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Indira Gandhi National Open University
School of Management Studies

BCOC-135
Company Law

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Block

1

COMPANY AND ITS FORMATION

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BLOCK 1 COMPANY AND ITS FORMATION

Businesses require large amount of funds and have to work in a complex modern-day environment. The company form of business organisation is most appropriate and popular form. In this form of organisation, money is invested by a large number of persons, called shareholders, who may be scattered over different parts of the country or even the world. In order to protect the interest of the investors, who cannot supervise those who are entrusted with the management of the affairs of the company, it is necessary that the Government monitors and regulates the affairs of the company. It is with this aforesaid objective that the company legislation is enacted and with changing complexities has been amended from time to time. The first company legislation in India was passed in 1850 which was followed by the Companies Act of 1857, 1866, 1913 and 1956. The Companies Act, 1956, was based on the recommendations of Bhabha Committee. With the changing needs and increased complexities of business as well as to offer better governance, the Companies Act, 1956 was amended several times. Last amendments were made by the Companies (Amendment) Act, 2006.

Companies Act, 2013

The Companies Act, 1956 has now been replaced by Companies Act, 2013, a more contemporary, simplified and rationalized legislation. The objective behind this new Act is said to be to bring our company law at par with the best global practices.

The Act of 2013 has, besides many others, introduced ideas like one person company, Corporate Social Responsibility (CSR), class action suits and a fixed term for independent directors.

It also tightens provisions for raising money from the public, prohibits any insider trading by company directors or key managerial personnel by treating such activities as a criminal offence. However, it permits shareholders' agreements providing for 'Right of first offer' or 'right of first refusal' even in case of public companies.

Further, it requires certain companies to earmark 2 percent of the average profit of the preceding three years for CSR activities and make a disclosure to shareholders about the policy adopted in the process.

You may note that the company law provides for the procedure of forming a company, its objects and scope, the rules for its internal management, the capital structure, the powers and duties of directors, the company meetings, the form and audit of accounts, powers of inspection and investigation of the affairs of the company and the manner in which the life of a company may be brought to an end.

The Companies Act 2013 has been amended quite a few times. The amendments have been made by Companies (Amendment) Act 2015, by Companies (Amendment Act), 2017 & 2019 and Insolvency and Bankruptcy code 2016 and Finance Act 2017. The amendments have been incorporated in the text at appropriate places.

In this introductory block, we have discussed the nature and types of companies, the position of a private limited company, the role of promoters, the procedure for the formation of a company and authorities under Companies Act 2013. It consists of five units.

Unit 1 explains the meaning and nature of company, the distinction between company and partnership and the various types of companies that can be formed, illegal associations and association not for profit.

Unit 2 describes the meaning of a public company and private company, distinction between public company and private company, privileges of private company and its conversion into a public company and vice versa.

Unit 3 deals with the legal position of a promoter. It discusses his functions, liabilities, remuneration and also the position of preliminary contracts entered into by him on behalf of the company.

Unit 4 describes the procedure for the formation of a company. It is divided into four stages: (i) Promotion; (ii) Filing of necessary documents; (iii) Incorporation/ Registration; (iv) Commencement of business.

Unit 5 explains the various authorities under Companies Act 2013. It discusses National Company Law Tribunal, National Company Law Appellate Tribunal and Special Courts and other authorities.

UNIT 1 NATURE AND TYPES OF COMPANIES

Structure

1.0 Objectives

1.1 Introduction

1.2 Meaning and Definition of a Company

1.3 Company vs. Body Corporate

1.4 Is Company a Citizen

1.5 Main Features of a Company

1.6 Lifting the Corporate Veil

  1.6.1 Under Express Statutory Provisions

  1.6.2 Under Judicial Interpretations

1.7 Distinction between Company and Partnership

1.8 Distinction between Company and Limited Liability Partnership

1.9 Kinds of Companies

  1.9.1 On the Basis of Incorporation

  1.9.2 On the Basis of Liability

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1.10 Other Kinds of Registered Companies

  1.10.1 Producer Company

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1.11 Association Not for Profit

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  1.12.2 Exceptions

  1.12.3 Consequences

1.13 Let Us Sum Up

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1.15 Answers to Check Your Progress

1.16 Terminal Questions

1.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a company;
- distinguish between company and body corporate;
- describe the characteristic features of a company;

- explain the concept of corporate veil;
- distinguish between company and partnership;
- distinguish between company and limited liability partnership;
- describe the various types of companies;
- understand associations not for profit; and
- describe an illegal association.

