their interests with the long-term success of the business. However, the governance issues and possible effects on other owners should be carefully considered. In order to ensure openness, justice, and accountability inside the organization, it is essential to balance the interests of all stakeholders. To guarantee that the interests of all shareholders are respected and safeguarded, the issuing of delayed or founders' shares should be supported by suitable governance procedures and transparent communication. Additionally, the interests of other shareholders and stakeholders should be taken into consideration when using deferred or founders' shares. To guarantee that the decision-making process is fair and accountable, the governance structure should have the necessary checks and balances.

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# CHAPTER 18

# REDUCTION OF CAPITAL VERSUS DIMINUTION OF CAPITAL

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**ABSTRACT**:

The concepts of reduction of capital and diminution of capital and their implications in the context of corporate finance and capital management. Reduction of capital refers to a deliberate decrease in the nominal value of a company's share capital, often undertaken to adjust the capital structure or return capital to shareholders. Diminution of capital, on the other hand, refers to an unintentional decrease in a company's capital resulting from losses or other factors.

This paper examines the legal and practical aspects of reduction of capital and diminution of capital, including the procedures, regulatory requirements, and consequences associated with each. It analyzes the implications of these concepts on shareholder rights, creditor protection, and financial stability. Through a comprehensive analysis of company law and case studies, this paper sheds light on the differences and significance of reduction of capital and diminution of capital in corporate finance.

**KEYWORDS**:

Authorized Capital, Capital Reduction, Capital Reserve, Debenture Holders, Diminution of Capital, Equity Capital.

## INTRODUCTION

Working previous losses against capital, canceling uncalled capital, or repaying excess capital are all examples of capital reduction.

It can entail a decrease in issued capital, subscribed capital, or paid-up capital for shares. Diminishment of capital refers to the cancellation of authorized or issued (but unsubscribed) capital. A decrease in capital does not indicate it has been reduced within the meaning of the Companies Act [1], [2]. Following are the differences between capital diminution and reduction:

1. The decline of issued capital is referred to as capital diminution. There is no decrease of the issued capital; rather, the subscribed or paid-up capital is reduced.

2. Both need article authorization, but capital reduction may only be accomplished by adopting a special resolution; 'diminution' can, however, be accomplished by an ordinary resolution (if so authorized by articles).

3. While 'diminution' does not need judicial approval (s. 94),'reduction' must (s. 100).

4. If there is a "reduction," the court may require the business to add "and reduced" after its name.

5. If there is a "diminution," the Registrar must be notified within 30 days after the cancellation date. At that point, the Registrar must record the notification and make the required changes to the memorandum and articles. Although there is no time constraint as there is in the case of "diminution," a more extensive protocol has been defined in the case of "reduction [3], [4]."

**Restructuring of Capital**

Shares must be issued by corporations limited by shares in order to obtain the funds required for their operations [5], [6]. There are three methods to issue shares:

1. Through a share private placement.

2. By allocating whole shares to an issue-house, which then makes the shares available for public purchase.

3. By distributing a prospectus that invites the general public to subscribe for shares of the firm.

Private Placement of Shares: The Act and the articles forbid a private corporation limited by shares from asking the public to subscribe for shares or debentures. In addition, no statement in place of prospectus must be filed. Its shares are secretly distributed to a select group of individuals who are either familiar to the promoters or linked to them via family ties [7], [8].

A public corporation may also obtain money via a private placement of shares without soliciting subscriptions from the general public. An underwriter or broker locates potential buyers of the shares, who are often his clients, in this kind of agreement. He only works as an agent, and his only duty is to find a buyer for the shares, or to put them. There is no requirement to publish a prospectus since there is no public offering of shares. A statement in place of a prospectus must be filed with the Registrar, however, under Section 70, at least 3 days before any shares or debentures are allotted.

According to the regulations set out by SEBI in June 1992, private placement of shares shall not be accomplished by the subscription of shares from unaffiliated investors through any sort of market intermediaries. This indicates that a promoters' share should not be provided by unrelated investors via brokers, merchant bankers, etc. subscribing to such shares. However, friends, family, and coworkers are permitted to subscribe for such shares [9], [10].

Through an Offer for Sale: In this scenario, the business assigns or promises to assign shares or debentures to a financial institution or an issue-house at a price for sale to the general public.

In order to sell shares or debentures to the public at a price over what it pays for them or at par, the issue-house publishes a document called an offer for sale with an application form attached. Considered to be a prospectus is this document. When the public submits applications, the issue-house renounces the allocation of the specified number of shares in favor of the applicant purchaser, who then receives a direct allocation of the shares.

By inviting the public via a prospectus: This is the most typical way for a business to solicit funding from the general public.

Through a prospectus, the corporation solicits bids from the general public to subscribe for shares or debentures. An investor is required to read the prospectus and then submit an application for shares if they are persuaded of the company's potential.

**Shares are issued to current shareholders**

Additionally, the capital is increased by issuing rights shares to the current owners (section 81). In this instance, the shares are distributed to the current equity owners in proportion to the initial amount of shares they possessed, for example, one share for every two shares held by a member.

**Public Share Issue**

The sale or marketing of shares for subscription by the general public via the release of a prospectus is known as a public issue of shares. A public company must abide by the provisions of the Companies Act, the Securities Contracts (Regulations) Act, including the Rules made thereunder, and the Guidelines and instructions issued by the concerned Government authorities, the Stock Exchange and SEBI, among other laws, in order to raise capital from the public through the issue of shares or debentures. The management of a public offering requires the coordination of the efforts and cooperation of numerous organizations, including the issue's managers, underwriters, brokers, registrars, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors, and other government/statutory organizations like the Registrar of Companies, Reserve Bank of India, stock exchange, SEBI, etc. Before issuing shares to the general public, it is important to bear in mind the SEBI standards referred to as "Guidelines for Disclosure and Investor Protection" with relation to share issuance.

submit an application to get a permanent account number. Applications that do not adhere to the rules are subject to rejection. For applications worth $50,000 or more, the applicant, or in the case of joint applications, each applicant, must include their permanent account number (PAN) or GIR number, as well as their income-tax circle, ward, or district, as applicable.

**Privilege of Preference in Voting Shareholders**

Only issues directly affecting preference shares will be put to a vote by the preference shareholders. The following issues pertaining to preference shares are mentioned in Section 87(2), and preference shareholders may vote on them: (i) any resolution calling for the dissolution of the business; (ii) any resolution calling for the reduction or return of share capital; and (iii) any resolution at any meeting, if the cumulative preference share dividend is not paid for at least two years. If dividends are delinquent for the two fiscal years within the six-year period concluding with the fiscal year before to the meeting, holders of non-cumulative preference shares are entitled to vote on all motions.

**Shares of Rights**

When the firm seeks to grow its subscribed capital, the current members have the right to be offered shares. These sharesalso referred to as "rights shares"are not given out for free. According to Section 81, if a public company limited by shares issues additional shares within the limits of the authorized capital after the expiration of two years from the date of the company's incorporation or after one year from the date of the first allotment of shares, whichever occurs first, its directors must first offer these shares to the existing holders of equity shares in proportion, as nearly as circumstances permit, to the capital paid up on t Each equity shareholder must get notification from the firm providing him the opportunity to purchase the shares the company is offering to him. The quantity of shares he has the option to purchase must be disclosed to the shareholders. At least fifteen days must pass before he is offered the choice to activate it. The shareholder will be considered to have rejected the offer if he fails to notify the firm of his choice. The directors must note in the notice of offer that the shareholder has the option to renounce the offer, in whole or in part, in favor of someone else, who need not be a member of the company, unless the articles of the business stipulate otherwise. The company's directors may dispose of those shares anyway they see appropriate if the shareholder refuses, is judged to have refused, or if the person in whose favor the renunciation is made rejects to purchase the shares.

Exception: However, the firm may, by special resolution at general meeting, determine that the directors may dispose of the shares in the additional issue in any way they want and are not required to sell them to the existing equity shareholders. However, if approval is acquired from the Central Government, the directors may not offer the shares to the current equity owners when it has only been feasible to assemble an ordinary majority. A private corporation is also exempt from the provisions of Section 81. Therefore, a private business does not have to offer its subsequent issue to current shareholders first; instead, its directors are free to do so in whatever way they see suitable. Additionally, s. 81 does not apply when shares are issued in exchange for loans or debentures that are being converted.

The following SEBI Guidelines about Rights Issues, 2000, have been released:

Application: These regulations are applicable to rights offerings undertaken by current listed firms with listed equity share capital. For rights offerings when the total value of the securities issued does not exceed 50 lacs, these rules do not apply. Registrar appointment: Registrars must be appointed to the Issue. This appointment is required.

Withdrawal of a Rights Issue After Announcement: For a minimum of twelve months from the announced record date, a firm that withdrew a rights issue is not allowed to submit an application for the listing of any of its securities. Underwriting: It's not required that rights issues be underwritten. However, in cases where the transaction is underwritten, the lead manager, if any, should say in the letter of offer that, in their judgment, the underwriters' assets are sufficient to cover their commitment. Choosing a merchant banker: Rights issues of listed companies worth more than 50 lakhs shall be handled by a category-1 merchant banker who is in possession of a current SEBI certification of registration.

Making Partially Paid Shares Fully paid: Any partially paid shares must be made whole, otherwise they will be forfeited. Disclosure in Letter of Offer: It shall be the responsibility of the merchant banker, acting as the lead manager, to ensure that the letter of offer contains all the matters specified by SEBI in this regard and, in addition, provides a true, correct, and fair view of the state of affairs of the company that is sufficient for the investors to reach a well-informed decision.

Agreement with Depository: A company is not permitted to issue a right issue unless it first enters into an agreement with a depository for the dematerialization of securities that have already been issued or that are planned to be issued to existing shareholders. It must also give subscribers and shareholders the choice of receiving a certificate or holding securities that have been dematerialized with a depository. Letter of Offer Filing: The Merchant Banker must submit the letter of offer with SEBI at least 21 days before filing it with the Regional Stock Exchange for rights issues worth more than 50 lakhs. However, if SEBI requires any modifications within 21 days of the date the draft letter of offer was filed, the Issuer or the Lead Merchant Banker must make such adjustments before submitting the draft letter of offer with the Regional Stock Exchange.

Rights issues must be open for no more than 60 days, but they must remain open for at least 30. Minimum Subscription: According to SEBI, the letter of offer must include the following language on the minimum subscription. "The whole subscription will be reimbursed to the applicants within 42 days of the date the issue closed if the firm does not obtain the requisite subscription of 90% of the issue. The firm must pay interest for the postponed time if the return of the application money is delayed by more than 8 days after the company becomes obligated to do so, or 42 days after the matter is resolved. @ 15% every year, as stated in Section 73(b)(2) and (2A) of the Companies Act of 1956.

The Lead Merchant Banker in a composite issue is responsible for ensuring that the minimum subscription criteria are met jointly and severally, or separately, for both rights and public issues. No Reservation in Rights Issues: According to SEBI regulations, preferential allocations in favor of the issuing firms, permanent staff, or financial institutions are prohibited. By following the rules in that respect, a firm may, independent of rights issues, provide any preference to its workers or any other named individuals. Contribution of Promoters and Lock-In Period: In the event of rights difficulties, the promoter contribution obligation shall not apply.

Rights of FCD/PCD Holders: While FCDs/PCDs are being converted, no firm may issue any shares in the form of rights unless the holders of those FCDs or PCDs also get a corresponding advantage. By reserving shares proportionate to the convertible fraction of FCDs/PCDs, the advantages will be prolonged. The shares that have been reserved may be issued under the same conditions as the rights issue at the moment the debentures are converted. No company may issue any additional capital during the period beginning with the date the company's offer document was submitted to SEBI on behalf of the company for a rights issue until the securities mentioned in the said offer document have been listed or application fees have been reimbursed on account of non-listing, under-subscription, etc.

Over-subscription is not to be kept: Under no circumstances is over-subscription to be kept. Issue to be Paid Off in whole: With the exception of cases where the issue size exceeds 500 crore, the issue must be paid off in whole within 12 months. Additional Application Facility: The Lead Merchant Banker should see that a notice stating the date on which the delivery of the letters of offer is complete is published in at least one English National Daily distributed in the area where the issuing company's registered office is located. The advertising must appear at least seven days before the issue's release date.

## DISCUSSION

### Federal Government Responsibilities against Food Industry

Canada has a federal government, ten province governments, three territory governments, and hundreds of local governments, all of which share responsibility for food. Three tiers of government are each governed by around 77 articles of law regarding food inspection. Exports and interprovincial commerce are the primary responsibilities of the federal government, which includes promoting and defending Canadian food export markets as well as enabling interprovincial trade. The federal government also implements legislation designed to prohibit the manufacture or sale of hazardous, adulterated, or misbranded goods in Canada, as well as standards for food safety, quality, and grading for goods supplied internationally and among provinces.

The intraprovincial parts of the food business, such as regional food processing, the food service industry, and the food retail sector, are within the jurisdiction of the provinces and municipalities. They choose whether and how to examine regional businesses, such as eateries, supermarkets, dairies, and meat processing factories whose goods are distributed inside the province. (P. 130, Moore and Skogstad) Early in the 1990s, a variety of food security issues encountered by the Canadian federal government made it easier to implement creative reforms:

1. The "tainted tuna" controversy had diminished Canada's reputation for high-quality food.

2. Resources were not only few but also becoming scarcer, making it impossible to evaluate fish products further.

3. The Government sought to restructure its public sector in a manner similar to that of the United Kingdom and New Zealand, where independent agencies were established from the main government.

4. International trade advancements and prospective interprovincial trade developments: (a) sector and governments supported standardized standards and simplified inspection to maintain the competitiveness of the Canadian food sector both domestically and abroad.

(a) In a disjointed system, Canadian growers and processors were exposed to trade risks.

(c) Despite the modest proportion of total output and the guarantees stated in the Auditor General of Canada's 1994 Report, processors saw gaps arising from non-inspection or insufficient inspection as a weak link.

(d) The industry was eager to minimize costs and inefficiencies brought on by varying provincial regulations, such as fluid milk, due to the closer integration of the US and Canadian markets under free trade agreements.

5. The North American Free Commerce Agreement's "national treatment" concept might be understood to suggest that imports must adhere to the provincial norm of the province they enter rather than the level needed for interprovincial or international commerce. As a result, Canadian food regulations may be lowered to the bare minimum.

(A) Canadian exporters were worried that their products would not be accepted into foreign markets because Canadian food safety standards and inspection procedures did not match those of the countries they were exporting to.

(b) The 1994 SPS Agreement mandated that nations utilize their laws governing food safety, as well as those governing the health of animals, plants, and people, solely to the degree necessary to safeguard human or animal life or health, and not to protect commerce.

6. The emergence of low-cost regulatory alternatives: The government was given chances by new scientific and technical instruments to transfer extra expenses and a significant portion of responsibility for food safety on the food sector itself. Methods for risk assessment made it possible to allocate resources for food inspection according to risk. The Hazard Analysis Critical Control Point (HACCP) system, a risk-based tool created for the US space program, has been shown to be more successful than current techniques in assuring food safety. The first nation to use this approach for its fish inspection program was Canada. It was so widely embraced that Canadian meat processing facilities were later forced to comply with US laws mandating big American meat processing facilities to put in place a HACCP plan by January 1998.

7. The preservation of national unity was in jeopardy, and Liberal candidates' winning campaigns in the 1993 and 1997 elections called for federation renewal, greater service coordination, and a decrease in overlap and duplication between ministries.

Beginning on April 1, 1997, the Canadian government combined all of its food inspection and quarantine functions from Health Canada, Fisheries and Oceans, and Agriculture and Agri-Food Canada into a single independent agency. The Agency reports directly to the Minister of Agriculture and Agri-Food, not to a deputy minister. Due to the Agency's distinct employer status, it is not necessary to go through the Public Service Commission in order to recruit and dismiss personnel. Additionally, it enjoys certain financial flexibility that is not offered to government agencies, most notably the ability to keep money. The creation of alternative service delivery agencies (ASDs) in Canada is heavily influenced by the need to protect the

public interest. The CFIA considered whether there was a proper emphasis on public goals, preservation of public service values, and sufficient control over public money and assets when evaluating ASDs using the Auditor General of Canada's definition of the public interest. The CFIA decided from its self-evaluation that it was acting in the public interest on every issue.

Under the CFIA Act, the Auditor General of Canada was appointed as an external auditor with the responsibility of auditing the agency's financial accounts and determining the accuracy and dependability of the performance data included in its yearly report to Parliament. Periodic value-for-money audits of the Agency may also be performed by the Auditor General.

**Management of the Business**

A firm behaves via human agency since it is an artificial person. Accordingly, a Board of directors is a requirement of the Act for every corporation. Additionally, according to Section 197-A, the following kinds of management employees may be hired:

**Manager or managing director**

Other management employees who do not fall within the definitions of "managing director" or "manager," such as executive or whole-time directors, may be employed without violating Section 197A. As a result, a business might appoint a managing director and a full-time director at the same time, or a manager and a full-time director. The concurrent appointment of a managing director and manager in the same firm is forbidden under Section 197A.

**Definition and Meaning of Directors**

The definition of a director in Section 2 (13) states that it includes "any person occupying the position of director, by whatever name called." This concept is strictly functional; if someone performs the duties of a director, they are considered directors. However, the Act offers no more explanation of the role, responsibilities, or status of a director. In actuality, directors are the people in charge of overseeing a company's operations. They are in charge of managing the company's affairs thanks to Section 291. Within the parameters of the firm's memorandum, they lay forth the overall policy of the company. They choose the company's executives and suggest the dividend yield. The term "Board of Directors" refers to the company's directors as a whole. As a result, a person's status as a director of a corporation is determined by his position and the tasks he does, not by the name by which he is known. According to Forest of Dean Coal Mining Co. Re (1878) 10 Ch D 450, "name matters nothing; function is everything." Whether or not he is designated as a director, a person is one as long as they are lawfully chosen by the company to manage its affairs and permitted by its articles to enter into contracts in its name and on its behalf. Occasionally, a company's articles may name its directors as governors, members of the governing council or the board of management, or under any other designation, but legally, they are just directors. For instance, even though they are not named as directors, members of the executive committee, governing council, or management board of organizations registered as corporations under Section 25 are directors for purposes of the Act.

A person may be considered a director of a firm even though they are not one for specific reasons. A person who the Board of Directors of a corporation is used to acting in accordance with is treated as a director under the Act. The definition of "director" is broadened as a result of this clause. However, this clause only has the effect of imposing obligations or restrictions on the person who is mistakenly believed to be a director. A presumed director, however, is

not given any authority or rights in relation to the company's management. He may be held accountable, but he cannot insist on attending board meetings or in any other manner managing the company's business. However, it is required to prove that the Board of Directors is used to acting in accordance with his directives and instructions in order to regard a person as a presumed director and invoke his culpability. A person who sometimes or carelessly follows specific directions from another individual would not qualify as a "deemed director." A considered director does not have to be a person. The individual might even be a legal entity, like a holding corporation.

It should be emphasized that individuals who advise a company's board of directors in their official role are not included in the definition of "deemed director." Thus, if a lawyer, accountant, or other professional adviser provides professional advice or instructions and the Board is used to acting in accordance with such advice or instruction, he will not be considered a "deemed director." According to Section 303(1), any individual who the Board of Directors of a corporation is used to acting with directives or instructions from is also regarded to be a director. However, a manager or any other member of the management team is not a director. Under English Law, a "deemed director" is known as a "shadow director.

## CONCLUSION

In conclusion, in corporate finance, decrease of capital and reduction of capital are two different ideas. Reducing capital entails purposefully lowering share capital, often to change the capital structure or give money back to owners. On the other hand, diminution of capital describes an inadvertent reduction in capital brought on by losses or other circumstances. To maintain efficient capital management, financial stability, and the preservation of stakeholder interests, it is essential for businesses, shareholders, and creditors to understand the processes, legal requirements, and repercussions of reduction of capital and diminution of capital. Companies that are thinking about reducing their capital or are already experiencing a decrease in capital should carefully analyze the legal and regulatory requirements, get expert counsel, and take into account the ramifications for all stakeholders. In order to ensure justice, defend rights, and maintain stakeholder trust, transparency, compliance, and communication are essential.