1.1 INTRODUCTION

The Companies Act, 2013 received the assent of the President on 29th August and was notified on 30th August, 2013. It has 470 sections and VII schedules, whereas the Companies Act 1956 had 658 sections and XV schedules. This Act provides detailed rules regarding formation, management and administration and winding up of companies by Tribunals. It has made changes in provisions relating to memorandum, definition of prospectus, appointment of auditors, and accounting standards and financial statements and investigations etc. This Act has been amended by Companies amendment Act 2015, 2017 and 2019. In this introductory unit you will study the meaning and definition of a company, the main features of a company form of business organization, its distinction from partnership as well as limited liability partnership and the various types of companies that can be formed in India.

1.2 MEANING AND DEFINITION OF A COMPANY

The term 'company' may be described to imply an association of persons formed for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. However, the term 'company' is normally reserved for those associated for economic purpose, i.e, to carry on a business for gain. **This should, however, not give you an impression that a company under the companies Act cannot be created for non-economic or charitable purposes. In fact, Section 8 of the Companies Act, 2013 allows formation of non-profit associations as companies.**

Partnerships often describe themselves as 'A, B, C & Company'. But, this does not make the firm a company in the legal sense of the word; it only suggests that there are other persons also in the association.

In legal terminology, a company means a company incorporated or registered under the Companies Act, 2013 or under any of the earlier Companies Acts. Section 2(20) of the Companies Act, 2013 defines a company to mean a company incorporated under this Act or under any previous company law. This definition, however, is not exhaustive because it does not reveal the meaning and characteristics of a company. Thus we have to see definition of a company as given by famous Jurists.

Lord Justice Lindley defines a Company as follows:

"A company is an association of many persons who contribute money or money 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. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are called members. The

proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."

Another definition as given by ***Chief Justice Marshall*** reads as follows:

"A company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

According to **Lord Haney**, "A company is an incorporated association which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal."

From the above definitions, it is clear that a company has a corporate and legal personality. It is an artificial person and exists only in the eyes of law. It has an independent legal entity, a common seal and perpetual succession.

1.3 COMPANY VS. BODY CORPORATE

Body corporate means an association of persons which has been incorporated under some statute having perpetual succession, a common seal and having a legal entity different from the members constituting it. Section 2 (11) of the Companies Act, 2013 defines the expression 'body corporate' as follows:

"Body corporate" or "Corporation" includes a company incorporated outside India, but **does not include**—

i) a co-operative society registered under any law relating to co-operative societies; and

ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf".

A body corporate may be-

a) corporation sole, or

b) corporation aggregate.

A **'corporation sole'** is a body corporate constituted in a single person who, in right of some office or function, has corporate status. Examples of 'corporation sole' are to be found in perpetual offices such as the President, Governors, Crown, Ministers, and a public trustee. A corporation sole is not a "body corporate' for the purposes of the Companies Act, 2013. It is still a legal person and as such person it can be a member of a company- **Star Tile Works Ltd. v. N. Govindan (1956).**

A **'corporation aggregate'** consists of a group of persons together associated so that they form a single person, e.g., a limited company, a trade union.

It may be of interest to note at this stage that because of inclusion of a company incorporated outside India within the definition of body corporate, a number of provisions of the Companies Act, 2013 apply to such companies; for example, Section 380 requires foreign companies carrying on business in India to deliver certain documents to the Registrar of Companies.

The expression 'corporation' or 'body corporate' is, thus, wider than the word 'company'. A company, as noted above, is a corporation aggregate.

1.4 IS COMPANY A CITIZEN?

Although a company is regarded as a legal person (though artificial), it is not a citizen either under the Constitution of India or the Citizenship Act, 1955- **Heavy Engineering Mazdoor Union v. State of Bihar (1969).** The Supreme Court of India in **State Trading Corporation Ltd. v. CTO (1963)** held that a corporation including a company cannot have the status of a citizen under the Constitution of India. Thus, under the Constitution, a company has no fundamental rights which are expressly available to citizens only. It can, however, claim the protection of those fundamental rights which are available to all persons, whether citizens or not, for example, the right to own property.

In **Narasaraopeta Electric Corporation Ltd. v. State of Madras (1951)**, the High Court observed that a company incorporated under the Indian Companies Act does not satisfy the requirements of the definition of 'citizen' in Article 5 of the Constitution and therefore is not a citizen.

A company is also not allowed to lay claim to fundamental rights on the basis of its being an aggregate of citizens. Once a company or a corporation is formed, the business of the company or the corporation is not the business of the citizens but that of the company or corporation formed as an incorporated body and the rights of the incorporated body must be judged on that footing and cannot be judged on the assumption that they are the rights attributable to the business of individual citizens-Supreme Court in **Telco Ltd. v. State of Bihar (1964)**.

Although a company cannot be a citizen, yet it has a nationality, domicile and residence. A company is said to be resident and national of the place and country where is incorporated.

1.5 MAIN FEATURES OF A COMPANY

On analyzing the various legal and juristic definitions of the term company, you will observe that a company formed and registered under the Companies Act has certain special features which distinguish it from the other forms of organisations. The main characteristic features of a company are as follows:

1) **Creation of Law:** A company is an association of persons (except in case of 'One Person Company') registered under the Companies Act. It comes into existence only when it is so registered. Minimum number required for the purpose is 2, in case of a private company and 7, in case of a public company. Only one person can form a 'one person company' (*Section 3*).

2) **Artificial Person:** A company is created with the sanction of law and is not itself a human being. It is, therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.

3) **Separate Legal Entity:** Unlike partnership, company is distinct from the persons who constitute it. Section 9 says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum.

The legal status of a company has been aptly described by the Supreme Court of India in **Tata Engineering & Locomotive Co. Ltd. v. State of Bihar** as follows:

"The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose".

Even though the company lacks physical existence, for purposes of law it is regarded as an independent legal person who has personality of its own and is different from the members constituting the company. Therefore, a company can enter into a contract with any of its members. A person can own its shares and also be its creditor. A shareholder of a company cannot be held liable for its acts and debts even though he virtually holds the entire share capital. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or on its winding up. Similarly, creditors of the company are the creditors of the company alone and they cannot take action against the members of the company.

Even where a single shareholder virtually holds the entire share capital, a company is to be differentiated from such a shareholder. In the well known case of **Salomon v. Salomon & Co. Ltd. (1895-99)**, Salomon was running a shoe business in England. He formed a company known as 'Salomon & Co. Ltd.'. It consisted of Salomon himself, his wife, his four sons and a daughter. The shoe business of Mr. Salomon was sold to the company for £30,000. Mr. Salomon received from the company purchase price in the form of £20,000 fully paid shares of £1 each and £10,000 in debentures which carried a floating charge over the assets of the company and the balance in cash. One share of £1 each was subscribed for in cash by each member of Salomon's family. Salomon was appointed the managing director of the company. During the course of business, the company became liable for some unsecured loan. The company in less than one year ran into financial difficulties and the liquidation proceedings started. On winding up, the assets realized £6,000. The company owed £10,000 to Mr. Salomon and £7,000 to unsecured creditors. Thus, after paying off the debenture holder (Mr. Salomon), nothing was left for unsecured creditors. The creditors claimed priority over the debentures contending that Mr. Salomon and Salomon & Co. Ltd. was one and the same person. The company was only a façade to defraud the innocent creditors. Mr. Salomon should not be treated as a secured creditor, outside creditors should be paid first. The House of Lords held that the company had been validly constituted, and it is independent of its members. So Salomon is entitled to get his money first as he is a secured creditor. The business belonged to company and not to Salomon. Salomon was its agent; the company was not the agent of Salomon.

In T.R. Pratt (Bombay) Ltd. vs. E.D. Sasoon and Co. Ltd., it was observed that under the law, an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is a distinct entity. Similarly, in **Abdul Haq vs. Das Mal**, an employee sued a director of the company for the recovery of the amount of salary due to him. It was held that he could not succeed because the remedy lied against the company and not against the directors or members of the company.

As a consequence of separate legal entity, the company may enter into contracts with its members and vice-versa. Thus, a shareholder can be the creditor of the company.

4) **Limited Liability:** A major advantage enjoyed by a company is that the liability of its members is limited. The company being a separate person, its

members are not as such liable for its debts. You will later study that on the basis of liability, companies may be classified as (i) Companies limited by shares, (ii) Companies limited by guarantee, (iii) Companies limited by guarantee but having share capital, and (iv) Unlimited liability companies.

In case of a *company limited by shares*, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. In case of a *company limited by guarantee*, the liability of the members is limited up to the amount guaranteed by a member. But, in case of a *guarantee company having share capital*, the liability shall be limited to the aggregate of the amount remaining unpaid on the shares held by a member and the amount guaranteed by him.