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# CHAPTER 19

# QUALIFICATIONS AND DISQUALIFICATIONS OF DIRECTORS: A REVIEW STUDY

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**ABSTRACT**:

The qualifications and disqualifications of directors in the context of corporate governance and directorship roles. Qualifications refer to the characteristics, skills, and attributes that individuals must possess to serve as directors of a company. Disqualifications, on the other hand, are legal restrictions or conditions that prohibit certain individuals from holding directorship positions.

This paper explores the importance of director qualifications in ensuring effective board performance, decision-making, and accountability. It also analyzes the reasons for director disqualifications, such as criminal convictions, conflicts of interest, and breaches of fiduciary duties. Through a comprehensive analysis of company law, regulatory frameworks, and case studies, this paper sheds light on the significance of director qualifications and disqualifications in promoting ethical conduct and protecting shareholder interests.

**KEYWORDS**:

Educational Background, Expertise, Good Character, Knowledge of the Industry, Professional Qualifications, Shareholding Requirements.

## INTRODUCTION

A director may be chosen by these small shareholders in the way that may be stipulated in a public company that meets the following requirements: (a) has a paid-up capital of at least five crore rupees; and (b) has at least 1,000 small shareholders.

A shareholder owning shares in a public corporation to whom this section applies with a nominal value of 20,000 rupees or less is referred to as a "small shareholder" for the purposes of this definition. The Companies (Appointment of the Small Shareholders' Director) Rules, 2001 have been established by the Department of Company Affairs.

A majority of the tiny shareholders will elect such a director. Such a director's term must not exceed three years, and he need not resign via rotation. At the end of his term, he is eligible for reelection for a further three years. Such a director may be fired in accordance with section 284. One cannot serve as a small shareholders' director for more than two businesses.

The candidate for election must also be a minor stakeholder in the business. Such a director is also unable to be appointed as the company's managing or full-time director. He is judged to have resigned from his position as "small shareholders director" if he no longer qualifies as a small shareholder. Example: The Board of Directors of ABC Ltd., an unlisted company with a paid-up share capital of 6 crores, comprised of 5 crores of equity share capital and 1 crore of preference share capital, as well as 11,000 small shareholders holding equity shares, has proposed the appointment of a director to represent the small shareholders [1], [2].

A public corporation may elect a director under Section 252 if it has a Paid-Up Capital of Five Crores or More and One Thousand or More Small Shareholders. It goes without saying that the corporation may choose to designate such a director; it is not required. Example:

There are more than a thousand tiny owners in a corporation, and its paid-up capital exceeds five crore rupees. Small shareholders have used their entitlement to nominate a director to the company's board of directors. Before the end of his appointment time, the corporation wants to fire him. Without the small shareholders' permission, the corporation may do so in accordance with Section 284.

Since there is no official definition of "Director," either statutory or judicial, it is difficult to pinpoint exactly what that role entails. But according to legal rulings, they are (i) agents, (ii) trustees, or (iii) managing partners. However, each of these statements is meant to indicate points of view from which they may be seen at the time and for the specific purpose, not as a full list of their authority and duties [3], [4].

**Acting as agents**

The directors represent the corporation as its agents, and the standard agency laws are in effect. Within the parameters of the company's articles and the Act, they execute the powers that are subject to the responsibilities [5], [6]. For instance, they are exempt from personal liability if they operate within their authority and enter into contracts on the company's behalf. However, they will also be held accountable if they sign a contract in their own name or fail to disclaim personal culpability.

The corporation may approve the same action if the directors go beyond their jurisdiction. However, if they take any action that goes against the firm's purposes clause, the conduct is ultra vires, and the company cannot approve it. However, directors represent the corporation, the artificial person, not the individual shareholders, who are not represented by them.

**Trusteeship by Directors**

Additionally referred as trustees, the directors. However, they are not trustees in the true meaning of the word since no ownership rights to the company's assets are transferred to them; as a result, they sign contracts on the company's behalf and in the company's name. However, when a trust is established, the trustee receives legal ownership of the trust's assets. As a result, he is able to sign contracts in his own name, but he always acts in the beneficiaries' best interests [7], [8].

Despite not being trustees in the traditional sense, directors have a position of trust and in some ways serve as the company's trustees. These instances include: They operate as trustees for any money that passes through their hands or that they truly have control over. If they misuse the company's funds, they must make amends just as trustees would [9], [10].They are trustees because they use the authority given to them for the company's advantage. For instance, the company's interests should be served when the authority to grant shares, issue calls, or forfeit shares is used. They have a fiduciary duty to the business, thus anytime his personal interest's conflict with those of the company, he should bear the company's interests in mind. A director is not in any manner a trustee for specific shareholders, unless the former uses misrepresentation to persuade the latter to sell the shares to the former.

**Managing Partners**

In other contexts, the directors are referred to as managing partners. A corporation is regarded as a partnership entity in this sense. A few shareholders who are chosen as directors by the shareholders handle the business of the company in a manner similar to how one or more partners may manage the firm's affairs on behalf of all partners. They oversee the company's operations on behalf of both themselves and the other elective owners.

**Directors as Company Employees**

The company's directors are not workers or paid by the company; they are also not slaves of the business or a part of the "staff" of the firm. However, a director may hold a salaried position or another office in addition to his directorship, which could, for these purposes, classify him as an employee or servant. In that case, he would be entitled to the same rights as employees, but his directorship and the rights he holds through it are distinct from those he holds as an employee. As a result, in addition to his compensation as a director under the Act, he is also entitled to compensation and other benefits that are available to him as an employee. This kind of circumstance is recognized under the Act. For instance, Sections 314 and 318 allow a director to have an office or place of business inside a corporation.

**Directors serving as Company Officers**

Directors are regarded as corporate officials. Also, according to Section 5, directors who violate specific Act restrictions are officers in default and may face fines.

**DISCUSSION**

The Act does not provide any educational or professional requirements for directors. The Act also exempts directors from share qualifying requirements. A director is thus not required to be a shareholder unless he chooses to be one freely, absent a provision to that effect in the company's articles of incorporation. However, the articles often provide a minimum share requirement. So, according to Regulation 66 of A, a director must own at least one share of a corporation. When a share qualification is established by a company's bylaws, the Act stipulates (s. 270) that:

Each director must take their qualification shares within two months of their appointment; it must be disclosed in the prospectus; the nominal value of the qualification shares cannot exceed 5,000, or the nominal value of one share where it does; and Share warrants do not count toward share qualification. A director automatically resigns from office two months after being appointed if he does not acquire the qualification shares within that time period, and if he continues to serve in that capacity after the two-month period has passed without doing so, he may be fined up to $5,000 per day until he ceases to do so (section 272). However, a person cannot be required by the company's articles to possess qualification shares prior to being elected a director or to acquire them sooner than two months after being appointed, and any provision to this effect in the articles is null and void.

Because his name cannot be entered on the register of members until he has applied for shares and those shares have been allotted to him, the director cannot be listed among contributors if the company is wound up during the two-month period. This is because there is no express or implied agreement requiring him to take the qualification shares. However, merely holding a position as a director does not constitute an agreement to acquire shares from the company; however, if in such a situation he is added to the register by the company's officers after the deadline for qualification has passed (i.e., two months after his appointment) and he continues to hold that position, he is prohibited by his conduct from repudiating the shares and will be obligated to pay for them. The two months are computed from the day that the election result is revealed, not the day the poll was actually taken, as the appointment of a director begins on that day.

If the fact that the director is also a trustee is not noted in the register of members and the company is permitted to treat the shares as its own, the director may hold the qualifying shares. Additionally, holding shares jointly with any other individual qualifies as holding

shares. In Grundy v. Briggs 1 Ch., it was decided. 444 states that, unless the articles specify otherwise, every joint holder of shares has the right to be appointed as a director. However, only one joint holder may be chosen. Unless the articles specifically state otherwise, a person cannot be nominated as a director if they have mortgaged shares. A later increase in the amount of share qualification cannot be made relevant to someone who already has the necessary qualification shares at the time of their appointment. The company will be held responsible for the actions of such a director until the error in appointment or disqualification is disclosed by the company, and acts done by him after the disclosure by the company will not bind it.

This applies when a director acts after the two-month period from the date of his appointment has passed without acquiring his qualification shares. For those who are unaware of the fault, a de facto director is thus just as effective as a de jure director (Section 290). To the extent that s. 270 and s. A private corporation (s. 273) is exempt from Section 272's application, and its articles may or may not include any share qualifying requirements. Thus, the articles may stipulate that shares must meet certain criteria, and the sum may exceed $5,000. Additionally, a private corporation that is not a subsidiary of a public firm may include in its bylaw's additional requirements for a director, such as the need that the individual be a B. Com., or possessing a fixed deposit receipt issued by the business in his own name. The following individuals cannot be nominated as directors of any corporation due to the disqualifications outlined in Section 274:

1. A person deemed to be mentally ill by a court;

2. Unsatisfied insolvent;

3. An individual who has asked to be declared bankrupt;

4. A person who has been found guilty by a court of an offense involving moral turpitude and sentenced to jail for that offense for at least six months, provided that five years have not yet passed since the sentence's expiration date;

5. A person who, six months after the payment date, has not paid calls on shares he owns alone or jointly with others;

6. A person who has been declared ineligible by a court according to s. 203, which gives the court the authority to prevent dishonest people from managing firms unless the court has granted permission for his employment;

7. Such a person is already a director of a publicly traded firm that: (a) has not submitted its annual reports and accounts for any consecutive three financial years; or

8. It has consistently failed over a period of one year or more to pay dividends, redeem its debentures on time, or refund its deposit or interest on it. Furthermore, for a period of five years following the date on which the public company in which he is a director failed to submit annual accounts and annual returns as required by (a) above, or failed to repay its deposits or interest, redeem its debentures by the due date, or pay the dividend mentioned in (b), such person shall not be eligible to be appointed as a director of any other public company.

The Central Government may eliminate the disqualifications listed under (iv) and (v) above by publishing a notice in the official gazette. A private business, on the other hand, may specify in its bylaws that a person is ineligible for nomination as a director for any other

additional reason. A public business or its subsidiary, however, cannot include any extra disqualifications in its articles.

**Additional Exclusions**

Directors may also be disqualified under the next two clauses:

(i) In cases where a director has been found guilty of a crime under s. 209A, he will be judged to have resigned from his position as such as of the date of his conviction. He will be unable to occupy the position of a director in any firm for five years from the date of such a vacation of office.

(ii) Unless the Central Government has agreed to shorten the time with the business Law Board, a director who has been fired from any management position is prohibited from serving as a director of a business for a period of five years after the date of the order of termination.

Although the Act does not directly prevent minors from holding directorships, they are unable to do so because they lack the legal capacity to do so. As a result, they cannot submit the proper paperwork to the company or the registrar as required by Section 264. However, as Section 264 only applies to public corporations, there is no law that forbids a youngster from serving as a director of a private firm. However, from a practical standpoint, a kid may serve as an ornamental director since he cannot be a party to any agreement that calls for legal adult capacity, and for the same reason, he cannot be given any board authority. He may cast a vote at board meetings on every resolution. For instance, Mr. Ram is a director of ABC Ltd. Both PQR Ltd. and XYZ Ltd. Although ABC Ltd. consistently filed yearly filings, it did not submit annual accounts for the fiscal year that ended on March 31, 2007.

Additionally, ABC Ltd. neglected to make interest payments on loans obtained from a public financial institution beginning on January 1, 2007, and failed to make timely installment repayments beginning on April 1, 2007. On June 1st, 2008, it is suggested that Mr. Ram be nominated as a second director of MN Ltd. Additionally, Mr. Ram wishes to keep serving as a director for PQR Ltd. and XYZ Ltd. Additionally, he requests re-appointment at the AGM of the relevant firms, which will be conducted in September 2008, when he retires by rotation. The disqualification under s. 401 does not apply in the case of ABC Ltd.'s failure to pay interest on term loans obtained from a public financial institution. 274(1)(g)(B). Mr. Ram is disqualified if the company fails to make its deposits on time and the problem lasts for more than a year. He is unable to be nominated as an extra director for MN Ltd. due to this disqualification. On or after June 1st, 2008. Only when Mr. Ram is appointed or reappointed as a director of any public corporation after the default takes effect will the disqualification go into effect. He may continue to serve as a director of any public corporations in which he is a director up to that point. Therefore, he is exempt from having to resign from his directorships at XYZ Ltd. and PQR Ltd. 283). When Mr. Ram retires by rotation at the AGMs scheduled for September 2008, he will not be eligible to run for re-election in XYZ Ltd. and PQR Ltd. Example: Mr. A is a director of ABC Ltd., which has been defaulting on maturing deposits since April 1, 2007, and has continued to do so. However, ABC Ltd. consistently files yearly accounts and taxes. Mr. A serves on the boards of PQR Ltd. and XYZ Ltd. as well.

ABC Ltd. has violated the provisions of s. Mr. A loses his eligibility to be appointed or reappointed as a director of any other public company under Section 274 (1)(g)(B) due to his position as a director of ABC Ltd. He does not, however, have to give up his directorships at

PQR Ltd. and XYZ Ltd. since neither s. 274 or s. 283. It is not possible for DEF Ltd. to nominate Mr. A as an extra director at the board meeting scheduled for May 15th, 2008.

Additionally, if Mr. A had resigned from his position as a director of ABC Ltd. on March 1st, 2008, the proviso to s. He may be appointed as a director of DEF Ltd. since 274(1)(g) would not be attracted. The qualification of a director shall be the holding of at least 1,000 equity shares in the company, and such a director, if not already so qualified, shall have to obtain his qualification within a period of 30 days from the date of his appointment as a director, according to the articles of association of MKP Ltd., which was incorporated with an authorized share capital of 50 crores divided into 5 crore equity shares of 10 each. As a result, the condition mandating that he acquires his qualifying shares within 30 days of his appointment is null and invalid.

In this instance, the exclusion outlined in s. Due to ABC Ltd.'s compliance with both topics (annual returns and annual accounts for three consecutive financial years), 274(1)(g)(A) does not apply. The condition also stipulates that he must own at least 1,000 stock shares worth $10 apiece. This equals 10,000 while s. 270(3) limits the nominal value of the qualifying shares to 5000 or, if it exceeds 5000, the notional value of one share. Example: Mr. A has sought to the court to be declared insolvent since his enormous personal obligations considerably outweigh his assets and properties. His case is still pending. He is ineligible to be named a corporate director. Example: Mr. B was sentenced to eight weeks in jail for misappropriation of money after being caught red-handed shoplifting two years earlier. He is not prohibited from serving as a director of a firm under the provisions of S. 274(1)(d) does not apply. Example: Mr. C, a former bank executive, was given a one-year jail term after being found guilty of embezzling money by a court eight years ago. He is unable to serve as a director of a firm under s. 274(1)(d) does not apply. An example is Mr. D, a director of DLT Ltd., which has not submitted its annual reports for the AGMs conducted in 2005, 2006, and 2007. Under s. he may be chosen to serve as a director of any other corporation. DLT Ltd.'s inability to comply with 274(1)(g) relates to yearly returns rather than the submission of annual accounts.The rules outlined in s. The following situations exclude a director from Section 274's disqualification provisions:

(i) The special directors appointed to a company's board of directors in accordance with the 1985 Sick Industrial Companies (Special Provision) Act;

(ii) The nominated directors chosen by public financial institutions and businesses created by Special Acts of Parliament, such as I.D.B.I., L.I.C., and U.T.I., to serve on a company's board of directors.

(iii) The nominated directors for a banking firm that the Central or State Government appoints.

**Validity of Directors' Acts (Section 290)**

According to Section 290, a director's actions are legal even if it is later determined that his appointment was void due to a flaw or disqualification, or if it was terminated according to a provision of the Act or the articles. People doing business with the corporation, such as lenders, suppliers, and buyers of shares and debentures, are protected under Section 290. So, if a party enters into a contract with a corporation via its director and is unaware of any irregularities, if any, in the selection of the director, the party may presume that the director's actions are lawful. The terms of Section 290, however, will not apply or the Acts would not be lawful where:

(i) His appointment is unauthorized, or there isn't one at all.

(ii) Despite being aware that his tenure has come to an end, he keeps working.

(iii) He was aware that his appointment was flawed from the start.

(iv) He performed his duties as a manager, managing director, or secretary.

(v) His behavior violates the company's rules.

(vi) In cases where the minimum number of directors is not met.

(vii) The third party was informed of his appointment's flaw.

**Selection of Directors**

The following individuals are responsible for choosing directors:

1. Clause 64 (A) and Section 254 apply to subscribers to the memoranda.
2. Ss. 255–57, 263-265, and Company in General Meeting;
3. 260, 262, and 313 refer to the board of directors.
4. Sections 408 for the Central Government and 255 for Third Parties.

**Choosing the First Directors**

The articles of a business often include a list of the original directors. However, the articles may provide the subscribers, or a majority of them, the authority to appoint the directors instead of appointing the first directors. Where the appointment is to be made by the majority of subscribers, the appointment must be approved by a majority of the subscribers, not only the quorum required under the articles. Clause 64 of A in Schedule I to the Act gives the subscribers, or a majority of them, the authority to choose the first directors in the absence of any articles or in the event that the articles do not designate them or provide the subscribers any such authority. The subscribers to the memorandum who are individuals are further considered to be the first directors of the company until the directors are duly appointed at a general meeting of the company in accordance with the provisions of s.255 if the articles neither name them nor contain a provision for their appointment by the subscribers and A is excluded.

**Selection of Future Directors**

Three alternative plans for the board of directors of a public business or a private firm that is a subsidiary of a public company are provided in Sections 255 and 265 of the Code. At least two-thirds of the total number of directors must be individuals whose term of office is subject to determination by retirement by rotation (s.255); alternatively, at least two-thirds of the directors may be appointed in accordance with the principle of proportional representation, by a single transferable vote, a system of cumulative voting, or in any other manner, and shall serve as directors for a term of three years. Unless otherwise specified in the articles, the company's general meeting shall also appoint the other directors in (ii) and (iii) as well as all other directors of a pure private company. As a result, a firm may have both retiring and non-retiring directors. The directors' retirement options are shown in s. 256 or after the three-year waiting period specified in s. 265. As a result, each firm should have a board that has been properly appointed in compliance with s. 255. In the case of a company limited by shares, after the distribution of shares, and in the case of any other business, following formation, a general meeting is called by the "first" directors with the express goal of electing directors.

**Limitations on the Nomination of Directors**

According to Section 266, a person cannot be listed as a director by the articles, in the prospectus, or in a statement in place of a prospectus unless, prior to registration of the articles, publishing of the prospectus, or filing of the statement in lieu of a prospectus, the following conditions are met: Written authorization to serve as such director, which was signed and submitted with the registrar; and either:

(i) if applicable, signed the memorandum for his qualifying shares;

(ii) purchased or agreed to purchase his qualifying shares from the firm, if any, or

(iii) signed and submitted a written commitment with the registrar promising to acquire his qualifying shares from the firm and pay for them.

(iv) Made an affidavit stating that his qualifying shares are registered in his name and submitted it with the registrar.

What is not covered by this section

1. A business without share capital; a private business;

2. A publicly traded corporation that began as a private company;

3. A company's prospectus published after the lapse of a year from the day it was permitted to open for business.

## CONCLUSION

In conclusion, A crucial aspect of corporate governance is how directors are qualified and disqualified. Disqualifications prevent unsuitable people from obtaining directorship roles whereas director qualifications support efficient decision-making, accountability, and shareholder protection. To improve corporate governance procedures and support sustainable company growth, organizations, regulatory bodies, and stakeholders should give priority to the appointment of competent directors, implement disqualification laws, and encourage transparency and ongoing professional development. Directors must participate in continuing professional development and training programs to advance their skills and maintain their effectiveness. To properly carry out their tasks and obligations, directors should keep up with market developments, legislative changes, and developing governance practices.