You may note that, the Companies Act, 2013 allows companies to be formed with liability of members as unlimited. In case of an unlimited liability company, the liability of members shall not be limited to the nominal or face value of the shares held by them; they shall continue to be liable till each paisa of company's debts and liabilities has been paid off. However, the company being a separate legal entity, no suit can be filed by the creditors directly against the members.

5) **Separate Property:** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in **Bacha F. Guzdar *v*. Commissioner of Income Tax, Bombay (supra)**. The Supreme Court held that a shareholder is not the part owner of the company or its property, he is given only certain rights by law, e.g., to vote or attend meetings, to receive dividends.

   In **Macaura *v*. Northern Assurance Co. Ltd. (1925),** it was held that a member does not even have an insurable interest in the property of the company. In this case, Macaura held all except one share of a timber company. He insured the company's timber in his own name. On timber being destroyed by fire, his claim was rejected because he had no insurable interest in that timber. The Court observed: "No shareholder has any right to any item of property of the company for he has no legal or equitable interest therein".

6) **Perpetual Succession:** The term perpetual succession means the continued existence. The existence of the company is not affected by reasons such as the insolvency, death, unsoundness of mind of its members. The company has a perpetual succession. Members may come and members may go but the company goes on. It continues even if all its human members are dead. Even where during the war, all the members of a private company, while in general meeting were killed by a bomb, the company survived. Not even a hydrogen bomb could have destroyed it. In the aforesaid eventuality, the legal successors of the deceased shareholders will become the members. But this does not mean that a company can never come to an end. You learnt that a company is creation of law, it can also be brought to an end by the process of law.

7) **Transferability of Shares:** One particular reason for the popularity of joint stock companies has been that their shares are capable of being easily transferred. The shares of a public company are freely transferable. A shareholder can transfer his shares to any person without the consent of other members. Articles of association, even of a public company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of a public company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the

manner provided for in the articles of association of the company. **The Companies Act, 2013, vide Section 58(2) provides that without prejudice to sub-section (*1*), the securities or other interest of any member in a public company shall be freely transferable Provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. Thus, the present Act upholds shareholders' agreements providing for 'Right of first offer' and 'Right of first refusal' as valid even in case of a public company.**

However, a private company is required to put certain restrictions on transferability of its shares but the right to transfer is not taken away absolutely even in case of a private company.

8) **Common Seal:** A company being an artificial person is not bestowed with body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company. A metallic seal should be used. A company may have a common seal with its name engraved on the same.

   As per Section 22, a company may, under its common seal, through general or special power of attorney empower any person to execute deeds on its behalf in any place either in or outside India. It further provides that a deed signed by such an attorney on behalf of the company and under his seal where sealing is required, shall bind the company and have the effect as if it were under its common seal as per Companies (Amendment) Act, 2015, common seal is optional. In case a company doesn't have a common seal, the authorization shall be made by two directors or by a director and the company secretary, wherever the company has appointed a company secretary. Again, except where so provided in the Act, a document or proceeding requiring authentication by a company may be signed by any key managerial personnel or an officer or employee duly aurhorised by the Board in this behalf and need not be under its common seal [Section 21].

9) **Company may sue and be sued in its own name:** As juristic person, company can sue and be sued in its own name. This is so because a company has a separate legal existence. A company may enter into contracts and can enforce the contractual rights against others and it can be sued by others if it commits a breach of contract.

Check Your Progress A

1) Define a company.

   ....

   ....

   ....

2) Enumerate the three main features of a company.

   ....

   ....

   ....

   ....

3) State, whether the following statements are true or false:

   i) A company is the creation of law.

   ii) A company is an artificial person.

   iii) Since company is an artificial person, it can commit no wrong nor can it be sued in its own name.

   iv) Like a partnership, a company comes to an end when any shareholder of the company dies.

   v) A company although is a corporate person yet it is not a citizen.

   vi) The liability of a member is limited to the face value of the shares held by him.

1.6 LIFTING THE CORPORATE VEIL

Under Para 1.5, you learnt that a company has a separate legal entity independent and different from its members. This principle of separate legal entity was well established in the famous case of **Salomon *v*. Salomon and Company Ltd.** On incorporation a line of demarcation or a veil is drawn between the company and its members. In fact, a company is an association of persons and such persons are the real beneficial owners of all the corporate property. Real persons behind the company are disregarded once they have formed a company and given the status of a legal entity.