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# CHAPTER 20

# MODES OF APPOINTMENTS FOR DIRECTORS: AN ASSESSMENT

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**ABSTRACT**:

The various modes of appointment for directors in the context of corporate governance and board composition. The appointment of directors is a critical aspect of ensuring effective leadership and governance within a company. This paper explores the different modes of appointment, including appointment by shareholders, appointment by the board, and appointment by third parties. It analyzes the implications, advantages, and challenges associated with each mode of appointment. Additionally, it discusses the legal and regulatory considerations, such as disclosure requirements and shareholder approval, that may apply to director appointments. Through a comprehensive analysis of company law, regulatory frameworks, and case studies, this paper sheds light on the significance of different modes of appointment for directors in promoting board diversity, independence, and accountability.

**KEYWORDS**:

Election, Ex-Officio, Government Appointment, Independent Director Appointment, Self-Nomination, Special Resolution, Statutory Appointment.

## INTRODUCTION

The Company's Act does not specify how directors are chosen; instead, this is up to the articles of incorporation of the businesses. Typically, members vote for directors at the company's annual general meeting. A provides provision for the nomination of directors and includes default articles. The default position in A will thus apply unless A is specifically prohibited by the company's articles, otherwise the company's articles will allow for the selection of directors. A company will not have to use its articles or depend on A to provide for the appointment of directors, unless the company decides to provide for a different form of appointment, thanks to the stated provision in the Companies Act that simplifies procedures. The steering committee heard from the industry that, in reality, A is often left out of the firms' articles because it is deemed not to be beneficial [1], [2].

The present method in Singapore, which does not specify in law how directors are selected, is comparable to the stance in the UK and Hong Kong. The Steering Committee debated whether the Australian and New Zealand models for the appointment of directors should be explicitly spelled out in the Companies Act. The Steering Committee suggests that the Companies Act include a specific clause stating that, unless the articles of incorporation provide otherwise, a company may appoint a director by ordinary resolution voted at a general meeting for the sake of clarity and simplicity. In order to allow firms flexibility, the form of appointment is subject to the company's articles [3], [4].

This strategy is similar to that used in Australia, where the replaceable rules in the Australia Corporations Act 20017 govern how directors are appointed. Additionally, it is compatible with the method under the New Zealand Companies Act 1993, where section 153(2) specifies that successive directors should be appointed by ordinary resolution, unless otherwise provided by the company's charter. The majority of participants in the focus group discussions endorsed including such an explicit clause on the selection of directors in the

Companies Act. The general meeting has the authority to nominate directors, subject to any provisions in the articles to the contrary, notwithstanding the fact that there is little disagreement in practice over how directors are chosen [5], [6].

**Executive Compensation**

According to Section 198, the total managerial compensation paid by a public company or a private company to its directors or manager for any fiscal year may not exceed 11% of that company's net profit for that fiscal year, with the 11% cap being calculated in accordance with Sections 349 and 359's guidelines. It excludes the expenses paid by directors to attend Board meetings [7], [8].

The word "remuneration" is defined in the section 198 explanation. According to it, "remuneration" includes the following for the purposes of Ss. 309, 310, 311, 381 and 387: 1. Any expenditure incurred by the company in providing rent-free housing, or any other benefit or amenity in respect of accommodation free of charge; 2. Any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the aforesaid persons; 3. Any ex-officio compensation;

Three different types of directors are envisioned under Section 309: (i) managing directors; (ii) full-time directors; and (iii) directors who are only directors. Additionally, Section 309 states that the pay shall be decided by the articles, by resolution, or, if the articles so demand, by a special resolution, approved by the company in general meeting, subject to the general rules of Section 198, dealing with the overall management salary. If the services were of a professional character and the director, in the view of the Central Government, holds the necessary credentials for the practice of the profession, no compensation paid for services in any other capacity must be included. A director who is neither a managing director nor a full-time employee of the firm is eligible to receive compensation. If the Central Government approves, payments may be made (a) by monthly, quarterly, or yearly payments; (b) by commission if the corporation approves payments in a special resolution; or (c) by both.

However, in either of the aforementioned scenarios, the compensation paid to such a director, or where there are multiple such directors, shall not exceed: (i) 1% of the company's net profits, if the company has a managing or full-time director or manager; (ii) 3% of the company's net profits in any other scenario. However, the company's general meeting may, with the Central Government's consent, authorize the payment of a commission at a rate greater than 1%, or as the situation may need, 3% of its net earnings [9], [10].

As long as it is permitted under the articles, each director is entitled to earn a sitting fee for each meeting of the Board or a committee thereof. A full-time director or managing director may receive compensation in the form of a monthly payment, a set percentage of the company's net profits, or a combination of the two methods, provided that, absent the approval of the Central Government, such compensation does not exceed 5% of the company's net profits for a single such director and 10% for all such directors combined. Additionally, a management or full-time director who receives a commission from the business is not permitted to take compensation from any of the firm's subsidiaries.

If a director receives compensation that is greater than the aforementioned limits, directly or indirectly, without the Central Government's approval, he must reimburse the company for the excess money and hold it in trust for the company up until the refund is made. Unless specifically authorized by the Central Government, the corporation is not entitled to forgo the collection of any refundable amounts. Private companies are exempt from the rules of Section 309 unless they are subsidiaries of public companies.

**Increasing Compensation**

According to Section 310, no increase in a director's compensation, including a managing or whole-time director, granted or provided by an amendment to his term of appointment that would increase the amount payable to him, whether directly or indirectly, would be effective unless the Central Government had approved it. However, if the increase in compensation is provided in line with the requirements listed in Schedule XIII, no Central Government permission is necessary. Additionally, if the increase in compensation is just a charge for each meeting of the Board or a committee of the Board that such director attends and the amount of the fee after such increase does not exceed such sum as may be stipulated, no permission of the Central Government is required. The differential scale of sitting fees has been established by the central government in accordance with the paid-up capital of the enterprises.

Remuneration Payable to a Manager Section 387 states that he may get compensation in the form of a monthly payment, a certain percentage of the company's "net profits," or a combination of the two. However, unless with the Central Government's agreement, such compensation cannot total more than 5% of net income.

**Managerial Compensation in Relation to Calendar XIII**

In accordance with the guidelines in Schedule XIII, a public firm may designate its management staff and determine their compensation without first obtaining the Central Government's consent. Schedule XIII stipulates the following:

1. Remuneration Payable by Companies Having Profits: Subject to the provisions of Sections 198 and 309, a company having profits in a financial year may pay any remuneration, by way of salary, dearness allowance, perquisites, commission, and other allowances, which shall not exceed 5% of its net profits for one such managerial person, or 10% for all of them together if there are more than one such managerial person.

2. Remuneration paid by companies with no profits or insufficient profits: If a company has no profits or insufficient profits in any fiscal year during the managerial person's tenure, it may pay remuneration to a managerial person in the form of a salary, dearness allowance, perquisites, and other benefits up to a maximum of $24,000 per year or $20,000 per month.

Effective capital is defined as the total of paid-up share capital (excluding share application money or advances against shares), any amount currently to the credit of the share premium account, reserves and surplus (excluding the revaluation reserve), long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantees, etc. and other short-term arran. The maximum sitting fee that may be charged to a director for each meeting of the Board of Directors or a committee thereof is currently set at $5,000. If it falls within the established boundaries, any increase in the sitting fee payable to a director should not need prior permission from the Central Government.

## DISCUSSION

**Disclosure**

Disclosure of interest by directors, Section 299 provides as follows:

1. At the board meeting when the contract is addressed, a director of a business who is in any way interested in or worried about a contract or agreement made by or on behalf of the company is required to declare such interest or concern. However, if the director did not have

an interest in the contract at the time of the meeting, he or she must disclose it at the subsequent board meeting.

2. However, it is sufficient to declare or disclose an interest if a director notifies the board in general that he is a director or member of a certain business or firm and should be considered as interested in any deal that is made with. However, such a broad notice must be sent only once a fiscal year, and that too at the board meeting.

3. A director who violates the aforementioned conditions is subject to a fine of up to $50,000.

4. Nevertheless, there is a disclaimer. The rules of Section 299 do not apply to any agreements or contracts between two businesses if a director or director of one business has an interest in the other that does not exceed two percent of the other's paid-up share capital. The legal precept that an agent cannot place himself in a situation where his duty and his interest are at odds with one another is upheld by Section 299 of the Code.

**Interested Directors to abstain from voting or taking part in board meetings**

According to Section 300, a director who has an interest in a specific contract or arrangement cannot vote on it or participate in discussions about it. If he casts a ballot, it will be invalid, and his attendance won't count toward the quorum. These limitations do not, however, apply to:A contract of indemnity against any loss which any director(s) may suffer as a result of becoming or being a surety or sureties for the company; 1. A private company which is neither a subsidiary nor a holding company of a public company; 2. A private subsidiary company in respect of contracts or arrangements entered into by it with the holding company; 3. A director faces a punishment of up to $50,000 if they willfully violate Section 300's rules.

**Register of Contracts Involving Directors**

Section 301 stipulates the following in order to guarantee that the rules of sections 297-300 are followed:

1. Each company is required to maintain one or more registers in which information about any contracts or agreements in which the directors and their family have an interest as well as information about the enterprises and businesses in which the directors have an interest as partners, members, or directors must be separately recorded. The information that must be recorded in the register includes the following: (i) the date of the contract or arrangement; (ii) the names of the parties thereto; (iii) the contract's main terms and conditions; (iv) the date the contract was presented to the board, where it must be presented; (v) the names of the directors who voted in favor of and against the contract or arrangement; and (vi) the names of directors who abstained.

2. Where the board's permission is necessary, the aforementioned information must be placed in the register within seven days after the board's approval.

If there is any other contract or arrangement, the information must be entered into the register within seven days of receiving it at the company's registered office or, if later, within 30 days of the date of the contract or arrangement, whichever comes first. Before the next board meeting, the register must be set up, and all of the directors present at the meeting must sign it.

3. The aforementioned record should also include the names of the businesses and corporate bodies to whom each director of the company has given notice in accordance with section 299 in regard to each director of the company.

4. Contracts for the sale, purchase, or supply of goods, etc., with a value of no more than $1,000 per year have been exempted, along with agreements between banking companies for the regular course of business bill collection and transactions between banking and insurance companies and any director, relative, partner, etc.

5. If any of the aforementioned conditions of Section 301 are not followed, the Company and any of its officers who is in default will each be subject to a punishment that might reach $5,000.

6. The aforementioned register must be maintained at the company's registered office and is subject to public examination. Any company member may request copies of any extracts made from the register. The requirements of Section 163 that pertain to the Register of Members also apply to the Register of Directors.

**Disclosure of Interest in Contract Appointment of Directors Managing Director or manager**

According to Section 302, the company must distribute an abstract of the matter and the director's interest therein to its members within 21 days of the date of the contract or its variation if it appoints or modifies the terms of appointment of a manager, managing director, or whole-time director and any director is directly or indirectly interested in the matter. These agreements must be maintained on file and accessible to members at the company's registered office. The aforementioned clauses will apply to any appointment or modification made pursuant to a board resolution. If there is a failure to comply with these regulations, the corporation and any officer who is at fault are subject to a punishment that might reach $10,000.

Additionally, any contracts that a business enters into for the appointment of a manager or managing director must be retained at the company's registered office and available for review by the members of the company. Any member may request copies of the register's contents and extracts from it. The requirements of Section 163 that apply to the Register of Members also apply in this situation.

**Directors of service contracts may not hold positions of profit or office**

The directors and their associates are subject to specific limitations when it comes to holding a position of profit or office inside a corporation under Section 314. Here is a list of the limitations that have been made available:

1. According to Section 314(1)(a), a director of a company may not occupy an office or position of profit (bearing a salary) within that business or a subsidiary without the company's express permission via a special resolution. However, passing the special resolution at the first general meeting conducted after the appointment should be sufficient.

2. Paragraph 314(1)(b): The following people are prohibited from holding any positions of profit with a total monthly salary above the amount that may be specified (currently $10,000 per month), without a specific decision and consent from the central government:

A private corporation in which such a director or manager, or relative of either, is a director or member; a partner or related of a director or management; a firm in which such director or manager, or relative of either, is a partner. Once again, a special resolution may be approved at the first general assembly after the appointment. However, if the aforementioned appointment is made without the director's knowledge, the firm may gain its approval at the

aforementioned general meeting or within three months of the appointment date, whichever comes first.

However, if the compensation received from such subsidiary in respect of such office or place of profit is paid over to the company or its holding company, a director or any of his associates may be appointed as managing director, manager, banker, or trustee for the company's debenture holders without the approval of a special resolution. Except in cases where an appointment on a time scale has already been approved by the special resolution, a special resolution is required for the aforementioned appointment of a director or his associates not only at the time of the initial appointment but also for every subsequent appointment with a higher salary that is not covered by the special resolution. It should be noted that the aforementioned restrictions do not apply when a director's relative or a partner in a firm where the relative works holds any office or profit-making position under the company or a subsidiary thereof and was appointed to that position prior to the director's appointment as a director of this company.

3. Paragraph 314(1)(B): No director, manager, or relative of either shall hold an office or place of profit in the company carrying a total monthly remuneration of less than such sum as may be prescribed (currently, 50,000 per month) without first passing a special resolution and receiving the approval of the board of directors. This includes: (i) no partner, firm in which the director, manager, or relative of either is a partner; (ii) no private company in which the director, manager, or relative of either is a director

4. Paragraph 314(2)(C): If any director or his associate holds an office or place of profit in violation of the aforementioned provisions, then (i) he shall be deemed to have vacated such office or place of profits as such on and from the date immediately following the date of the general meeting; and (ii) he shall be responsible for returning to the company any compensation received or the financial equivalent of the perquisites or advantage enjoyed by him.

Except with the Central Government's permission, the corporation cannot waive the recovery of any amount that is refundable to it in the manner described above. These clauses won't have an impact on the director's position as a whole, and he won't be required to repay any compensation he received while serving as a director.

For example, if a commission or monthly salary is paid to all the directors, it won't be refundable; however, if a director receives something in addition to that, he'll be required to pay it to the company. Accordingly, an office and place of profit is to be deemed to be one of profit for the purposes of this section if it is held by a director, who receives compensation from the company in addition to his or her salary as a director, or if it is held by any other person, firm, private company, or body corporate, who receives compensation from the company in the form of a salary, fees, commission, or perquisites, such as the right to occupy any property rent-free as  A punishment of 5,000 and an additional fine of 500 for each day the violation persists throughout the time covered by Section 629 (A) are also provided.

Every person, firm, private company, or other corporate body proposed for appointment to an office or place of profit to which this section applies is required by section 314 (2A) to declare in writing, either prior to or at the time of appointment, whether he or it is or is not connected to any director of the company in any of the ways listed in section 314 (1). The aforementioned prohibitions do not apply to a person who is appointed by the Central Government under Section 408 as a director of the firm while holding any post with a profit-making nature.

## CONCLUSION

In conclusion, the methods used to nominate directors have a big impact on how well the board governs the company. Transparency, accountability, and diversity should be given top priority throughout the selection process, whether executives are chosen by shareholders, the board, or outside parties. Companies should take into account the unique requirements of their company, adhere to the law, and work to create a board composition that encourages independent thought, experience, and a steadfast commitment to shareholder interests. Regardless of the method of nomination, a diverse and well-balanced board is essential for good corporate governance. For effective decision-making, risk management, and stakeholder engagement, boards benefit from a variety of talents, knowledge, backgrounds, and viewpoints.

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# CHAPTER 21

# A REVIEW STUDY ONREMOVAL PROCESS FOR DIRECTORS

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**ABSTRACT**:

The process and implications of removing directors in the context of corporate governance and board dynamics. The removal of directors is a significant decision that can have a profound impact on the leadership and governance of a company. This paper explores the legal and procedural aspects of director removal, including the grounds for removal, the authority responsible for initiating the process, and the steps involved in the removal process. It analyzes the reasons and implications for director removal, such as conflicts of interest, underperformance, breach of fiduciary duties, or loss of shareholder confidence. Through a comprehensive analysis of company law, regulatory frameworks, and case studies, this paper sheds light on the significance of the removal process in maintaining effective corporate governance and safeguarding shareholder interests.

**KEYWORDS**:

Board Resolution, Disqualification, Extraordinary General Meeting (EGM), Impeachment, Misconduct, Notice of Removal.

## INTRODUCTION

### Removal by Shareholders

According to Section 284, a business may dismiss a director before the end of his term of office by ordinary resolution voted in general meeting after specific notice. The corporation is required to provide a copy of the special notice to the affected director as soon as it is received, allowing him to respond. If he submits a written representation and asks that the company tell the members of it, the business must, unless it receives the representation too late to convey to the members, include a statement to that effect in any notice of the resolution it sends to the members. Every company member who receives notice of the meeting should also get a copy of the representation. If the letter is not sent as directed, the corporation must read it aloud at the meeting at the request of the director in question. The director has the right to speak at the meeting about the resolution. The reason(s) for the director's dismissal must be stated in the special notification provided by the member(s).

However, if the company or any other party claiming to be wronged has made an application to CLB to prevent such circulation or reading out on the grounds that such circulation or reading out would amount to an improper conflict of interest, then the copy of the representation of the director sought to be removed need not be circulated, nor shall the concerned director be permitted the right to have the representation read out in the general meeting (where the same was not circulated earlier due to late receipt). The person nominated to replace the vacancy left by the removal of a director may only take office for the remaining term of the removed director if it is filled at the same meeting. The board of directors may replace the position as if it were a casual vacancy in line with s. 262 if the vacancy is not filled by the company at the annual meeting, but it cannot appoint the ousted director [1], [2].

A dismissed director may seek damages for the termination of any other office as a result of the removal or compensation for the loss of their position as a director, or they may elect to

retain the other office [3], [4]. However, the company's general meeting cannot dismiss the following directors: a director chosen by the Central Government in accordance with Section 408.

On April 1, 1952, a director of a private corporation holds a life appointment. a director chosen in accordance with section 265's proportionate representation approach. a director appointed under the 1951 Industries (Development and Regulation) Act by the Central Government. a director chosen in accordance with the 1985 Sick Industrial Companies (Special Provisions) Act. a director chosen by financial institutions in accordance with their legal authority. a director nomination. a director chosen by the CLB (section 402).

It should be noted that Section 284 is not all-inclusive as it states that nothing in Section 284 shall be construed as limiting any other ability to remove a director that may exist. A director's dismissal may be outlined in the company's bylaws [5], [6]. Therefore, it should be recognized that the authority to remove a director is neither unfettered or absolute. Example: At a meeting, the shareholders of X Co. Ltd. wanted to fire a director. The concerned director said that since no particular notice was provided to approve a resolution to remove him, it was impossible to do this. The shareholders' argument that the special notice's distribution and the director's ability to make a representation were just formalities was unpersuasive since he was deprived of his right to do so. The director's argument was accepted as true. An illustration would be if, in the aforementioned case, a shareholder who owned ten equity shares worth $10 each sent a special notice to remove the director without providing any justification [7], [8]. Even in this scenario, the director cannot be removed since the concerned director has the right to submit a written submission against his removal, therefore the revelation of the reason for removal is a question of content rather than form. If he doesn't know the grounds for his expulsion, how can he make a representation?

**Central Government's removal**

The provisions of Sections 203 and 204 forbid certain people from holding office or being nominated as directors and only allow for their removal if they have been found guilty of crimes involving moral turpitude. In each of those situations, a court conviction or judgment of guilt is required in order to enact vacation of office. In a criminal prosecution, strict evidence of guilt is necessary, and often, these people are let off the hook despite their transgressions [9], [10]. The Central Government will be able to quickly take action against those implicated in fraud cases, etc. thanks to the CLB's conclusions. Sections 388B through 388E have been added to the Act for this reason. The Central Government is empowered to report any management individual to the CLB under Section 388B. The power can be exercised where, in the opinion of the Central Government, there are circumstances suggesting: 1. At the personal level, that any person concerned in the conduct and management of the affairs of a company is or has been guilty of fraud, misfeasance, persistent negligence of default in carrying out his obligations and functions under the law, or breach of trust in connection therewith; or 2. At the company level. that the business of the company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or 3. At the industry level, that the business of the company is or has been conducted or managed by such person in a manner which is likely to cause or has in fact caused, serious injury or damage to the interest of trade, industry or business to which such company pertains; or 4. At the community level, that the business of the company is or has been conducted and managed by such person with an intent to defraud its creditors, members, or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

The CLB may be referred to by stating a case against the person in question and requesting that it look into the matter and make a determination regarding whether or not the person is qualified to hold the office of director or any other office related to the conduct and management of any company. The individual against whom the matter is stated and referred should be included as a respondent to the application, and the Central Government should explain its case in the form of an application submitted to the CLB. The application must include a brief summary of any relevant facts and documentation that the Central Government may deem important for the CLB's investigation. Similar to a complaint in a lawsuit brought against the Central Government under the Code of Civil Procedure, the application must be signed and confirmed. The CLB will then hear the respondent's case following that. The CLB may, at any time during the proceedings, permit the Central Government to modify or amend the application in a way and under conditions that may be just, and all such modifications and amendments shall be made in order to address the inquiry's primary inquiry (s.388B).