As a consequence of this separate legal entity, the company enjoys several advantages which you have studied in foregoing Para. But, the advantages of incorporation are allowed to be enjoyed only by those who want to make an honest use of the 'company'. In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons who are behind the scene and are responsible for the fraud. The corporate veil is said to be lifted when the court ignores the company and concerns itself directly with the officers or members of the company. Prof. Gower has observed, "When the law disregards the corporate entity and pays regard instead to the individual members behind the legal façade, it is known as lifting the veil of corporate personality".

You should, however, note that the power of the court to lift the corporate veil is purely discretionary. The court will lift the corporate veil when it is in the public interest to do so. In **Cotton Corporation of India Ltd. *v*. G.C. Odusumathd (1999**), the Karnataka High Court observed that lifting of the corporate veil of a company, as a rule is, not permissible in law unless otherwise provided by clear words of the statute or by very compelling reasons such as where fraud is intended to be prevented or trading with enemy company is sought to be defeated.

The circumstances under which the courts may lift the corporate veil may broadly be grouped under the following two heads:

A) Under express statutory provisions

B) Under judicial interpretations

Let us now discuss them in detail.

1.6.1 Under Express Statutory Provisions

The Companies Act, 2013 provides for certain circumstances in which the directors or members of the company may be held personally liable. In such cases, while

the separate entity of the company is maintained, the directors or members are held personally liable along with the company. These circumstances are as follows:

1) **Mis-statements in prospectus [Sections 34 & 35]** - In case of misrepresentation in a prospectus, the company and every director, promoter, expert and every other person, who authorised such issue of prospectus shall be liable to compensate the loss or damage to every person who subscribed for shares on the faith of untrue statement (Sec. 35).

   Besides, these persons may be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud **(Section 34 and Section 447 read together**). **However, a person may escape the aforesaid conviction if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.**

2) **Failure to return application money [Sec. 39]** - In case of issue of securities by a company to the public, if minimum subscription, as stated in the prospectus has not been received within 30 days of the issue of prospectus or such other period as may be specified by the SEBI, then as per Rule 11 of Companies (Prospectus and Allotment of Securities) Rules, 2014, the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

   In case of default, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

3) **Non-disclosure /Misdesciption of Name [Sec. 12]** - ***As per Section 12,* a company shall have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed.** Thus, where an officer of a company signs on behalf of the company any contract, bill of exchange, hundi, promissory note, cheque or order for money, such person shall be personally liable to the holder if the name of the company is either not mentioned, or is not properly mentioned. Accordingly, where on a cheque, the name of a company was stated as 'LR agencies limited' whereas the real name of the company was 'L&R Agencies Ltd.' the signatory directors were held personally liable **[Hendon v. Adelman (1973)]**. Besides, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

4) **For facilitating the task of an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company [Sec. 219]** - Section 219 provides that if an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company considers it necessary for the purposes of investigation, he may investigate into the affairs of another related company in the same management or group as well as into the affairs of any person who is or has at any relevant time been the company's managing director or manager or employee.

5) **For investigation of ownership of company [Sec. 216]** - Under Section 216, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons—

   a) **who are or have been financially interested in the success or failure, whether real or apparent, of the company; or**

   b) **who are or have been able to control or to materially influence the policy of the company.**

6) **Liability for *ultra vires* acts** - Directors and other officers of a company will be personally liable for all those acts which they have done on behalf of a company if the same are *ultra vires, i.e,* beyond the powers of the company.

7) **Fraudulent Conduct of business (Section339)**

   Under Section 339 of the Act if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly party to such acts may be held personally liable for any debts and other liabilities of the company. In such a situation, the Tribunal may disregard the legal entity of a company and make the fraudulent persons personally liable for the debts of the company.

8) **Liability under other statutes** - Besides the Act, directors and other officers of the company may be held personal-ly liable under the provisions of other statutes. *For example*, under the *Income-tax Act*, where any private company is wound-up and if tax arrears of the company in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally liable for payment of tax. Similarly, under *Foreign Exchange Management Act, 1999*, the directors and other officers may be proceeded individually or jointly for violations of the Act.

1.6.2 Under Judicial Interpretations

It is difficult to deal with all the cases in which courts have lifted or might lift the corporate veil. Some of the cases where the veil of incorporation was lifted by judicial decisions may be discussed to form an idea as to the kind of circumstances under which the facade of corporate personality will be removed or the persons behind the corpo-rate entity identified and penalised, if necessary.