If the CLB determines that it is necessary for the members or creditors of the company during the course of the case, it may, either on the request of the Central Government or on its own initiative, direct that the respondent not perform any of the functions of his office until further orders and appoint another sui person in his place to perform the respondent's functions. This individual will be considered as a public servant within the meaning of section 21 of the Indian Penal Code (section 388C), since they have been temporarily appointed to perform the respondent's responsibilities.

After the matter has been heard, the CLB must record its conclusions, clearly noting whether or not the respondent is qualified to occupy the office of director or any other position related to the conduct and administration of any firm (s.388-D). Despite any other Act requirements, the Central Government may issue an order removing the delinquent responder from his position based on the aforementioned findings (section 388E(1)).

A person must be given a fair chance to contest an order issued under Section 388E before one may be made against them. However, no subject that has previously been resolved by the CLB may be brought up by such a person before the Central Government (section 388E(2) and its proviso). The guilty individual will not be permitted to hold office for a period of five years from the date of the order of removal, and he will not be compensated for the loss of his position as a consequence of the removal. However, the Central Government may relax the time restriction with the prior approval of the CLB, and the Central Government may subsequently permit such a person to hold the office of a director or any other office related to the conduct and management of the company's affairs even before the period of five years has passed. Upon removal of the individual, the corporation may, with the prior consent of the Central Government, nominate a new individual to that position in line with the Act's requirements.

## DISCUSSION

### Removal by Company Law Board

When an application is submitted to it for the prevention of oppression and mismanagement under Ss., Section 402(b) gives the CLB the authority to fire selects managerial staff members. 397 and 398. Any agreement between the company and the managing director, any other director, or the manager may be terminated, set aside, or modified under this provision if the CLB determines that the relief should be given. When a managerial employee's appointment is so terminated or set aside, he is no longer permitted to work for the company in any managerial capacity for a period of five years following the date of the order

terminating or setting aside his contract with the company. He also is not permitted to file a lawsuit against the company seeking damages or compensation for the loss of his position. Additionally, the ousted director will not be eligible to receive any kind of reimbursement from the business for the loss of his position. A managing director is hired by a private corporation for a salary of 10,000 per month. The argument against this is that a director cannot be nominated to a position of profit. Advise.

**Director has retired**

The directors who are scheduled to retire by rotation leave their positions no later than the last day that an annual general meeting might have been conducted in accordance with s. 166, therefore the directors cannot claim that they may continue beyond the day on which the meeting was supposed to be convened if it is not held. The reason for this is that since it is the directors' responsibility to call the AGM within the allotted time, they cannot be permitted to take advantage of their own default and use it as a justification for staying in office for an extended period of time.

**A Director other than a Retiring Director is Appointed**

The process for appointing someone other than the retiring director is outlined in Section 257. Any candidate for a directorship, whether a company member or not, must notify the company of his intention to do so by giving it 14 days' notice prior to the meeting. The company must then notify the members of the candidate's intentions no later than seven days before the meeting, either through individual notices to each member or by publication of an advertisement in at least two local newspapers, one of which must be published in the area where the company's registered office is located. Additionally, if the candidate is chosen, the 500 that was deposited by the member who intended to suggest him as a director will be returned to that member or, as the case may be, to the other member. If that individual is not chosen to serve as a director, he or she, depending on the situation, will not be eligible for a 500 refund, and the money placed will be lost to the firm. Additionally, s.264 mandates that every individual nominated for the position of director sign and submit his or her agreement to serve in that capacity to the business before filing it with the registrar within 30 days of the appointment. Example: The BOD of XYZ Ltd. selects Mr. A as a director to fill the void left by Mr. B's departure. Mr. A is now required to resign from his position at the upcoming AGM. He may be reappointed as a director by the corporation, who will regard him as a retired director. According to s., the business cannot regard A as a retired director. 257. He cannot thus be considered to have been reappointed. The steps outlined in s. It will be necessary to follow 257 for his appointment.

**Board of Directors' Authority**

The Board of Directors' general powers are outlined in Section 291. However, the Board cannot exercise any power or perform any act or thing that is directed or required, whether by this or any other Act, by the memorandum or articles of the company or otherwise, to be performed by the company in general meeting. This is because the Board of Directors of a company is authorized to exercise and perform all the acts and things that the company is authorized to perform and execute. The provisions of this or any other Act, the company's memorandum or articles, or any regulations that are not inconsistent with those provisions and are duly made thereunder, including regulations adopted by the company's general meeting, must be followed by the board when exercising any such power or performing any such act or thing.

The Board is therefore permitted to wield all corporate authority and to take all corporate actions. However, the Board's use of these powers must adhere to the terms of the Companies Act or any other Act as well as the company's memorandum, articles, and general meeting resolutions. As a result, the board's authority may be limited by a general meeting by an amendment to the articles. However, the meeting cannot invalidate any action taken by the board that was done so in good faith, with the exception of the following situations: (1) where the directors are unable or unwilling to act; (2) where the directors act in total disregard of the company's interests; and (3) when the Board has become incompetent to act, such as when all of the directors who make up the Board are involved in a deal or when none of the directors were duly appointed.

**The Way in Which the Board Exercises Its Powers**

According to Section 292, a corporation's board of directors may act on behalf of the corporation solely via resolutions approved at board meetings. The following authorities include:

(i) The authority to contact shareholders over unpaid dividends on their shares;

(ii) The ability to repurchase shares under s. 77A;

the capability of issuing debentures;

(iv) The ability to borrow money without using debentures;

(v) The ability to invest corporate money (subject to sections 293 and 372A);

vi) The capability to provide loans. in accordance with articles 293 and 372 A.

The Board may, however, provide the authority set out in sections (iv), (v), and (vi) to any committee of directors, the managing director, the manager, or any other key officer of the firm by resolution adopted at a meeting, subject to whatever limitations the Board may specify. In addition to the rights listed in section 292, there are several more powers that can only be used at Board meetings. Which are:

1. the authority to fill temporary Board vacancies (section 262);

2. approving a deal in which a director has a stake;

3. the authority to suggest the amount of dividend that the firm should declare at the annual general meeting, subject to shareholder approval.

When exercising the following authorities, each director present and eligible to vote must agree in addition to the exercise taking place at the Board meeting:

1. the authority to name a managing director or manager who is already a managing director or management of another firm as managing director or manager (Sections 316 and 386).

2. the ability to purchase shares and debentures from any other corporate entity (Section 372).

Limitations on Directors' Authority

According to Section 293, the following rights cannot be used by the board of directors of a public business or a private firm that is a subsidiary of a public company without the approval of the shareholders in general meeting:

1. Sell, lease, or otherwise dispose of the whole or practically the entirety of the firm's undertaking, or if the company owns several undertakings, the entirety or substantially the entirety of each of those undertakings.

However, a business whose primary activity is the sale or rental of real estate is exempt from this prohibition.

2. Except in the event of a renewal or a continuation of an advance provided by a banking company to its director in the regular course of business, remit or grant time for the repayment of any debt owed by a director.

3. The amount of compensation obtained by the firm in relation to the forced purchase of any fixed assets of the company should be invested, other than in trust securities.

4. Borrow money that is more than the sum of the company's paid-up capital plus its free reserves. Temporary loans taken from the company's bankers in the regular course of business are not included in the definition of "borrowing." 'Free reserves' refers to reserves that are not set aside for any particular use. Additionally, every resolution adopted by the company's general meeting must state the maximum sum that the board may borrow in monetary terms. The term "temporary loans" also refers to short-term, cash credit arrangements, the discounting of bills, and the issuance of other short-term loans with a seasonal theme that are repayable immediately or within six months of the loan's date, but excludes loans raised to fund capital expenditures.

5. Any sum above $50,000 or 5% of the company's average net profit over the previous three fiscal years, whichever is larger, may be contributed to chari and other funds that are not specifically related to the company's operations or the welfare of its workers in any calendar year. The aforementioned restrictions do not apply to donations made to the National Defense Fund or any other fund authorized by the Central Government for national defense purposes. Any donation may be made without needing the approval of the company's general meeting. In the company's profit and loss report for the year in which the contribution was made, the amount donated to these funds must be declared.

Companies are not explicitly permitted to borrow money under the Companies Act. As a result, the majority of businesses explicitly include such borrowing capabilities in the agreement. In such a scenario, when the memorandum authorizes the corporation to borrow, the articles specify how and who would use these rights. Additionally, it may establish the maximum amount that the business may borrow. As of April 1, 2008, XYZ Ltd.'s paid-up share capital and free reserves totaled 100 crore. The company's shareholders authorized the board of directors to borrow funds "exceeding the paid-up share capital and free reserves of the company, to the extent required by the board of directors," in a resolution passed at their general meeting on April 4, 2008. The board subsequently borrowed funds totaling 130 crores, including 20 crore as a short-term loan and 25 crore as a temporary loan for financing the construction of a building for the company. Because (i) the borrowing exceeds paid-up capital and free reserves, even after subtracting a short-term loan of 20 crore, and assuming that the loan was received from the company's bankers in the normal course of business, the borrowing authorized by the board is in violation of the Act's requirements. (ii) The general meeting resolution authorizing the board to borrow more money than its paid-up capital and free reserves without defining the maximum amount the board may borrow. Example: If the company's paid-up share capital and free reserves were increased to 150 crore and the board borrowed 140 crores, neither of which included any short-term loans nor temporary loans for financing the construction of a building for the company, the situation would be different.

There has been no violation of the Act's provision since the board was only able to raise 140 crores instead of the maximum 150 crores.

**Director Responsibilities and Good Corporate Governance**

Directors' responsibilities may be broken down into two categories: (1) Statutory obligations; and (2) General responsibilities. The responsibilities and commitments imposed by the Companies Act are known as statutory obligations. These have already been addressed in the proper forums. Important ones include:

1. Return of Allotments must be filed: Section 75 requires a firm to submit an allotment return to the Registrar within 30 days, including the required information. Directors will be held accountable as "officers in default" for failing to submit this return. a fee of up to

500 may be charged every day as long as the default persists.

2. It is against the law for a business to issue irredeemable preferred shares or shares that may be redeemed after 10 years, according to Section 80 of the Companies Act. Directors who make any such issuance may be subject to a 1,000 fine and be deemed "officers in default."

3. Disclosure of Interest: A director must inform the board of his interest in a transaction involving the firm. At the first Board meeting after he expresses interest, the disclosure must be made. This is due to the fact that a director has a fiduciary responsibility to the business and as such, he cannot put himself in a situation where his obligations clash with his personal interests. Interests should be managed so as to prevent conflicts with the director's obligations to the firm.

However, take note that the Companies Act does not prevent a firm from concluding a deal in which a director has a stake. Only that such an interest be stated is necessary. A director who is interested in a topic shouldn't participate in the conversation about it. His attendance will not count toward the quorum requirement. On that issue, he won't cast a vote. If he casts a ballot, it will be invalid. When an interest is not disclosed, the contract becomes voidable rather than void. According to Venkatachalapathi v. Guntur Mills (AIR 1929 Mad 353), a formal disclosure is not required where the whole Board of Directors is aware of the facts. In one instance, the wife of a director advanced a loan, putting a lien on the company's property. The director even cast a vote on the issue without disclosing his conflict of interest. Later, the business filed a lawsuit to set aside the mortgage.

4. According to Section 319, any funds received by the directors from the transferee in connection with the transfer of the company's assets or commitments must be notified to the members of the company and authorized by the company in general meeting. If not, the directors must hold the money in trust for the firm. This money could be claimed as compensation for losing an office, but in reality, it can be due to a change in the company's ownership. However, s.321(3) protects it if it is a genuine payment of damages for a contract violation.

5. To disclose receiving compensation from share transferees: According to Section 320 of the Companies Act, if a director loses their position as a result of the transfer of all of the company's shares under certain circumstances, they are not entitled to any compensation from the transferee unless the company has first approved it in a general meeting. Any money received by the directors should be retained in trust for the shareholders who have sold their shares if the proposal is not accepted or the approval is not sought. In accordance with any agreement relating to any of the aforementioned transfers, Section 320 further states that any payments received by the directors from the transferee within a year of the transfer or within

two years of the transfer must be reported to the company unless the director can demonstrate that the payment is not in lieu of compensation for loss of office. In accordance with Section 321's additional provisions, any additional valuable consideration given to a retiring director or the price paid for his shares of the company is to be considered compensation and must be disclosed to the shareholders. Other legislative obligations include: attending Board meetings; calling and holding general meetings; preparing and presenting financial statements to the AGM; and making a declaration of solvency.

Following are the general responsibilities of directors:

1. The directors have a duty of good faith to act in the business's best interests. On the assumption that the firm will continue as a going concern, the interest of the company entails the interests of current and future members of the company.

A director shouldn't accrue any unreported gains. Additionally, he shouldn't leverage company possibilities for his personal gain. It was stated in Cook vs. Deeks (1916) AC 554 that "Men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interest which they are bound to protect and while ostensibly acting for the company, direct in their own favour business which should properly belong to the company they represent." In this case, the company had been offered a contract. Directors who controlled 3/4 of the voting shares decided that the firm had no interest in the contract and went on to join it on their own.

2. Duty of Care: A director has a duty to use caution while carrying out the tasks entrusted to him. However, he is only required to show the level of caution that a normal, reasonable guy would use in his own situation. "His (the director's) duties will depend upon the nature of the company's business, the manner in which the work of the company is distributed between the directors and other officials of the company," Justice Romer said in Re City Equi Fire Insurance Company. A director must use considerable expertise and care in carrying out these tasks. He does not, however, owe his company an obligation to exercise the greatest caution or care. In fact, he is not required to do his job with a higher level of expertise than what is logically anticipated of a person with his knowledge and experience. Therefore, it is possibly another way of saying that directors are not accountable for simple mistakes of judgment.

A clause in the company's articles of incorporation or in any agreement that limits the responsibility of the directors for carelessness, default, misfeasance, breach of duty, or breach of trust is invalid, according to Section 201. Even the directors cannot be protected from such responsibility by the firm. However, if a director has been cleared of such accusations, the firm may reimburse him for his legal expenses. A director may be held liable for negligence, default, breach of duty, misfeasance, or breach of trust, but if he acted honestly and reasonably and in light of all the circumstances, he ought fairly to be excused, the court may release him from liability entirely or in part on the terms it deems appropriate, according to Section 633.

3. Duty to Attend Board Meetings: The board of directors sometimes holds meetings during which they exercise a variety of corporate powers. Although a director is not required to attend every meeting, his office will immediately become empty if he misses three consecutive sessions without authorization or all meetings for a period of three months, whichever is longer.

4. The rule "delegatus non protest delegare" states that a delegate cannot further delegate, and as an agent, the director is bound by this maxim. A director must thus carry out his duties personally. However, a director may delegate in the following circumstances:

When allowed by the Companies Act or the firm's bylaws, some tasks may be transferred to other company authorities. Taking into account commercial needs.

Other responsibilities include calling statutory, annual, and extraordinary general meetings as needed by the company's shareholders, preparing and presenting a report on the company's operations at the AGM alongside the balance sheet and profit and loss statement, and making a declaration of solvency in the event of a member's voluntary winding up. The company's articles of incorporation typically set down the obligations of the directors. They must use reasonable care, honesty, good faith, skill, and diligence in carrying out their obligations. They are required to use a reasonable amount of competence and care in carrying out their obligations since they have a fiduciary relationship with the corporation and are in some ways both agents and trustees.

## CONCLUSION

In conclusion, the procedure of removing directors is a serious choice that should be carried out with caution and in accordance with the law. It works as a vehicle to promote good corporate governance practices, protect shareholder interests, and preserve strong business leadership. A fair and accountable removal process that contributes to the overall integrity and success of the organization must be ensured via the use of transparent processes, reasonable reasons for termination, and adherence to legal and regulatory standards. Corporate governance best practices, such as frequent board evaluations, performance reviews, and open lines of communication, may aid in identifying and resolving problems with underperformance or conflicts of interest before they become serious enough to call for director removal.

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# CHAPTER 22

# ANALYZING THE IMPORTANCE OF EFFECTIVE CORPORATE GOVERNANCE

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**ABSTRACT**:

The concept of corporate governance and its significance in the management and oversight of companies. Corporate governance refers to the system of rules, practices, and processes by which companies are directed and controlled. It encompasses the relationships between shareholders, the board of directors, management, and other stakeholders, and aims to promote transparency, accountability, ethical conduct, and long-term value creation. This paper examines the key components of corporate governance, including board composition, shareholder rights, executive compensation, risk management, and disclosure practices. It analyzes the importance of effective corporate governance in enhancing investor confidence, mitigating risks, and fostering sustainable business growth. Through a comprehensive analysis of corporate governance principles, regulatory frameworks, and case studies, this paper sheds light on the role and significance of corporate governance in promoting sound business practices and protecting the interests of stakeholders.

**KEYWORDS**:

Corporate Culture, Disclosure, Ethics, Executive Compensation, Financial Transparency, Independence.

## INTRODUCTION

Following the wave of corporate scandals that occurred in the middle of 2002including Enron, and Tyco, to mention a fewcorporate governance has become a hot subject in business. Although there has always been interest in corporate governance, the magnitude of the financial fallout from these scandals has eroded investor trust on both the institutional and individual levels and raised questions about the capacity and determination of private companies to safeguard their interests. The pressure on stock prices to decline, notably in the United States, was exacerbated by the crisis of confidence in the business sector. The S&P 500 plummeted 16% in the first half of 2002, while the heavily weighted NASDAQ fell 36%. After the U.S. government stepped in, new laws mandated that CEOs personally swear to the integrity of their companies' financial statements and provide results more rapidly. Corporate America boosted its degree of self-regulation at the same time [1], [2].

### Corporate Responsibility

Corporate governance refers to the collection of procedures, norms, rules, regulations, and institutions that influence how individuals lead, manage, or control a firm. The links between the various participants (the stakeholders) and the business objectives are also included in corporate governance. The shareholders, management, and board of directors are the main participants. Employees, vendors, clients, banks and other lenders, regulators, the environment, and the society at large are other stakeholders. A corporation's direction, management, and control are all impacted by a collection of procedures, practices, laws, and institutions together referred to as corporate governance [3], [4]. The phrase can also refer to

the company's adherence to relevant laws (corporate governance guidelines), its active ownership-based investment strategy (as in corporate governance funds), or a branch of economics that focuses on the myriad problems brought on by the separation of ownership and control [5], [6].

The stakeholder connections and the objectives for which the organization is managed are also included in corporate governance. Corporate governance is a problem that affects global business. Due to corporate scandals and commercial failures like Enron and WorldCom, corporate governance has gained significant attention in the US. However, comparable crises on a global scale have made corporate governance a problem that all firms have prioritized. Accountability to shareholders, clients, workers, and other stakeholders is a crucial aspect of corporate governance. Corporate governance must include ethical duties in addition to compliance with federal laws and monetary responsibility. In the simplest sense, businesses should aim to abide with the law for the benefit of all its stakeholders [7], [8].