1) **Protection of revenue** - In ***Sir Dinshaw Maneckjee Petit, Re* (1927)**, the assessee was a millionaire earning huge income by way of dividend and interest. He formed four private companies and transferred his investments to each of these companies in exchange of their shares. The dividends and interest income received by the company was handed back to Sir Dinshaw as a pretended loan. It was held that the company was formed by the assessee purely and simply as a means of avoiding tax and company was nothing more than assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interest and to hand them over to the assessee as pretended loans.

2) **Prevention of Fraud or improper conduct -** Where the medium of a company has been used for committing fraud or improper conduct, courts

have lifted the veil and looked at the realities of the situation. In ***Gilford Motor Company* v. *Horne* [1933]**, 'Horne' had been employed by the company under an agreement that he shall not so solicit the customers of the company or compete with it for a certain period of time after leaving its employment. After ceasing to be employed by the plaintiff, Horne formed a Company which carried on a competing business and caused the whole of its shares to be allotted to his wife and an employee of the company, who were appointed to be its directors. It was held that since the defendant (Horne) in fact controlled the company, its formation was a mere 'cloak or sham' to enable him to break his agreement with the plaintiff. Accordingly, an injunction was issued against him and against the company he had formed restraining them from soliciting the plaintiff's customers.

Similarly, in ***Jones* v. *Lipman* [1962]**, seller of a piece of land sought to evade specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose. It was held that specific performance of the contract cannot be resisted by the vendor by conveyance of the land to the company which was a mere 'facade' for avoidance of the contract of sale and specific performance of the contract was therefore ordered against the vendor and the company.

3) **Determination of the enemy character of a company** - Company being an artificial person cannot be an enemy or friend. However, during war, it may become necessary to lift the corporate veil and see the persons behind as to whether they are enemies or friends. It is because, though a company enjoys a distinct entity, its affairs are essentially run by individuals. In ***Daimler Company Ltd.* v. *Continental Tyre & Rubber Co. (Great Britain) Ltd.* [1916]**, a company was incorporated in London for the purpose of selling tyres manufactured in Germany by a German company. Its majority shareholders and all the directors were Germans. On declaration of war between England and Germany in 1914, it was held that since both the decision-making bodies, the Board of directors and the general body of shareholders were controlled by Germans, the company was a German company and hence an enemy company. Accordingly, the suit filed by the company to recover a trade debt was dismissed on the ground that such payment would amount to trading with enemy and thus against public policy.

4) **Formation of subsidiaries to act as an agent** - In ***Merchandise Transport Limited* v. *British Transport Commission* [1982]**, a transport company wanted to obtain licences for its vehicles, but it could not do so if it made the application in its own name. It, therefore, formed a subsidiary company and the application for licences was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary. Held, the parent and the subsidiary company were one commercial unit and the application for licences was rejected.

In the ***State of U.P.* v. *Renusagar Power Co.* [1991]**, the Govt. of U.P. announced certain subsidies to companies which produced power for their captive (own) use. Renusagar Power Supply Company was a 100% subsidiary of Hindalco and supplied its entire power output to Hindalco and none else. The Supreme Court held that where the holding company holds 100% shares in a subsidiary company and the latter is created only for the purpose of the holding company, corporate veil can be lifted. Thus, Hindalco was held entitled to the subsidies. 'Hindalco' and 'Renusagar Power Supply Company'

were considered as one entity. *You may note here that, in this case corporate veil was lifted for the benefit of the company and not to punish the company, its officers or directors.*

Again, in ***J.B. Exports Ltd.* v. *BSES Rajdhani Power Ltd.* [2007]**, appellant No. 1 company acquired entire share capital of appellant No. 2 company, which was a registered consumer of electricity connection granted at its factory premises and on finding that electricity was being consumed by appellant No. 1, Electricity Board passed impugned order demanding sub-letting charges from appellant No. 2, Court *held that* by applying principle of piercing of corporate veil, both companies appeared to be same entity and, therefore, there was no question of sub-letting.

5) **Where a company acts as an agent for its members/shareholders** - If there is an arrangement between the shareholders and a company to the effect that the company will act as the shareholders' agent for the purpose of carrying on the business, the business is essentially that of the shareholders. Thus, where an arrangement, as aforesaid, prevails, the individual shareholders may be identified for fixing their liability. In ***R.G. Films Ltd's case***, an American company financed and produced a film 'Monsoon' in India. But technically, the film was made in the name of a company incorporated in England. This Brirish company had only a capital of £ 100 divided into 100 shares of £ 1 each. Of this, 90 shares were held by the President of the American company. The Board of Trade declined to register the film as a British film. The view of the Board of Trade was upheld by the Court. The Court held that the British company acted only as an agent of the American company which was the true maker of the film.

6) **In case of economic offences** - In ***Santanu Ray* v. *Union of India* [1989]**, it was held that in case of economic offences a court is entitled to lift the veil of corporate entity and pay regard to the economic realities behind the legal facade. In this case, it was alleged that the company had violated section 11(*a*) of the Central Excises & Salt Act, 1944. The Court held that the veil of the corporate entity could be lifted by adjudicating authorities so as to determine as to which of the directors was concerned with the evasion of the excise duty by reason of fraud, concealment or willful misstatement or suppression of facts or contravention of the provisions of the Act and the rules made thereunder.

7) **Where company is used to avoid welfare legislation** - Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction — ***Workmen of Associated Rubber Industry Ltd.* v. *Associated Rubber Industry Ltd.* [1986]**. In this case, a new company was formed with no assets of its own except those transferred to it by the principal company. Further, the new company had no business of its own; it only received dividends on shares transferred to it by the principal company. Thus, the principal company was able to reduce its gross profits and consequently the amount of bonus to workmen was also reduced. The Supreme Court rejected the independent status of the new company and directed that the amount paid to the new company as dividend should also be taken into account determining the gross profit of the principal company.

8) **Where company is used for some illegal or improper purpose** - Courts have shown themselves willing to lift the veil where device of incorporation is used for some illegal or improper purpose - ***PNB Finance Limited* v. *Shital Prasad Jain* [1983].** Again, in ***SEBI v. Libra Plantation Ltd. [1999]***, Bombay High Court allowed the property acquired under fraudulent schemes to be chased even in the hands of third persons.

9) **To punish for contempt of court** - Company being an artificial person cannot disobey the orders of the court. Therefore, the persons at fault should be identified **[*Jyoti Limited* v. *Kanwaljit Kaur Bhasin* (1987)]**.

10) **For determination of technical competence of the company** - The Supreme Court in ***New Horizons Ltd.* v. *Union of India* [1995]** held that the experience of the promoters could well be considered as the experience of the company in determining its technical competence. *Once again, you may note that the veil in this case was lifted for the benefit of the company.*

11) **Where company is a mere sham or cloak** - In ***Delhi Development Authority* v. *Skipper Construction Company (P.) Ltd.* [1996]**, the Supreme Court held that the fact that the director and members of his family had created several corporate bodies did not prevent the court from treating all of them as one entity belonging to and controlled by the director and his family if it was found that these corporate bodies were mere cloaks and that the device of incorporation was really a ploy adopted for committing illegalities and/or to defraud people.

1.7 DISTINCTION BETWEEN COMPANY AND PARTNERSHIP

You learnt that a company is an artificial person created by law, with limited liability and perpetual succession as its main features. Let us now study the difference between a company and another popular association of persons formed to run business in India, namely, Partnership.

The main points of difference between a company and a partnership are as follows:

1. **Mode of creation** - A company comes into existence only when it is registered under the Companies Act.

   A partnership, on the other hand, is created by mutual agreement between partners. Registration of partnership firm is not compulsory under the Partnership Act, 1932. An unregistered partnership, therefore, is not an illegal association.

2. **Membership**

   a) Minimum - The minimum number of members in a partnership is two whereas the minimum number of members in a private company is two and in case of public company, seven.

   b) Maximum - In partnership, the maximum number of partners is 50. The maximum number of members in private company is 200 (excluding employee and ex-employee members and joint shareholders counted as a single member) but in a public company there is no limit on the maximum number of members.

3. **Legal status** - A company has a separate legal personality of its own whereas a partnership is not a distinct person. A partnership, commonly called a firm, has no legal existence apart from its members. Firm is only a convenient way of addressing the partners collectively. A company being a juristic person is quite distinct from its members.