Corporate governance is used to keep an eye on whether results match up with expectations and to encourage the company to become better educated in order to keep up with or change organizational activities. Corporate governance is primarily the means through which people are encouraged to align their actions with the general corporate good (i.e., the greatest possible amount of value produced by the firm and equitably distributed among its participants). The operational procedures of a firm are defined by corporate governance in its widest definition. The laws of the nation, fiduciary or economic responsibility, moral conduct, fraud prevention, risk reduction, and general good corporate citizenship will all be covered by these standards. Corporate governance involves everyone in a company, from the boardroom to the front line [9], [10].

**Corporate governance is necessary**

Modern businesses must establish and put into practice sound management procedures in order to safeguard stakeholders' interests. It is possible for businesses to fulfill their corporate goals, safeguard shareholder interests, comply with regulatory obligations, and show the general public how they are doing business while also improving performance and attracting investment. These procedures are now essential to international efforts to safeguard investors, enhance and stabilize the world's financial markets. Through careful planning and risk management, good corporate governance enables an organization to fulfill its commitments and accomplish its goals. It offers a way to facilitate decision-making and enhance accountability. Additionally, it aids in developing accountability to the organization's stakeholders, including its members and the people it serves.

**Good corporate governance characteristics**

When evaluating the governance of your organization, there are a few important aspects of excellent governance to take into account. These elements ought to be at the core of a company's corporate governance framework and should be covered in any documentation related to governance, such as organizational plans, business plans, marketing strategies, policy and procedure manuals, risk management assessments, and/or quality assurance manuals. The characteristics are:

1. Setting and planning strategies Consultation on risk management

2. Responsibilities and roles

3. Resources, freedom, and skills Ethics and behavior

4. Performance succession preparation

5. Reporting on finances and operations auditing panels.

Professional investors place a high value on good company governance. When assessing investment choices, major institutions compare corporate governance to the firm's financial statistics. According to a McKinsey report, professional investors are even willing to pay significant premiums for investments in companies with strong standards of corporate governance. The typical premium varied from 13 percent in North America and even Western Europe to 20 or 25 percent in Asia and Latin America. Easter Europe and Africa had considerably higher premiums. In general, businesses may anticipate a gain in market value of 10 to 12 percent when shifting from the worst to the best in terms of corporate governance. Several organizations have released excellent corporate governance recommendations. Corporate governance is defined as "providing the structure for determining organizational objectives and monitoring to ensure that objectives are attained" in the 1999 publication "OECD Principles for Corporate Governance," which was found to be very helpful. The OECD emphasized that "there is no single model of good corporate governance," but it also pointed out that in many nations, corporate governance is in the hands of a supervisory board, which is in charge of upholding the rights of shareholders and other stakeholders (such as customers, employees, and creditors). In turn, the board collaborates with a senior management group to put governance concepts into practice that guarantee the efficiency of organizational procedures.

**Governance of corporate And Key Assets**

It is suggested to use a framework to integrate corporate and IT governance. The connections on the board are shown at the top of the framework. As the board's representative, the senior executive team outlines plans and ideal conduct to carry out board directives. A collection of options is how most people define strategy. Who are the intended clients? What services and products are available? What distinct and important position is the company aiming for? What fundamental procedures define the company's distinct market position? The beliefs and culture of the corporation are established and put into practice via not just strategy but also corporate value statements, purpose statements, business principles, rituals, and structures. Desirable actions represent these ideas and cultures. Every organization has its own set of desirable behaviors. Strategies do not produce value; behaviors do. For over a century, Johnson & Johnson, for instance, depended on independent business segments to maximize shareholder profit. Customers eventually maintained, however, that they wanted to work directly with J&J and not a collection of distinct J&J operating entities. As a result, J&J's well-known corporate credo has evolved to specify ideal behaviors, such as lowering the cost of its products to customers, developing tools for better understanding the particular needs of each customer, and moving employees between J&J businesses to advance their careers and help them identify with the company identifies the six essential resources that businesses use to implement their plans and create value for their shareholders. Senior executive teams develop rules to control how each of these assets is managed and used, both alone and together. The following are some of each asset's essential components:

Human Resources: Individuals, abilities, career opportunities, education, reporting, mentorship, competences, and so on. Cash, investments, liabilities, cash flow, receivables, and other financial assets are examples. Buildings, machinery, and equipment, as well as their upkeep, security, and use, are examples of physical assets. Intellectual property (IP) assets include product, service, and process know-how that has been legally patented, protected by copy rights, or ingrained in an organization's people and systems. Digitalized data,

information, and knowledge about customers, the effectiveness of business operations, finances, information systems, and other topics. Assets in the form of relationships include those inside the organizations as well as those with consumers, suppliers, business divisions, regulators, rivals, channel partners, and so forth.

Numerous organizational techniques are used to govern the primary assets. Some processes (like the IT architecture committee, for example) are exclusive to one kind of asset while others bridge and integrate other asset types to ensure synergy amongst important assets. In today's organizations, the maturity of the governance of the six core assets varies greatly, with financial and physical assets often being the best regulated and information assets typically being among the poorest. It is argued that businesses operate better when their many assets share common processes. A company may achieve greater integration and increase value, for instance, if the same executive committee oversees both financial and IT assets. other processes, such as the IT architecture committee and the audit committee for financial assets, will always be specific to each asset, while other shared mechanisms improve coordination across the six assets.

Make a brief list of the controls your company uses to oversee each of the six assets as a sobering exercise. Could you make the lists complete? How many of the mechanisms were shared by more than two or one asset? It is challenging to coordinate an enterprise's six primary resources. A group of 42 CIOs gave an average rating of less than three on a five-point scale for how successfully their organizations linked IT governance with the governance of the other essential assets. While establishing uniform governance procedures across the assets won't improve integration, the fewer number of mechanisms that arise will be easier to interact with and put into action. A crucial and continuous effort for good governance is educating the senior management team on how the various governance processes interact to work for the organization. We claim that stronger IT governance will result in numerous real advantages.

## DISCUSSION

### Corporations as Social Entity

Even if it produces and distributes products and services, a company is more than simply an economic and legal organization. Without a question, companies are necessary for the provision of products and services to society, but they cannot overlook the social repercussions of their overall operations. The truth is that a company is both a social and an economic organization. Today, there is no question about this reality, and the societal consequences of how companies operate are being researched with great interest. Every firm that does business does so in a certain social setting. No company, no matter how small, can operate only as the private or personal office of its promoters and/or management staff; it must submit to some kind of social oversight that is enforced both internally and externally in order to function. No commercial firm can be seen as an entity that exists just to maximize profits. Any company corporation's creation has a wide range of social effects in addition to legal and financial ones. In order to effectively manage and bring about social change, business managers must see their organizations as both significant economic institutions and powerful agents of change.

### Managers of corporations as Trustees

A fiduciary connection exists between the corporate management staff and the company they are employed by. They have the right to manage the corporation's resources, which is the foundation of this partnership. They possess both financial and non-financial authority. They

are granted discretionary authority in a variety of circumstances. Regarding the administration and supervision of the corporation's business, they are granted discretion. They are more than just the company's workers. They are unable to adapt to the employer-employee relationship anymore. They serve the company as trustees and agents in addition to being workers. First and foremost, a manager acting in the capacity of an agent should refrain from using company chances for personal advantage. Second, he should do his job as well as he can.

A management should be aware that he or she is a trustee for the company for which they are responsible. He is not, however, a trustee in the legal meaning of the word since, in his function as manager, he has no ownership or property rights. Nevertheless, he has several responsibilities that are similar to those of a trustee for the organization. He will be held accountable for making excellent money since, first and foremost, he is a trustee of resources that enter his hands or are genuinely under his authority. In the second category, a manager acts as a trustee for the company while using all of the authorities that he is permitted to use on the entity's behalf. Thirdly, a manager cannot allow his interests and those of the company to conflict because of the fiduciary nature of his role, which is similar to that of a trustee.

**Corporate executives as interest guardians**

A few further concerns are brought up by the manager's fiduciary role in connection to his organization. Is a manager not in a position of trust with regards to customers who purchase his company's goods? Is he not in a position of trust with regard to the company's employees? What is his stance toward suppliers, dealers, rivals, etc.? How does he interact with the neighborhood where the firm operates? There is a lot of discussion about these issues, and most people agree that the answers should be "yes." Managers have obligations to their team members, customers, and the community at large. A company may be referred to as a "public" institution since it affects society. Managers are public trustees in this sense. Therefore, the managers must consider all interests—internal and external—that are impacted by the business' activities.

As a result, managers' duties must gradually include social responsibility and awareness of one's place in society. All of this elevates the manager's role much above that of a straightforward business manager. He must lead the company to promote social good. The managers are the community system's administrators, and they have power over the nation's riches. This provides the managers the financial ability to influence how the general populace lives since every position of authority comes with legal obligations. As a result, the managers are accountable to different societal groups. The managers' duties extend to the whole extent of the business influence area. They have a responsibility to ensure that the working conditions for the corporation's workers are appropriate. They have a responsibility to the customers to provide a large selection of products and services at fair costs. They have a responsibility to society to prevent contamination of the environment. The managers must embrace these life's facts and do their duties to the diverse facets of society. The management of the companies become public trustees if they are deemed to be public institutions. The expectations of managers' responsibilities have altered, both from the standpoint of the general public and the government. The interests of the different societal divisions are now taken into account by new ethical standards.

**Corporate Responsibility in the Indian Situation**

The notion of corporate governance has gained prominence as a result of several socioeconomic issues in India. First, the Indian constitution calls for economic and social fairness for everyone, and the government is dedicated to eradicating poverty and

establishing a socialist society in which individual interests are put aside in favor of national interests. Because our nation is a welfare state, numerous regulations have been passed to make businesses feel accountable to the many facets of society. The Consumer Protection Act of 1986, the Companies Act of 1756, and other laws have recently undergone a number of revisions that imply a new look at the economic and social principles behind the current legal measures. One may fairly expect and forecast that the newly proposed idea of the firm, which is legally outlined in the Indian Corporate Legislation, will play a major role in determining corporate policy in the years to come. Second, banks and financial institutions provide significant contributions to the financial requirements of the business sector. Banks and other financial institutions compel borrowing firms to follow the governments publicly stated social and economic agenda. By proposing members to the Board of Directors of the borrowing firms, this is secured.

Thirdly, some of our great national leaders have firmly ingrained the ethical component of business in their ideas and actions. This ties to some of our old teachings. In the contemporary setting, one must think of Mahatma Gandhi, who dedicated his life to advancing the idea of trusteeship in almost every area of lifepolitical, social, and economic. Gandhi believed that all existence is based on trust and that every authority implies responsibility. Thus, corporate governance may be described as an intentional attempt by the company's management to wisely balance the interests of its many stakeholders. Shareholders, workers, customers, society, the government, suppliers, creditors, etc. are a few examples of stakeholders.

A committee was established by the Securities and Exchange Board of India (SEBI) in 1999 to advance and improve India's corporate governance standards. The group became known as the Kumara Manglam group on Corporate Governance since it was led by Mr. Kumara Mangalam Birla. The committee's agenda included three items, namely:

1.(a) To propose legally binding modifications to the Listing Agreement between the firms and the stock exchanges

(b) To provide any further suggestions for ways to raise the bar for corporate governance in the listed businesses, including the regular disclosure of important information—both financial and non-financialin a clear and timely manner, as well as the duties of non-executive directors.

2. To create a corporate best practices code.

3. To provide recommendations for safety measures to be put in place inside the businesses to handle insider trading.

Three stakeholders were singled out by the committee as being crucial to raising the bar for corporate governance. These include the company's stockholders, board of directors, and executive team. To promote efficient corporate governance, these stakeholders' duties were determined. The group made many suggestions, including:

1. There should be at least 50% non-executive members on the board of directors. Furthermore, when the chairman is a non-executive, the Board should have at least a third of independent directors, and if the chairman is an executive, the Board should have at least half independent members.

2. To decide the compensation package for executive directors, the Board shall form (a) a "Audit Committee" and (b) a "Remuneration Committee."

3. The Board shall meet no less than four times each year, with no more than a four-month interval between any two sessions.

4. Disclosures on director compensation in all forms should be made in the corporate governance section of the annual report.

5. A separate section on corporate governance with information on the company's compliance with the obligatory recommendations of the committee should be included in the annual report.

6. The report shall include a separate section on compliance with the obligatory recommendations of clause 49 of the Listing Agreement and explain the specifics of non-compliance.

## CONCLUSION

In conclusion, corporate governance is crucial for creating a framework of openness, responsibility, and moral behavior inside corporations. Corporate governance promotes effective board supervision, shareholder rights, executive remuneration practices, risk management, and disclosure transparency, which helps organizations remain successful, stable, and sustainable over the long term. Companies that place a high priority on good corporate governance procedures are better able to overcome obstacles, build trust, and benefit their stakeholders. Strong corporate governance procedures draw in investment, promote company expansion, and safeguard the interests of stakeholders. They support businesses in navigating complicated regulatory frameworks, successfully managing risks, and forging enduring relationships with shareholders, staff, customers, and the larger community.

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# CHAPTER 23

# EVALUATING THE COMPANY MEETINGS AND PROCEEDINGS

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**ABSTRACT**:

The concept of company meetings and proceedings and their significance in corporate governance and decision-making. Company meetings are essential forums for shareholders and directors to come together to discuss and make important decisions regarding the company's affairs. This paper explores the types of company meetings, such as annual general meetings and extraordinary general meetings, and their purpose in facilitating communication, accountability, and shareholder participation. It also analyzes the legal requirements, procedures, and documentation associated with company meetings. Furthermore, this paper delves into the importance of proper meeting conduct, voting procedures, and the recording of minutes. Through a comprehensive analysis of company law, regulatory frameworks, and case studies, this paper sheds light on the role and significance of company meetings and proceedings in corporate governance.

**KEYWORDS**:

Meeting Minutes, Notice of Meeting, Proxy Voting, Quorum, Resolutions, Shareholder Meetings.

## INTRODUCTION

Because a firm is an artificial person, it cannot act on its own. It must use a person as a middleman in order to act. The numerous legal laws provide stockholders specific rights. They are set aside expressly for corporate general meetings to conduct them. The Board of Directors is given authority to run the company's affairs under Section 291. Meetings of shareholders and directors are required under this situation. The following various categories of shareholder meetings are covered by the Act: (i) Statutory Meetings; (ii) Annual General Meetings; (iii) Extraordinary General Meetings; and (iv) Class Meetings [1], [2].The following are some of the most significant law provisions relating to the statutory meetings:

1. It must only be owned by public companies with share capital. No such meeting must be held by a private business or a public corporation registered without share capital [3], [4].

2. It must be held no later than one month and no later than six months after the day the firm is permitted to open for operation.

3. A notification of the meeting informing each member that it is a statutory meeting must be issued at least 21 days prior to the scheduled date.

4. In addition to sending each member a notice of the meeting, the Board of Directors shall also order a report known as the "statutory report." If the statutory report is sent later, it will be considered to have been properly transmitted if all members eligible to attend and vote at the meeting agree that it has been done so. After being given to the members, a copy of the statutory report must also be forwarded to the Registrar [5], [6].

The statutory report includes (a) the total number of fully paid-up and partially paid-up shares allotted, as well as shares allotted for cash and for consideration other than cash; (b) the total cash received by the company in respect of all allotments; (c) an abstract of receipts and

payments up to a date within seven days of the report's date, as well as the amount of cash on hand; (d) any commission or discount paid on the issue of shares or Deben [7], [8].At least two directors, one of whom must be the managing director if there is one, must certify the accuracy of the statutory report. Additionally, the company's auditors must certify the portion of the statutory report that deals with the shares issued, the cash paid for them, the receipts and payments, and the remaining cash on hand [9], [10].

5. Without prior warning, the members present at the meeting may address any topic pertaining to the company's establishment or resulting from the statutory report.

6. The meeting may be called again and will have the same authority as the first one. Therefore, the postponed meeting may take any action that the first meeting may have taken.

7. The following outcomes might happen if the requirements of s.165 are not followed: (a) A fine of up to 5,000 is imposed on each director or other official of the corporation who is in noncompliance. (a) The company's winding up may be requested by the Registrar or a contributing in a court application. Instead of issuing a winding-up order, the court may instead issue instructions for the convening of the meeting for the submission of the statutory report.

8. It should be kept in mind that a public corporation with a share capital is only needed to hold this meeting once throughout its existence.

**General Assembly (AGM)**

This is an annual meeting of a firm, as the name suggests. The following rules apply to this meeting:

1. This meeting is required for all businesses, whether they are public or private, limited or unlimited, have a share capital or not.

2. No more than fifteen months may pass between meetings, and the meeting must take place every calendar year. However, the first AGM may be convened within eighteen months of the date of formation, and if it does, the company is not required to have any more general meetings in the year of incorporation or the year after. The Registrar, who may do so for any particular cause, must be asked for approval in order to prolong the maximum space between two such meetings by three months. According to the business Law Department, even if the extension enables the business to convene its AGM outside of the calendar year, the Registrar may grant a time extension for unique circumstances up to a maximum of three months. However, the Registrar must receive an application for the aforementioned extension before the time limit specified in s. 166 (1) expires in order for it to be granted.

3. The meeting must take place at the company's registered office or another location within the city, town, or village where the registered office is located, during business hours, and on a day that is not a public holiday.

4. The following matters might be discussed at such a meeting (Section 173):

(i) Regular business, including the following items: (a) review of the financial statements, the balance sheet, and the audit committee's and board of directors' reports; (b) dividend declaration; (c) appointment of new directors to replace retiring ones; and (d) selection of auditors and determination of their compensation.

(ii) All business conducted during the meeting that is not regular business shall be regarded as special business. An Explanatory Statement must be included to the notice in relation to any special business.

5. What happens if the annual accounts are not prepared to be presented to the AGM? It is possible for the firm in question to postpone the relevant AGM to a later date when the annual accounts are anticipated to be prepared for approval in the AGM if the annual accounts are not ready for laying at the pertinent AGM. Directors are required by law to conduct the meeting even if discussing yearly accounts is only one of the topics that will be covered. The right procedure is to call the meeting, postpone it, and then reconvene it at a later time to discuss the accounts. However, the postponed meeting must be convened within the s.166-permitted time frame.

6. The combined application of Sections 166 and 210 mandates adherence to the following: (a) Each calendar year must have at least one meeting. (a) The interval between general meetings should not exceed fifteen months. (c) The Registrar may extend the 15-month term to 18 months. (d) The accounts must cover a period beginning on the day immediately following the period for which they were submitted and ending on a day that cannot be more than 6 months prior to the meeting date, or 6 months plus the extension granted by the Registrar, for a maximum period of 9 months, unless it is the first AGM.

7. The auditor as well as all of the company's members must be notified twenty-one days in advance. If all members eligible to vote at the meeting agree, a shorter notice may be considered acceptable (Section 171). Such approval may be granted in advance of the meeting or after the adoption of the resolutions. The notification must be accompanied by a copy of the directors' report on the company's performance for the year, the audited financial statements, and the auditors' report. Additionally, a proxy form must be sent with the notice, on which it must be made clear that anybody who is eligible to vote may choose a proxy who need not be a business member.

The notice must include a summary of the matters to be discussed at the meeting as well as the location, date, and time of the meeting. The meeting will be void and any decisions adopted at it will be of no force or effect if the notice does not include the time of the meeting's holding and other crucial information that is needed by the section. Every member, the assignee of an insolvent member, the legal representative of a dead member, and the auditor or auditors must receive the notification.

8. If the meeting is not held as scheduled, the Central Government may, at any member of the company's request, convene or order the summoning of the meeting. The company and each officer who is in default are subject to fines of up to 50,000 and an additional fine of $2500 per day while the default is ongoing if the company fails to hold the meeting as originally scheduled or when instructed to do so by the Central Government (Section 168).

## DISCUSSION

### Certain Typical Issues in Respect of AGM

1.AGM dates: Section 166(2), among other things, stipulates that every AGM must be convened on a day that is not a public holiday. It is a requirement, according to the Department of Company Affairs. Bank holidays (for closure reasons), although if they are recognized as public holidays under the Negotiable Instruments Act of 1881, are not to be counted as such for the aforementioned reason. Thus, the 30th of September and the 31st of March will not be observed as public holidays.

However, in the following circumstances, an AGM may be held on a holiday: (i) Section 2(38) states that if a day is declared a holiday by the central government after the notice convening the meeting has been issued, that day shall not be regarded as a holiday for the purposes of the meeting. (ii) When a public corporation or its subsidiary has set the timing of its AGM in its articles and the day ends up being a holiday. (iii) When a public business or its subsidiary has set the schedule for its following AGM by a resolution voted at one AGM and the day ends up being a public holiday. (iv) A private business that is not a subsidiary of a public company may also specify the time and location of its AGM by a resolution approved by all of its members; this resolution is still enforceable if the date falls on a public holiday. (v) A business that receives a license under s. 25 is not subject to the rules in s. 166(2). (vi) If the AGM is postponed due to a lack of quorum, it must be rescheduled for the same day, time, and location the following week (section 174). If the day unintentionally becomes a public holiday, it will not constitute a violation of section 166(2).

2. Is it required to advertise notice of meetings in the newspapers? No, but the company may do so as a strong precaution to avoid complaints from shareholders who live outside of India and who, incidentally, might not receive notices served by mail.

3. Voting rights of members are decided as of the meeting date rather than as they would have been if it had taken place within the allotted period.

4. Meeting Past the Stipulated Time: It cannot be deemed null or unlawful. Directors will face increased fines if the central government does not extend the deadline for convening the AGM in accordance with Section 167, but the meeting will still be legal. The position in law would be impossible otherwise.

5. Power to Cancel or Postpone: The Board of Directors may cancel or postpone a scheduled meeting, but only for legitimate and acceptable reasons.

**Exceptional Meeting**

An extraordinary general meeting is any general gathering of the company's members that isn't the statutory meeting, annual general meeting, or any postponement of either of those events. The Board of Directors often calls such a meeting when there is urgent business that cannot wait until the next Annual General Meeting. At such a conference, only special business is conducted. The notification of the meeting should be accompanied by an explanation of the special business. The notification should include the nature and amount of each director's or manager's involvement in the special business as well as their respective percentages of ownership in the firm. The notification must also specify that any document that has to be approved by the members at the meeting will be available for examination at the company's registered office during the times and days mentioned.

A company's articles of association may include language allowing for the call of an extraordinary general meeting. For instance, it might state that "the board may call an extraordinary general meeting whenever it deems appropriate" or that "any director or any two members of the company may call an extraordinary general meeting if at any time there are not within India, directors capable of acting who are sufficient in number to form a quorum."

**General Meeting Extraordinary on Request**

A company's members have the ability to request that the directors hold an extraordinary general meeting. A company's board of directors is required to call an extraordinary general meeting (EGM) in the event that at least one-tenth of the voting rights in the matter to be

discussed at the meeting are held by members of the company at the time the demand for an EGM is made. Members who, at that time, own at least one-tenth of the company's total voting rights in relation to the relevant topic, if the firm has no share capital.

The requisition must be signed by the members who are requesting the meetings and must include the meetings' objectives. The company's registered office is where the request must be submitted. The directors must move to convene a meeting within 21 days of the request being submitted at the company's registered office, and the meeting must be conducted 45 days after the demand was lodged. The requisitionists, or any of them meeting the requirements at (a) or (b) above, as the case may be, may proceed to call the meeting themselves within three months of the date of the requisition and claim the necessary expenses from the company if the directors fail to call and hold the meeting as aforesaid. This amount may be recovered by the corporation from the defaulting directors. Any item that is not on the agenda included in the meeting notice cannot be voted on during such an EGM. A (Schedule I) Clause 47 states that all general meetings other than AGMs must be referred to as EGMs. The following legal requirements apply to such meetings:

1. An EGM is called to do any urgent or unusual business that may come up between two AGMs, such as a change to the objectives, a change to the registered office, or a change to the capital. At such sessions, all business is referred to as special business. Therefore, a "Explanatory Statement" is required for each item on the agenda.

2. The following parties have the authority to summon an EGM: (i) the directors on their own initiative; (ii) the directors upon request; (iii) the requisitionists themselves; and (iv) the Company Law Board. A general meeting of the members may be called by the board of directors at any time with at least 21 days' notice. However, if members of the corporation with 95% or more of the voting rights agree, a shorter notice may be considered genuine (s. 171). If the following requirements are met (s.169), the board of directors shall call a general meeting. The requisitionists must be a certain number of members who, as of the day the requisition was deposited, held 1/10th of the total voting power. As a result, in the event that a corporation has share capital, they must own at least 1/10 of the paid-up capital that entitles them to vote on that issue. Only issues involving the preference shareholders are subject to the voting rights of preference shareholders. They are not allowed to vote, and as a result, they are not permitted to make requests about other topics. They should have at least one tenth of the firm's overall voting power in relation to that issue if the company has no share capital. The meeting's purpose, or the topics for discussion for which the meeting is to be convened, must be stated in the request. Additionally, the request had to be filed at the company's registered office. The requisitionists are required to sign the request. If all of the aforementioned requirements are met, the board of directors must convene the meeting within 21 days of receiving the request and provide at least 21 days' notice, setting the meeting for 45 days after receiving the request. When a special resolution is being submitted, s. 189(2) conditions must be followed, which include that the resolution be characterized as such and that an explanatory statement be attached.

The meeting may be called by the requisitionists themselves if the board of directors fails to do so as described (i.e., at least 21 days' notice setting the date of the meeting within 45 days of the deposit of a valid requisition): (a) In the case of a company with share capital, by one or more requisitionists as represent either (i) a majority in value of the paid-up share capital held by all the requisition

When the Articles, in line with s.180's requirements, provide that members who have not paid calls on their shares would not be eligible to vote, they are unable to convene a meeting or

cast a vote at one, and the proceedings would be illegal if they did. Within three months following the request's deposit date, the requested meeting must take place. Furthermore, for the purposes of this section, a request or a notification summoning a meeting signed by one or a few of the parties holding any shares or interests in a corporation jointly shall have the same force and effect as if it had been signed by all of them.

Any reasonable costs spent by the requisitionists as stated above will be reimbursed by the firm, and any associated costs shall be recovered from negligent directors. The requisitionists' meeting must go as closely as feasible in the same way as meetings convened by the board of directors. They may, however, convene the meeting elsewhere if the registered office is not made accessible to them for that purpose.

**Company Law Board's authority**

In the event that convening a meeting of the company other than an AGM is impractical for any reason, the Company Law Board may order the summoning of the meeting: (a) on its own initiative; (b) upon the application of any director; or (c) upon the application of any member with voting rights. The Company Law Board may provide instructions for the aforementioned meeting on the location, date, and format of the meeting. It may also provide such supplementary or follow-up instructions as it deems appropriate, such as directing that a meeting should be regarded to have been convened if one member is present in person or by proxy.

An example is Superclean Industries Pvt. A corporation called Ltd. has three stockholders, all of whom serve as the business's directors. Mr. Superman owns 60% of the paid-up share capital, while the other two directors each own 40% of the remaining shares. Due to a disagreement, the two directors who own a combined 40 percent of the business's shares have banded together and begun blocking meetings for the company. In accordance with the company's constitution, a quorum for board meetings and general meetings must consist of a minimum of two directors or members. Despite being a majority stakeholder, Mr. Superman is powerless since there isn't a quorum for meetings to take place. Under the provisions of s. 186 for calling the general assembly. If the CLB is satisfied, it will order a meeting to be convened with a quorum of one member. The quorum requirement cannot prevent Mr. Superman from using his statutory right to participate in the decision-making process since he is the majority shareholder.

**General Shareholders' Meeting**

A meeting of the holders of those shares may be called when it is proposed to change, vary, or affect the rights of a specific class of shareholders (e.g., when accumulated dividends on cumulative preference shares are to be cancelled) and it is not possible to obtain the consent in writing of the holders of 3/4th of the issued shares of that class. A class meeting is the term used to describe such a gathering. All resolutions at a class meeting must be approved as special resolutions, it should be highlighted. The resolution will not take effect unless and until it is confirmed by the court, which must be done within 21 days of the application being made by the holders of at least 10% of the issued shares of that class who did not consent in favor of the resolution.

**Conditions for a Successful Meeting**

**Public Meeting Notice**

A notification of each general meeting is due to each company member. Every member must get a written notification with a minimum of 21 days. However, if all members with voting

rights agree, a shorter notice for the AGM will be acceptable. If members representing at least 95% of the voting power or those holding at least 95% of the paid-up capital with voting rights agree, a shorter notice for additional meetings will be accepted. Members may receive the notification either physically or via mail at their registered addresses. An announcement of a meeting may also be made by placing an advertisement in a local newspaper near the company's registered office.

The secretary is responsible for ensuring that everyone who is eligible receives a suitable notice of the meeting. A meeting's legitimacy and the effectiveness of any decisions adopted at the meeting may be affected by inappropriate, inadequate, or no notification. The members should be fully and honestly informed in the notice of the matter on which they will be requested to vote.

**Schedule for the Meeting**

The business that will be discussed during a meeting is referred to as an agenda. It is set up for all types of meetings so that they may be performed in a structured manner. The secretary often creates the agenda after consulting with the chairman. It is written in a way that will make it easier for the chairman to run the meeting efficiently. The secretary should keep the following in mind when creating the agenda: (i) the agenda should be explicit and clear; (ii) it should be written in a concise manner; (iii) all items of routine business should be listed first, followed by the contentious issues; and (iv) all items of a similar nature should be arranged continuously.

The aforementioned details are crucial because when a member receives a copy of the agenda, he is in a position to establish a firm judgment on the topics that will be covered at the meeting.

The sequence of the topics to be covered should be carefully considered while creating the agenda since it cannot be changed without the meeting's approval. There are occasions when the agenda is written in a way that it may subsequently be used as minutes. This approach is often used when creating the agenda for board meetings. A gap is left next to each item on the agenda, and the secretary fills it in while the discussion is still going on. Companies may sometimes keep an agenda book where the agenda items are listed. It is presented to the meeting's chairperson and used as the agenda. Only copies of those presented to the members or other directors. The agenda book thereafter serves as a permanent record for future use.

**Proxy**

In the case of a corporation, any shareholder with the right to attend and vote at a meeting may choose another person, member or not, to represent him or her. The person thus chosen is referred to as a "proxy."

It also refers to the legal document that a business member uses to choose a third party to represent him at meetings and cast his vote. The correct word for this document is "proxy form" or "proxy paper," nonetheless. It is important to keep in mind the following considerations about proxies: (i) A proxy has no authority to speak at the meeting. (ii) A proxy does not have to be a corporate member. (iii) The appointment document must be in written and include the appointor's signature. (iv) The meeting date must appear on the proxy form.(v) No firm may require that proxies be submitted more than 48 hours prior to a meeting. (vi) A proxy may be canceled before the designated individual casts a ballot. (vii) A proxy may ask for a vote. (viii) A proxy cannot vote against the instructions of the person who appointed them.

**Office job related to proxies**

Examine the proxy forms carefully to ensure that they adhere to the Act's requirements as well as the company's bylaws and procedures. (b) Any proxies that are received beyond the allotted time period shall be returned and marked as being unacceptable. (c) The chairman of the meeting should be informed of any anomalies in proxy forms since he has the ultimate say over whether to accept or reject them. (d) The secretary countersigns each valid proxy form. (e) Fill out the proper proxy forms and submit them to the register of proxies. (f) Give the member the completed proxy form and an admittance card with the proxy's name.

**Voting and Survey**

It is never possible to reach consensus before a meeting on all issues. The chairman requests to know the wishes of those in attendance if there isn't unanimous agreement. This is referred to as discerning the sense of the house, and for this reason, he must present the issue to the members of the house. The chairman may use a variety of techniques to submit the topic to a vote and establish the members' preferences.The Act specifies two ways to determine the preferences of the members in the event of a firm. Which are:

(i) By Show of Hands: In this procedure, the chairman asks everyone who is in favor of the resolution to raise their right hand, and after taking note of the total, he asks everyone who is against to do the same. The chairman then announces the outcome of the vote, indicating whether or not the motion was adopted.

(ii) By Poll: Voting by poll at corporate meetings is based on the amount of shares a member owns. According to this procedure, each voter casts a ballot and places it in a ballot box that has been set aside for that purpose. The outcomes are determined by tallying the votes cast in favor of and against the motion. Voting secretly is ensured by using this strategy. It's possible that the vote by show of hands doesn't always represent the members' values-based opinions. There could also be a few proxies who can only cast their votes via poll and not by showing their hands.

**Regulations For Voting**

According to the Act's provisions, the following voting guidelines may be noted:

1. Each owner of equity shares is entitled to one vote.

2. A shareholder's ability to vote cannot be restricted on the grounds that he has not held his shares for a certain amount of time prior to the meeting or for any other reason (Section 182). In the case Ananthalakshmi v. H. I. & F. Believe in AIR 1951 Mad. 927, a clause in a company's bylaws that states that only shareholders whose names have been on the register for two months prior to the date of the meeting are eligible to vote is in violation of the Act. Only non-payment of calls by a member, other amounts owed by a member, or when the business has used its power of lien on the member's shares may result in the exclusion of the ability to vote (section 181).

3. A preference shareholder may only cast a vote on issues that directly relate to the rights associated with his preference shares. The proposed resolution was held to affect the rights of the preference shareholders and could, therefore, only be implemented with their approval in cases where the directors proposed to increase the shares of the company (i) by issue of additional equity shares or (ii) by capitalizing an amount standing to the credit of the company's reserve account and applying the same in paying-up the new equity shares and distributing the same as fully paid among the equity shareholders.

4. A member's voting rights are unaffected by the fact that his shares have been seized, pledged, or assigned to a receiver.

5. first round of voting by show of hands. A motion placed to a vote at a general meeting must be resolved by a show of hands under Section 177, unless Section 179 is invoked. The chairman's statement that, after a show of hands, a resolution has been adopted or rejected by a certain majority or not, and an entry to that effect in the company's minutes book, shall constitute conclusive proof of the fact. No evidence of the quantity or percentage of votes cast in favor of or against the resolution is necessary (s. 178).

**Request for a poll**

According to Section 179, the meeting's chairman may, at his own initiative, and shall, upon the demand of the person or persons set forth below, order the taking of a poll before or upon the declaration of the results of the voting on any resolution on a show of hands:

(a) In the case of a public company with a share capital, by any member or members present in person or by proxy and holding shares in the company that (i) confer a voting power on the resolution that is not less than 1/10th of the total voting power in respect of the resolution; or (ii) on which an aggregate amount of not less than $50,000 has been paid up;

(b) When a private corporation with a share capital is involved, one member must be present in person or by proxy if there are no more than seven members present in person, and two members must be present in person or by proxy if there are more than seven members present in person;

(c) In the event of any other company, by any member or members who are present in person or by proxy and who have a minimum of 1/10th of the total voting power for the resolution.

The way the poll should be taken may be regulated by the meeting's chairman. He is required to choose two scrutinizers to examine the votes cast in the poll and report back to him. The chairman will then announce the outcome. voting by businesses and the government (Sections 187-187-A). A firm or corporation that belongs to another company may send a representative to attend meetings of the other company. The Board of Directors or another governing body must make the appointment in a resolution. The President or the Governor of the State, as the case may be, has the authority to nominate representatives to attend meetings of the firm where the Central Government or a State Government is a member. The selected individual will act as a proxy.

## CONCLUSION

In conclusion, corporate governance is greatly aided by the efficient communication, decision-making, and shareholder involvement that are made possible through company meetings and processes. Companies may increase shareholder involvement, boost accountability, and create stakeholder confidence by holding meetings in a fair, open, and inclusive way. To guarantee the success and efficacy of corporate meetings and procedures, it is crucial to adhere to legal standards, conduct meetings properly, take correct minutes, and maintain strong communication channels. Company meetings and processes support good corporate governance by fostering communication, accountability, and shareholder involvement. They provide a forum for shareholders to interact with the board, express their concerns, and exercise their rights. Meetings also provide the board the opportunity to collect insightful input, coordinate initiatives, and reach informed choices that support the goals of the business and the interests of its stakeholders.

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# CHAPTER 24

# COMPREHENSIVE ANALYSIS OF FINANCIAL: PRACTICES BORROWING AND DEBENTURES

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**ABSTRACT**:

The concepts of borrowing and debentures in the context of corporate finance and capital raising. Borrowing refers to the practice of obtaining funds from external sources, such as banks or financial institutions, to finance a company's operations, investments, or other financial needs. Debentures, on the other hand, are debt instruments issued by companies to raise capital from investors. This paper explores the implications, benefits, and risks associated with borrowing and debenture issuance. It analyzes the different types of debentures, such as convertible debentures or secured debentures, and their features and characteristics. Additionally, it examines the legal and regulatory considerations, disclosure requirements, and investor protection measures related to borrowing and debenture issuance. Through a comprehensive analysis of financial practices, regulatory frameworks, and case studies, this paper sheds light on the significance of borrowing and debentures as financing tools for companies.

**KEYWORDS**:

Bondholders, Callable Debentures, Convertible Debentures, Credit Rating, Debenture Holder.

## INTRODUCTION

Any clause asking or obliging a candidate for shares in or debentures from a firm to waive adherence to any of its obligations under this section (S.56) or claiming to impact him with notice of any contract, document, or issue that isn't expressly included in the prospectus is invalid. Without a prospectus that complies with the requirements in connection with a genuine invitation to a person to enter into an underwriting agreement with respect to the shares or debentures, or in relation to shares or debentures that were not offered to the public, no one shall issue any form of application for shares in a company or debentures of a company. Any individual who violates the terms of this subsection would be subject to a fine that might reach 5,000 rupees [1], [2].

### Investments

Although it utilizes the word "investment" in many areas that are examined below, the Act does not define it. In slang, it refers to any asset or right that receives financial investment. The next parts, however, only refer to the act of a firm purchasing securities, such as shares and debentures of another company [3], [4].

Investing must be done in the company's name (s. 49)

A firm must make and hold any investments made on its behalf in its own name. There are a few exceptions to this rule, however. These exclusions include the following:

1. The corporation may make and hold investments under any other name if any other legislation now in effect enables it.

2. Where the company has the authority to appoint a person or persons as a director or directors of any other body corporate, shares in such other body corporate may be registered or held by the body corporate jointly in the names of the company itself and of each such person or nominee or in the name of each such director, up to an amount not exceeding the nominal value of the qualification shares [5], [6].

3. To guarantee that the number of members of any subsidiary is not decreased, where it is a public company, below seven, and where it is a private business, below two, a company may hold any shares in its subsidiary in the name or names of any nominee or nominees of the company.

4. If the investments are made by a business whose primary activity is the purchase and sale of shares or other securities, the firm may keep its holdings under any other name. Debentures and stock are examples of securities.

5. A corporation may deposit any shares or securities with a bank, acting as the bankers of the company, for the purpose of collecting any dividends or interest due thereon [7], [8].

6. In order to expedite the transfer of shares or securities, a business may deposit, transfer to, or hold in the name of the State Bank of India or a Scheduled Bank, which are the bankers of the company. The corporation is only allowed to do this for a six-month period. The company must have the shares or securities re-transferred to it from the State Bank of India, the Scheduled Bank, or as the case may be, and again hold the shares or securities in its own name as soon as practically possible after the expiration of that period of 6 months if the transfer of such shares or securities does not take place within that time frame [9], [10].

7. As security for the repayment of any loan made to the business for the execution of any obligation assumed by it, a company may deposit with or transfer any shares or securities to any person. Except in the situations (4) to (7) mentioned above, the certificate or letter of allocation related to the shares or securities in which an investment has been made by a business must be in the custody of the company, the State Bank of India, or a Scheduled Bank, who are the company's bankers.

**Investments Not Held in the Company's Own Name Register**

When a company invests in shares or securities that are not held in its own name, it is required to record the following information in a register it maintains for that purpose: (a) the nature, value, and any other information that may be required to fully identify the shares or securities in question; and (b) the bank or person in whose name or custody the shares or securities are held. Any member or holder of a debenture of the corporation may examine the register. The Central Government may issue an order for an urgent examination of the register if any inspection of the register is rejected. In the event that Section 49 is not followed, the Company and any of its officers who is in default are subject to a fine that may reach $50,000.

**The capacity of a company to borrow**

Although an inferred right to borrow exists for every trading business, it is advisable to add an explicit power to borrow in the Memorandum's purposes section. However, borrowing must be specifically permitted by the Memorandum of non-trading corporations. Any stated or implied right to borrow includes the right to pledge corporate assets as collateral to the lender. Companies are not explicitly permitted to borrow money under the Companies Act. As a result, the majority of firms explicitly include such borrowing capabilities in the Memorandum. The Articles specify how and who will use these rights in situations when the

Memorandum authorizes the corporation to borrow. Additionally, it may establish the maximum amount that a firm may borrow.

**Use of Borrowing Authority**

A public firm must first get the certificate to open for business before using its borrowing authority. However, a private firm may use the borrowing authority as soon as it is incorporated. The ability to borrow money is often used by the directors, although the Articles typically include certain limitations on this ability. The directors' borrowing authority is likewise limited by Section 293 to the sum of the paid-up capital of the company and its free reserves, excluding any short-term loans acquired from the bankers of the company in the normal course of business.

## DISCUSSION

**Ultra Vires Borrowing**

When a firm borrows even though it has no legal authority to do so or borrows more than is allowed by its memorandum or articles of incorporation, such borrowing is considered supra vires. Any such loan to the Company shall not constitute a debt enforceable in any manner whatsoever. However, such a lender shall be entitled to the following remedies:

1. Injunction and Recovery: The lender may get an injunction to prevent the firm from parting with the money, assets, property, etc., acquired with the money and remaining in the business's control. They may also seek a tracing order to locate and reclaim the funds.

2. Subrogation: If the borrowed funds were used to pay off the company's legitimate creditors, the lender may be able to subrogate to those creditors' rights, taking their place as new creditors in order to get his money back. Even if the obligations that were paid off have precedence, he will not be given any preference over other creditors.

3. Suit against the Directors: If the directors violate the lender's promise of power, the lender may sue each individual director for damages. However, the lender shall not be allowed to demand damages from directors on this premise as he was not mislead since he is presumed to have knowledge of these public papers if it is clear from the company's memorandum or articles that the firm has no borrowing authority.

Borrowing is against company policy but is against directors' rules.

If the borrowing exceeds the directors' authority alone, rather than the authority of the company as a whole, the company may ratify and validate any borrowing that exceeds $2,000 without the consent of the shareholders (i.e., a borrowing that is ultra vires the directors) if the Articles limit directors' authority to borrowing to amounts up to $2,000 only. The loan will be fully lawful and enforceable against the corporation if it is approved. The "Doctrine of Indoor Management" will safeguard a lender, providing he can show that he loaned the money in good faith, even if the firm refuses to approve the directors' conduct. In response, the corporation may take legal action against the directors and demand indemnification.

**Additional Limitations on the Board's Borrowing Powers**

The following powers, among others, may only be used by the Board via resolutions approved at board meetings and not through publication of resolutions: (i) the authority to issue debentures; (ii) the power to borrow money on terms other than debentures. The Board may, however, provide the authority in (iii) above to any committee of directors, the managing director, the manager, or any other senior officer of the firm by resolution adopted

at a meeting, with a stipulation on the maximum amount that may be borrowed by the delegate. The Act also gives the corporation the authority to set limitations and conditions on the Board's ability to borrow money and issue debentures.

**Method for Transferring Authority to Borrow Money Other Than on Debentures**

According to Section 292, the Board may borrow money on behalf of the firm by resolution adopted at a Board meeting. However,

1. In accordance with Section 292 (1), the Board may assign the authority to borrow money other than on debentures to a committee of directors, the management, or any other principal official of the business by a resolution adopted at a meeting.

2. According to Section 292 (2), any resolution granting the aforementioned authority to borrow money other than on debentures must state the total amount due at any given moment up to which the delegate may borrow money. If a corporation has a branch office, the chief executive officer of that branch may be given the authority to borrow as previously said.

Therefore, the corporation shall adhere to the following approach when assigning its authority to borrow money in a manner other than via debentures:

1. Organize a board of directors meeting.

2. Make sure that each director receives the right agenda and notice of the meeting.

3. Pass a resolution transferring the specified authority to the selected corporate representative during the board meeting.

4. Make sure that the resolution specifies the maximum sum that the official may borrow.

**Prevention of Mistreatment and Oppression**

The administration of the company's affairs is subject to the majority rule concept. By a simple majority vote or a three-fourths majority, the shareholders approve resolutions on a variety of issues. A resolution becomes enforceable after it has been approved by the majority of the company's members. The court will not intervene to defend the minority against the resolution as a consequence of the corollary that when a shareholder joins, they agree to adhere to the decision of the majority of the members. As a result, if the corporation is wronged, it may file a lawsuit against the offender as it is a legal entity with its own personality; stockholders do not have this same ability. This rule was established in the landmark case of Foss v. Harbottle, in which F and T sued the defendants, who included 5 directors, a solicitor, and an architect of the company, claiming that through coordinated and illegal transactions they had caused the company's property to be lost to the company on behalf of themselves and all other shareholders. Additionally, it was claimed that the Board lacked qualifications. F and T demanded compensation from the defendants for damages owed to the business. The Court ruled that the minority shareholders could not bring the lawsuit. The majority of the members may agree that the corporation had been wronged. In cases when the business has been wronged, the competent party to file a claim is the corporation, which can only be represented by the majority of its shareholders. The decision to file a lawsuit against the directors should be left up to the majority of the members. Since then, a variety of instances have involved the majority rule idea.

S. Nageshwara Rao v. Rajahmundry Electric Supply Co., AIR (1956), S. C. In its ruling 213, the Supreme Court stated: "The Courts will not, in general, intervene at the request of shareholders in matters of internal administration and will not interface with the management

of the Company by its Directors so long as they are acting within the powers conferred upon them by the Articles of the Company." Furthermore, the minority owners often have little recourse if the directors are acting in accordance with the wishes of the majority shareholders. It should be noted that the aforementioned rulings are basically an extension of the idea that a corporation is a different legal entity from the individuals who make up its membership. A corporation is the appropriate party to file a claim if a harm is done to it if it is acknowledged that the business is a distinct legal entity. This straightforward procedural rulethat only the person who has been harmed may file a lawsuitapplies to all wrongs. If, for example, X pushes Y down the stairs on purpose and Y fractures his leg as a result, C, who saw the whole occurrence, is unable to file a lawsuit against X. C is the incorrect plaintiff since he hasn't been wounded and isn't the injured person. Y is the proper plaintiff. But the regulation is a bit trickier when it comes to businesses. After all, the firm has suffered because of the deceitful directors. There are members of the business. All of the company's members are impacted by losses, not just the majority, the minority, or any one member in particular. So why shouldn't a member who has been hurt file a lawsuit?

The explanation is that being injured is insufficient. The injured party must demonstrate that a duty owed to him was broken, leading to the harm. A person experiences numerous hurts during their life for which they are unable to take legal action since no obligation owed to him has been violated. The directors' attempts to prove that the individual shareholdersor even the minority shareholdersowe them a personal obligation in their administration of the company's assets would undoubtedly fail. The sole responsibility the directors have is to the corporation as a whole, not to the individual members. A corporation is a person, thus if it is harmed due to a violation of a duty owed to it, the sole plaintiff is the company acting via its majority, as it must always do. However, it should be highlighted that the aforementioned Foss v. Harbottle concept only applies when a member's corporate right is violated. Where a member's individual right is violated, the regulation does not apply. By signing a contract with the company, each shareholder agrees to accept as binding on him the decisions made by the majority of shareholders, provided they are made in accordance with the law and the articles. These membership rights are known as corporate membership rights. Other shareholder rights, such as the right to vote or the right to receive dividends, are his personal or individual rights and cannot be taken away by the majority. If the company refuses to record his vote or pay him the dividend, he may bring a lawsuit in his own name, and any decision made by the majority has no bearing on this right of action. BOD of a Pvt. Co. has borrowed more money than its combined paid-up capital and free reserves for long-term goals. Is the business bound by it?

**'The Majority Rule' (Protection of Minority Rights) Exceptions**

The Foss v. Harbottle rule is not applicable in the following situations, which allows the minority shareholders to file a lawsuit to safeguard their interest:

1. When an act is being done that is illegal or ultra-vires the company, a shareholder has the right to file a lawsuit against the company and its officers because no majority of shareholdersnot even the entire body of shareholderscan approve of such actions. 2. Each shareholder may be seen as an authorized organ to file the case when a director violates their fiduciary obligation. In the case of Blakesly v. Johnson (1980), the majority shareholder and president of a corporation failed to adequately inform the minority shareholder of the facts pertaining to the sale of the company, and as a result, the latter permitted the corporation to redeem his stock for a low price. It was decided that the president had violated his fiduciary obligations.

3. When the alleged wrongdoing amounts to a fraud against the minority, the majority of the members of the firm may be held accountable for their actions even if only one shareholder files a complaint.

The Honorable M.R. According to Greenhalgh v. Ardene Cinemas Ltd. (1951), "a special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders, so as to give the former an advantage with which the latter were deprived." Accordingly, in this case, the majority of the members of company 'A', who were also members of company 'B', passed a resolution to compromise an action against company 'B'.

The resolution was allegedly biased against business "A" and in favor of firm "B." Held, the minority of business 'A' might have the settlement overturned.

4. An action by the minority is maintainable if it is brought to stop the company from carrying out an act for which a special resolution is necessary but such a resolution has been improperly passed or passed by trick. This occurs when the act in question required a special resolution to be effective but was actually carried out by a simple majority.

5. Where a member's personal rights have been violated: As previously mentioned, the majority rule concept only applies to a member's corporate membership rights. A member is allowed to continue in his own name if his personal rights, such as the right to vote and the right to dividends, are violated.

6. Protection under the Companies Act: Under some specified sections, the Companies Act of 1956 gives protection to minority owners by granting them the following rights:

(i) Modification of Class Rights: Where a company's share capital is divided into different classes of shares, the rights attached to each class's shares may be modified in accordance with the company's memorandum or articles with the approval of the 3/4th majority of its shareholders. The holders of at least 10% of the outstanding shares of that class that had not consented to the variation may move to the Court for the cancellation of the variation under s.107 when this is done and the rights are changed by the necessary majority vote.

(ii) Plan of rebuilding and Amalgamation: Section 394 protects minorities and outlines plans of rebuilding. The court will not approve any compromise or agreement related to a plan to amalgamate the company unless it has received confirmation from the Registrar that the company's affairs have not been run in a way that is against the interests of its shareholders or the general public.

(iii) Oppression and Mismanagement: In situations where Ss. 397 and 398 are relevant for preventing oppression and mismanagement, the majority rule principle does not apply. A member may petition the Court under section 397 if they believe that the company's business practices are oppressive to certain members, including themselves. The Delhi High Court decided in O.P. Gupta v. Shiv General Finance (p) Ltd. (1977) that an arbitration provision in a company's articles of association cannot impact a member's ability to petition the court under Section 397 since it is a statutory right.

(iv) Rights of dissident shareholders during takeover bids: If an offer to buy all the shares is received and approved by the owners of 90% of the shares, the party making the offer may purchase the remaining shares as well, under the same conditions. However, a notice must be made to the dissident shareholders who may petition the court to prevent the acquisition of their shares under the rules of the program. The court issues an order after hearing from the parties involved as it sees suitable.

**Company Law Board's Authority to Prevent Mismanagement and Repression**

According to provision 397, any shareholder who believes that the company's operations are being run in a way that is oppressive to any member or members (including one or more of themselves) may submit an application to the Company Law Board under this provision.

If the Company Law Board believes that (i) the company's affairs are being conducted in a way that is detrimental to the public interest or oppressive to any member or members; and (ii) winding up the company would unfairly disadvantage the members who have filed the complaint, the court would be willing to make a winding-up order on the grounds that the company is in violation of this section.

Any member of a company may submit an application to the Company Law Board under Section 398 if they believe that the company's affairs are being conducted in a way that is harmful to the public interest or the company's interests, or if they believe that because of a material change in the company's management or control, the company's affairs are likely to be conducted in a way that is harmful to the public interest or the company's interests. The Company Law Board may issue whatever order it sees suitable after hearing the petition.

**Those Who May File Complaints**

The individuals eligible to petition to the Company Law Board for redress in situations of oppression and mismanagement complaints made in accordance with Sections 397-398 are listed in Section 399.

To submit such an application, a company must have the following numbers: (i) 100 members, or 10% of its total membership, whichever is less, or members holding 10% of the issued share capital; (ii) 20% (one fifth) of its membership, in the case of a company without a share capital. In the right circumstances, the Central Government may provide permission to any fewer members to submit such an application to the Company Law Board.

**Ability of CLB to Offer Relief**

According to Section 402, the Company Law Board may provide remedy, and the relief that the CLB may grant in its order includes:

1. Regulation of future business operations of the corporation;

2. The corporation or another member acquiring the shares or interests of any member;

3. The resultant decrease in share capital in the aforementioned situation (b);

4. Any agreement, whatever it was reached, between the business and the management, managing director, or any other director may be canceled, set aside, or modified;

5. Any agreement between the corporation and another party may be dissolved, set aside, or modified with that party's approval;

6. The annulment of any transfer, delivery of goods, payment, execution, or other act pertaining to the property made by the firm or done against it within three months of the application that would constitute a false preference in the event of an individual's bankruptcy;

7. Any other situation for which, in the company law board's judgment, a provision should be made is reasonable and equitable.

**Central Government's Authority to Prevent Repression or Poor Management**

Section 408 gives the Central Government the authority to appoint directors to a company's board of directors in order to stop tyranny or poor management. In addition to the aforementioned restrictions, the Act includes several provisions under the heading "Investigation" to avoid oppression or poor management by individuals who oversee the operations of the corporation.

## CONCLUSION

In conclusion, Debentures and borrowing are crucial financing instruments for businesses because they provide them access to outside capital and support their goals for investment and development. Although these techniques provide advantages and prospects, it is important to carefully assess the dangers, regulations, and safeguards for investors. Successful borrowing and debenture issuances are facilitated by proper appraisal, transparency, and adherence to legal and regulatory requirements.

These factors also encourage sustainable financial practices inside businesses. The terms and circumstances of borrowing and debenture issuances should be carefully considered. When choosing the best financing instruments and structures, businesses must consider their capital requirements, cash flow capabilities, and risk tolerance.

Additionally, they should evaluate how it could affect their credit scores, financial ratios, and general financial health.

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# CHAPTER 25

# UNDERSTANDING THE WINDING UP OF COMPANIES

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**ABSTRACT**:

The process and implications of winding up, or liquidation, of companies in the context of corporate law and business dissolution. Winding up refers to the formal process of bringing a company's operations to an end, liquidating its assets, and distributing the proceeds to creditors and shareholders. This paper explores the different modes of winding up, such as voluntary winding up and compulsory winding up, and the legal requirements, procedures, and consequences associated with each mode. It analyzes the reasons for company winding up, such as insolvency, financial distress, or fulfillment of the company's objectives. Additionally, it examines the role of liquidators, the rights of creditors and shareholders in the winding-up process, and the implications for employees and other stakeholders. Through a comprehensive analysis of company law, regulatory frameworks, and case studies, this paper sheds light on the significance of winding up of companies and its impact on various parties involved.

**KEYWORDS**:

Liquidation, Assets, Bankruptcy, Creditors, Dissolution, Insolvency.

## INTRODUCTION

The term "registered office" refers to the location that served as the company's registered office for the longest period of time during the six months immediately before the presentation of the petition for winding up. The memorandum for a company limited by guarantee must also state that each member agrees to contribute to the company's assets in the event of its being dissolved while he is a member or within one year after he ceases to be a member, for the payment of the company's debts and liabilities, or of any debts and liabilities that may have been contracted before he ceases to be a member, as the case may be, as well as of the costs, charges, and expenses of winning [1], [2].

A firm is wound up when its existence is terminated and its assets are managed for the benefit of its shareholders and creditors. A liquidator, sometimes known as an administrator, is chosen to take over the business, collect the assets, settle the debts, and then distribute any remaining funds to the members in line with their entitlements. In plain English, winding up implies using a company's assets to pay off its debts and giving any surplus to those who are entitled to it, less any associated costs [3], [4]. 'Liquidation' is the legal procedure that accomplishes this. Because a corporation cannot be declared bankrupt under the insolvency legislation, corporate winding up varies from individual insolvency. Furthermore, even a profitable business may be shut down.The following three methods may be used to wind up a firm under Section 425:

1. Compulsory winding up according to a court order.

2. Willful winding down.

3. Voluntary dissolution under judicial supervision.

Bringing Things to a Close by the Jurisdictional Court. The following courts have competence to hear the petition for forced winding up:

(A) High court has jurisdiction over the location where the company's registered office is located. The location that served as the company's registered office for the longest period of time in the six months just before the petition for winding up was presented is referred to as the registered office [5], [6].

(b) A District court that is under the High Court and has been given the aforementioned authority. However, a High Court is required to hear cases involving businesses with paid-up capital of at least $15,000 (section 10). For instance, Mumbai is where X Ltd. maintains its registered office. Mr. Y, who lives in Chennai, is one of the company's creditors. He submits a plea to the Chennai High Court. One crore is the company's paid-up capital. The petition cannot be heard by the High Court in Chennai because it lacks jurisdiction. The petition for winding up should be filed with the High Court in Mumbai. In the situations listed in s.433, the court may impose forced winding up, often known as winding up by the court. On an application made by and on behalf of the individuals specified in Section 439, the court will issue an order for winding up.

**Justifications for mandatory winding up**

The following reasons may be used by the court to dissolve a company:

1. Special Resolution: The business may decide by special resolution that the court should wind it up. Any reason at all may lead to the resolution's passage. The court cannot, however, impose a winding-up order if it determines that doing so would be against the public interest or the interests of the corporation as a whole [7], [8].

2. Failure to Hold the Required Meeting: The firm may be ordered to be wound up if the required meeting or the statutory report are not held as required. The Registrar or a contributory may bring a petition on this basis. If it has to be submitted by someone else, it must be done so before the 14-day period after the last day on which the required meeting should have taken place.

3. Failure to Start Up: A company may be ordered to be wound up if it does not start up within a year after formation or if it suspends operations for a full year. Unless the firm has no intention of doing business or it is now impossible to do so, failing to start or conduct business is not considered a reason for compelled winding up [9], [10].

4. Reduction in Membership: The business may be required to be wound up if the number of members falls below the statutory minimum of 7 for a public company or 2 for a private one.

5. Inability to Pay obligations: If a firm is unable to pay its obligations, the court may order that it be wound up. In accordance with Section 434, a company is deemed to be unable to pay its debts if either of the following occurs: (a) a creditor for more than one lakh rupees has served the company at its registered office with a demand under his hand requiring payment and the company has neglected to pay, secure, or compound the amount for three weeks after that; or (b) execution or other process issued on a judgement or order of any court or court in favor of a creditor of

Although a contingent and future obligation is not a debt, the clause stating that the court must consider the contingent and prospective liabilities of the corporation is crucial. If a company's assets and obligations indicate that it will or may be unable to pay its debts as they become due in the future, it may nevertheless be ordered to be wound up. The term

"inability" should be used in the commercial sense of a functioning business rather than in the sense of liquidation, meaning that if a firm cannot satisfy its present demand even if its assets, when realized, would outweigh its obligations, it may be wound up. The debt must have become immediately due and payable and the creditor must have full ownership to the obligation, which must be for a specific or definite amount of money. The corporation cannot be held liable for failing to pay the debt where there is a legitimate dispute surrounding it. The application fee that must be returned to a share applicant whose application was rejected is not a debt. Additionally, the interest that is owed on such a sum is not a debt. Additionally, the company's obligation to pay an employee's wages or compensation is not a debt. A creditor (including a secured creditor), a debenture holder, and a trustee for debenture holders may all file a petition alleging that a firm is unable to pay its obligations. A petition may even be submitted by a contingent creditor, such as the holder of a bill of exchange. An organization may petition on its own behalf. The registrar's ability to submit a petition for the winding up of a corporation is restricted.

6. fair and Equity: If the court determines that dissolving a corporation is fair and equitable, it may also issue a court order for that purpose. The court must pay fair consideration to the interests of the business, its workers, creditors, shareholders, and the general public when using its authority on this basis. When alternative remedies are insufficient to safeguard the company's general interests, relief based on the fair and reasonable clause is only used as a last option. The 'just and equi' clause leaves the whole subject up to the court's 'broad and wise' discretion, unlike the 'just and equi' situations where specific circumstances must be met. The winding up must be fair and reasonable to everyone involved, including the corporation and all of its shareholders in addition to the applicants. Following are a few examples of "just and equi" reasons on why the court may order the winding up:

(i) After the company's foundation is gone: Where a company's goals have fallen short of expectations or have proven impossible to accomplish, the foundation of the business is said to be gone.

There are certain measures to determine whether the company's foundation has disappeared that were established in 31 Comp Cas 46, In re Kaithal and General Mills Co. Ltd. (1951). These situations include (a) those in which the company's sole asset has been lost; (b) the goal for which it had been incorporated has largely failed; (c) it is impossible for the company to continue except at a loss; or (d) the liabilities currently in place are significantly greater than the company's actual and potential assets.

(ii) When management is completely at a standstill Even if a firm is producing strong profits, it might nevertheless be closed down for this reason. The sole shareholders and directors of a private limited business grew so antagonistic toward one another in Re Yenidje Tobacco Co. Ltd. 2 Ch 426, A and B, that they would only communicate with one another via the secretary. Held: The corporation was ordered to be wound up since there was a total impasse.

Fraud in the prospectus or in the way the firm conducts business is insufficient for this purpose. (iii) Where the company was created for fraudulent or unlawful reasons. It must be that the company's initial purpose in being created was dishonest or unlawful.

However, the court will only order winding up when it is satisfied that it is impossible for the business of the company to be carried on for the benefit of the company as a whole due to the way in which voting power is held and used. (iv) Where the principal shareholders have adopted an aggressive or oppressive policy towards the minority.

(v) When the business is in a "bubble" Thus, it never conducted any actual business.

(vi) In cases when the company's operations can only be maintained at a loss: The mere fear that certain stockholders may experience a loss rather than a gain has, however, been ruled to be inadmissible. Similar to this, it was determined in Re Shah Steamship Navigation Co. that the court would not be justified in issuing a winding-up order simply because the firm had suffered losses and was expected to continue doing so. If conditions exist that would make it reasonable and equitable for the Court to order the dissolution of the partnership firm, it may be ordered to be wound up when a private corporation is essentially or essentially a partnership. In Re Davis & Coltett Ltd., one member illegally barred the other from participating in the company's affairs despite the fact that they both controlled half of the shares. Hold, the corporation be dissolved. In this case, Ebrahimi v. Westbourne Galleries Ltd. 2 All ER 492 established certain guiding principles for the use of reasonable and equal grounds for winding up. These include (a) the fact that the company was founded on a foundation of trust and personal relationships (b) an understanding that all or some shareholders will participate in the operation of the business as in the case of a partnership concern (c) restrictions on the transfer of a member's interest in the private company. However, the transformation of an existing partnership business into a private corporation does not mean that the company automatically keeps the characteristics of a partnership firm.

(viii) Conditions for the Investigation The company was ordered to be wound up when Directors made accusations of dishonesty against one another regarding misappropriations of the company's funds on the grounds that the conduct of some of the officers of the company required an investigation, which could only be obtained in a winding up by the Court.

**Technique for Closing Order**

1. The court must be submitted with the winding up petition.

2. The firm, a creditor, or contributories may ask the court to appoint a temporary liquidator to protect the assets until the hearing after the petition is presented but before the hearing. But before scheduling such an appointment, the court must give the corporation notice so that it may make a representation in the issue, unless it decides to do without notice for reasons that must be stated in writing. Unless otherwise restricted by the court, the interim liquidator has the same powers as a liquidator (section 450).

3. The court may take one of the following actions after hearing a winding up petition: (i) dismiss it, with or without costs; (ii) postpone the hearing conditionally or unconditionally; (iii) make any interim orders it deems appropriate; or (iv) make an order for the company's winding up, with or without costs, or any other order it deems appropriate.

However, the court cannot decline to issue a winding up order solely on the grounds that the business's assets are mortgaged for a sum equal to or more than those assets or that the firm has no assets. If the petitioners argue that winding up the company would be just and equitable, the court may decline to issue an order of winding up if it determines that they have access to another remedy and that their request to wind up the company is unreasonable given their access to that other remedy. When a petition is filed because the Registrar has not received the required report or the required meeting has not been held, the court may: (a) instead of issuing a winding-up order, order that the required report or meeting be held; and (b) order that those who, in the court's opinion, are at fault for the default pay the costs. The court may consider the views of creditors or contributories of the company as shown to it by any adequate evidence in all cases connected to the winding up of a business, and for this reason may order that their meetings may be called or conducted as ordered by the Court (s. 557).

## DISCUSSION

### Statement of Affairs to be made to the Liquidator

When the court issues a winding-up order for the company, the directors are required to provide the liquidator with a statement about the company's affairs that includes the following information: (i) the company's debts and liabilities; (ii) the assets of the company, showing separately any cash on hand and in the bank; (iii) the name, address, and employment of each creditor, along with a breakdown of the amount owed for secured and unsecured debts; and (iv) Such a statement's purpose is to provide the liquidator with information on the company's financial situation and liabilities. The statement is available for inspection by the company's contributors and creditors. The statement must be submitted within 21 days after the relevant date (or any further time up to three months that the official liquidator or Tribunal may provide for unusual circumstances). The court's winding up order date or, in the case of a temporary liquidator, the day of the liquidation's appointment, is the crucial date. The declaration must be presented and attested to by an affidavit signed by one or more of the directors at the relevant period as well as the manager, secretary, or other top executive officer of the firm. For each day that the default persists, the offender faces a fine of up to $1,000 or a sentence of up to two years in jail, or both.

### Inspection Committee

A committee of inspection may be constituted to work with the liquidator at the moment the court issues an order for the winding up of a firm or at any point in the future. In this situation, the liquidator is required to call a meeting of the company's creditors within two months of the date of the directive in order to elect the committee's members. The liquidator must call a meeting of the contributories to discuss the creditors' meeting's decision on the composition of the committee within 14 days of the meeting date (or within such additional time as the Court in its discretion may provide for the purpose). The decision of the creditors' meeting may be accepted by the meeting of contributories with or without changes, or it may be rejected. The liquidator must ask the court for instructions on how the committee should be organized and who should serve on it. In cases when the meeting of contributories accepts the creditors' meeting's decision in its entirety, it won't be essential to ask for guidance in this respect. According to Section 465, (i) a committee of inspection may not have more than 12 members; (ii) the committee has the authority to examine the liquidator's financial records at any time that is reasonable;

(iii) It must meet at the times it may designate from time to time, and the liquidator or any committee member may also call a meeting of the committee whenever he or she deems it necessary; (iv) The quorum for the committee meeting shall be one-third of the total number present, or two, whichever is higher; and (v) A committee member may resign by giving written notice of their intention to do so. However, a committee member will no longer be a member if he or she is declared bankrupt, compromises or makes arrangements with his or her creditors, or misses five consecutive sessions of the committee without the members' permission.

### General Court Authority

The following are the court's general powers:

1. Power of Court to Stay Winding Up (Section 446): The court may, at any time after issuing a winding up order (on the application of the official liquidator of any creditor or contributor and upon proof to the satisfaction of the court that, all proceedings in relation to the winding

up order be stayed), issue an order staying the proceedings either completely or for a specific period of time, on such terms and conditions as the court deems appropriate.

2. Settlement of the List of Contributors (Section 467): The court has the authority to order that the company's assets be gathered and used to satisfy its debts. The court has the authority to compile a list of contributories for this reason. The court must make a distinction between individuals who are contributories in their own right and those who are contributories as agents or accountable for the obligations of others when determining the list of contributories.

3. The Court May summon Any or All Contributors (Section 470): The Court may summon any or all contributories to the extent of their culpability. It should be noted that no legal obligation for an unpaid call may be offset against a credit, with the exception of the following circumstances: (a) in the case of an unlimited company, a contributory may offset his debt against any money owed to him from the company on the basis of any independent dealing or contract with the company. In the case of a limited company, any director or manager whose liability is unlimited shall have the same right of setoff as described in (a) above; (b) in the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whether to a contributory from the company may be set off as described in (a) above; and (c) no set off is allowed for any money due to him as a member of the company in respect of any dividend

4. Payment into Bank of Moneys Due to firm (Section 471): The court may order that any contributor, purchaser, or other person who owes the firm money pay it into the Reserve Bank of India's public account rather to the liquidator.

5. The court may set a deadline or deadlines by which creditors must establish their claims or debts (Section 474). Creditors who fail to do so will be excluded. If the creditors in this situation are unable to timely demonstrate their claims, they may not get any distributions.

6. Adjustment of Contributors' Rights (Section 475): The court has the authority to divide any excess among those who are entitled to it and to adjust Contributors' Rights among themselves.

7. The court may issue an order for the payment out of the assets of the fees, charges, and expenditures spent in the winding up in such order of priority inter se as the Court judges reasonable in the event that the assets are inadequate to cover the obligations.

8. Power to Summon Persons believed of Possessing Company Property, etc. (Section 477): The court has the right to summon any official of the company as well as any person who is known or believed to be indebted to the business or who is known or suspected to be in possession of any company property, books, or documents. Any such individual is subject to oath examination. The court may also order him to turn over any records he has in his possession or control that pertain to the corporation, but if he has a claim to any lien on any records he produces, such claim must remain unaffected by the production. The court may order that any officer or person called be seized and brought before the court for questioning if they fail to appear before the court at the time scheduled despite having been paid or offered a fair amount for their costs.

9. When the Official Liquidator reports to the court that, in his opinion, a fraud has been committed by any person in the promotion or formation of the company, or by any officer of the company since its formation, the court has the authority to order that person or officer to appear before the court and be publicly examined. The subject of the test will be his behavior and transactions while serving as an officer of the firm, as well as its promotion,

establishment, or commercial operations. Any creditor or contributor may participate in such an examination, including the official liquidator. The court has the right to ask the individual being questioned any questions it sees suitable. The subject must submit to an oath-based examination and respond to whatever questions the tribunal may direct or permit to be directed at him. The notes of the examination may thereafter be used as evidence against the subject and must be recorded in writing, read to or by the subject of the examination, and signed by him. Any creditor or donor may examine the statement that has been so recorded at any time that is fair.

10. Upon showing probable cause that a contributory is about to leave India or otherwise abscond, or is about to remove or cancel any of his property, for the purpose of avoiding payment of calls or avoiding examination in regard to the company's affairs, the court may, at any time (either before or after making a winding up order, cause: (a) the contributory to be arrested and safely held unharmed.

11. Power to Order for Dissolution of the Company (Section 481): When a company's affairs have been fully wound up or when the court determines that the liquidator cannot proceed with the winding up of a company due to a lack of funds and assets or for any other reason at all and it is just and reasonable in the circumstances of the case that an order for the company's dissolution should be made, the court shall make an order that the company be dissolved from the date of the order. Within 30 days, the liquidator is required to deliver a copy of the order to the Registrar, who will record the company's dissolution in his records. If he fails to transmit a copy as required, he will be subject to a fine that might reach $500 for each day that the failure persists.

The name of the firm shall be removed from the registry five years after the date of dissolution. However, the court may issue an order, with the conditions it deems appropriate, declaring the dissolution to have been invalid within two years of the date of the dissolution upon request from the company's liquidator or from any other person who appears to the court to be interested. Following the issuance of such an order, the same legal actions may be conducted as would have been permitted if the corporation had not been dissolved (Section 559).

**Active Winding Down**

'Voluntary winding up' refers to the process of a company being dissolved by its creditors or members without the involvement of a court. In a voluntary winding up, the business and its creditors are allowed to handle their financial issues on their own without having to seek the court's guidance or approval every time anything goes wrong. Insolvency should not be confused with winding up.

Even if a company is solvent and operating profitably, it may choose to be wound up willingly, such as as part of a plan for reconstruction or merging. The following situations may result in a company being wound up voluntarily: (1) the company decides by special resolution that it shall be wound up voluntarily (s. 484); (2) the period set forth in the articles of incorporation for the duration of the company has expired; or (3) the circumstance specified in the articles of incorporation for the dissolution of the company has occurred.

A company that has passed a resolution for voluntarily winding up is required to publish notice of the resolution within 14 days of the resolution's passage in an official gazette and a newspaper that is widely read in the area where the company's registered office is located. If there is a default, the corporation and any of its officers who is in default are subject to a fine that may reach $500 for each day that the default persists (Section 485).

**Voluntary Winding Up's Effects**

The following are the effects of voluntarily winding up:

1. According to Section 486, a voluntary winding up is considered to start when the resolution for it is approved. This will be the case even if the court files a petition for winding up the company after approving a resolution for voluntarily winding up (Section 441).

2. Even if the corporate status and powers of the company remain until ultimate dissolution, the company must stop operating as of the beginning of the winding up process, unless it may be necessary to ensure a beneficial winding up (section 487).

3. After the beginning, any transfer of shares and changes to a member's status are invalid (s. 536), unless the liquidator approves them.

4. Except in cases where (a) the liquidation is only for the purpose of "reconstruction" or (b) the liquidator continues operations in order to efficiently wind up the firm, a decision to wind up serves as notice of discharge to the company's workers.

5. All of the Board of Directors', managing directors, and "manager" powers are terminated upon the appointment of the liquidator, with the exception of the following (section 491): (a) for the purpose of notifying the Registrar of the name of the liquidator appointed; or (b) to the extent that the company in general meeting or the liquidator may approve the continuation of their powers.

**Voluntary Winding Up Types**

Three different sorts of voluntary winding up are possible: (a) voluntary winding up by members; (b) voluntary winding up by creditors; and (c) voluntary winding up with judicial oversight.

**Member's Voluntary Dissolution**

Only when the firm is viable and able to fully meet its obligations is members' voluntary winding up conceivable. The key clauses pertaining to members' voluntarily winding up are listed below.

**Statement of Solvency (section 488)**

When a company's voluntary dissolution is being considered, its directors, or if there are more than two directors, the majority of the directors, may, at a board meeting, make a declaration, which must be supported by an affidavit, stating that they have conducted a thorough investigation into the company's affairs and that after doing so, they have come to the conclusion that the company has no debts or that it will be able to pay all of its debts in full within a time This declaration must meet the following requirements in order to be valid: (i) it must be made within five weeks of the date on which the members vote to wind up the company; (ii) it must be delivered to the registrar for filing prior to that date; and (iii) it must be accompanied by a copy of the audit report from the company's auditors on the profit and loss account prepared since the date of the most recent account and the balance sheet of the company prepared as of the most recent date. A director of a company who makes a declaration under this section without having reasonable grounds to believe that the company will be able to pay its debts in full within the time frame specified in the declaration is punishable by up to six months in jail, a fine of up to $5,000, or a combination of the two. It will be assumed, until proven otherwise, that the director lacked reasonable grounds for his

opinion if the company is wound up as a result of a resolution adopted within five weeks of the declaration's making but its debts are not paid in full within that time frame.

If the aforementioned requirements are not met, the winding up shall not be a members' voluntary winding up, and in such a scenario, laws (Sections 490 and 498) pertaining to members voluntary winding up cannot apply. If a liquidator is appointed in accordance with Sections 490 or 498, it is also not applicable in this situation. A 490 or 498 appointment would be illegal under the law. According to M. Kakshmiah v. Registrar of Companies, Trivandrum-unreported case decided by the Kerala High Court, in such a situation, the provisions relating to creditor's voluntary winding up (Ss. 500-509) should be followed, and the violation of these provisions will render the winding up proceedings void ab initio. If a default is made in calling a meeting of the creditors, the company and the Directors, as applicable, shall be punished with Instead of declaring the winding up proceedings illegal, the Court may, at the request of the firm or its shareholders, order the company to call the creditors meeting. Even if a statement of solvency has been submitted, the aforementioned guidelines must still be followed in accordance with s.488(2). After meeting the conditions of s.488 (Declaration of Solvency), the corporation may, however, adopt a new resolution for its winding up.

**Liquidators' Appointment and Compensation (Section 490)**

For the purpose of winding up the business's affairs and dispersing its assets, the firm must: (a) appoint one or more liquidators; and (b) specify the compensation, if any, to be given to the liquidator or liquidators. Any compensation thus set cannot be raised under any circumstances, with or without the Court's approval. A liquidator cannot assume responsibility for his position before his compensation is set. Additionally, the company in general meeting may replace the vacancy in the office of the liquidator designated by the company if a vacancy arises due to a death, resignation, or other circumstance, subject to any agreement with its creditors. Any contributing, the continuing liquidator, or the Court may request that a meeting be called for this reason (Section 492).

**Board's Authority to Stop**

All of the Board of Directors' and the managing director's or whole-time directors' or manager's authority will end with the appointment of a liquidator, with the exception of the ability to notify the Registrar of the appointment. However, inasmuch as the penalty applies, their functions may still be used if approved by the general body or the liquidator (section 491).

With the intention of distributing them among the members of the transferor company, the liquidator may accept shares, policies, or similar interests in exchange for the sale of the company's undertaking to another company, provided that (a) a special resolution is passed by the company to that effect, and (b) he purchases the interest of any dissenting member at a price to be determined by agreement or by arbitration. Before the corporation is dissolved, the dissident members should get their money, which should be raised in accordance with any special resolutions that may be passed.

**In the event of insolvency, the liquidator must summon a meeting of creditors (section 495)**

The liquidator is required to call a meeting of creditors as soon as possible and present the meeting with a statement of the company's assets and liabilities if at any point he believes the company will not be able to pay its debts in full within the time frame specified in the

declaration of solvency or if that time frame has passed without the debts having been paid in full. He will face a fine that might reach $5,000 if he doesn't follow the aforementioned rules.

**Liquidator's obligation to summon the annual general meeting (Section 496)**

If the winding-up process lasts longer than a year, the liquidator is required to: (a) call a general meeting of the company at the end of the first year following the start of the winding-up process and at the end of each succeeding year, or as soon as may be convenient within three months of the end of the year, or such longer period as the Central Government may allow; and (b) lay before the meeting an account of his acts and dealings and of the conduct of the winding-

**Meeting adjourned and dissolved**

The liquidator is required to do two things as soon as the company's affairs are completely wound up: (a) prepare an account of the winding up detailing how it was handled and how the company's assets were distributed; and (b) call a general meeting of the company to present the account and provide any necessary justifications. The meeting must be summoned by notice that includes the date, time, and purpose of the meeting.

The notice must also be published at least one month prior to the meeting in the official gazette and a newspaper that is widely read in the area where the company's registered office is located. A copy of the account and the return detailing the holding of the meeting must be sent by the liquidator to the Registrar and the official liquidator, respectively, within one week following the meeting. He must report appropriately if a quorum was not present at the called meeting. The Registrar will register the aforementioned documents as soon as they are received, and the official liquidator will examine the company's accounts and records and submit his findings to the court. If the official liquidator's report demonstrates that the company's affairs have not been managed in a way that is detrimental to the interests of its members or the general public, the company will be assumed to have been dissolved as of the day the court's report is submitted. If the report is unfavorable, the court will order the official liquidator to look into the business's operations once again.

The court has two options after receiving the official liquidator's report on this further investigation: it may either order that the corporation be dissolved with effect from the date mentioned in the order, or it can order whatever is necessary given the facts revealed in the report.

## CONCLUSION

In conclusion, A major procedure that signifies the end of a firm's activities is corporate winding up. It entails following legal processes, appointing a liquidator, paying off debts, and distributing assets to shareholders and creditors. For the winding-up process to effectively safeguard the rights and interests of stakeholders, legal standards must be followed with accuracy, openness, and fairness.

The process of winding up a business offers a way to settle financial issues and put an end to its activities, enabling the payment of debts and the distribution of any residual assets.

A method for settling a company's financial issues and ending its business activities is winding up. It permits the payment of obligations, the realization of assets, and the fair distribution of gains. The company's affairs may be settled in an orderly fashion, shareholders can get any residual assets, and creditors can reclaim their obligations by winding up.

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