4. **Liability of members** - The liability of every shareholder of a limited liability company is limited up to the nominal value of shares held by him or up to the amount of guarantee given by him. The creditors of a company can proceed only against the company and not against any member or members. Even in case of unlimited liability company, the company being an entity distinct from the members, the creditors are not allowed to proceed against members individually or even jointly; they can only proceed against the company. But in partnership the liability of partners is unlimited and partners are severally and jointly liable for the debts of the firm. Creditors of the firm are the creditors of all the partners and they can proceed against the partners individually as well as collectively.

5. **Transfer of shares** - Shares in a public company are freely transferable. A private company does place restrictions on free transferability of shares without denying transferability. In partnership, no partner can transfer or sell his share in the firm without the consent of all the other partners.

6. **Perpetual succession** - A company enjoys perpetual succession. The existence of the company is not affected by the death, insolvency, insanity or separation of a member. But, it is not so in case of partnership. Unless otherwise agreed, death, insolvency, etc. of a partner dissolves the firm.

7. **Management** - The affairs of a company are managed by a Board of directors. Directors on the Board are elected, appointed or reappointed by shareholders in a general meeting. Members of a company have no role in managing the affairs of the company. Every partner, on the other hand, unless otherwise provided in the partnership deed/agreement, can participate in management of the firm.

8. **Agency relationship** - A shareholder is not an agent of the company and thus has no power to bind the company by his acts. In partnership, every partner is an agent of the firm and that of other partners. A partner is bound by all the acts of other partners done within the scope of his apparent or ostensible authority.

9. **Property** - In the case of a company, the property of the company is in the name of the company and is owned by it. It does not belong to the individual shareholders of the company. During the lifetime of the company, no shareholder has any legal or equitable interest in any property of the company. But, in the case of partnership, the partners are the joint owners of the property of the firm.

10. **Statutory requirements** - A company is required to comply with various statutory formalities, such as maintaining statutory books, getting the accounts audited by chartered accountants, whereas a partnership firm is not required to perform any such statutory obligations.

11. ***Powers*** - The powers of the company are contained in the object clause of the memorandum of association. A change can be effected by following the rigid procedure as laid down in the Act. In partnership, the partners can do

anything which they agree to do. Changes in partnership deed can be effected by mutual consent.

12. ***Dissolution*** - A company's existence will come to an end only according to the provisions laid down in the Companies Act, 2013. A partnership firm can be dissolved at any time by an agreement between the partners or in case of partnership at will, by the withdrawal of even one partner.

13. **Governing legislation** - A company is governed by the Companies Act, 2013, SEBI Regulations, Listing Requirements of Stock Exchanges. A partnership, on the other hand is governed by the Partnership Act, 1932.

1.8 DISTINCTION BETWEEN COMPANY AND LIMITED LIABILITY PARTNERSHIP

Limited Liability Partnership (LLP) Act, 2008, is a new piece of legislation. This Act enables formation of partnerships with liability of partners being kept limited like that of share holders as in case of companies. Thus, the public has been given a choice to form a partnership either under the partnership law, i.e, Partnership Act, 1932 or under Limited Liability Partnership Act, 2008. Although, in case of a Limited Liability Partnership, the liability of partners is limited but it differs from a company in many respects. The main points of distinction between a 'limited liability partnership' and 'limited liability company' are as follows:

1. **Regulating Act:** A Limited Liability Partnership is regulated by the Limited Liability Partnership Act, 2008, whereas a company is governed by the Companies Act, 2013.

   The name of a company must end with words 'Limited or Private Limited' whereas of Limited Liability Partnership with words 'LLP' or 'Limited liability partnership'.

2. **Minimum and Maximum Number of Members**: In case of Limited Liability Partnership, minimum numbers of partners required are 2 whereas in case of public company minimum number of members required are 7. There is no limit to maximum number of partners in case of Limited Liability Partnership but in case of a private company number of members cannot exceed 200.

3. ***Governance Structure***: A basic difference between a Limited Liability Partnership and a joint stock company lies in that the governance structure of a company is regulated by statute (i.e., Companies Act, 2013) through memorandum ad articles of association whereas for a Limited Liability Partnership it would be by contractual agreement between partners.

4. ***Management***: In the case of a Limited Liability Partnership, management rests with those partners (including designated partners) who are authorized by Limited Liability Partnership agreement. But in the case of a company the right to control and manage the business is vested in the Board of Directors elected by the shareholders. Thus, the management ownership divide inherent in a company is not there in a limited liability partnership.

5. ***Transfer of Interest***: In the case of a limited liability partnership, a partner's economic rights (i.e. right to a share of the profits and losses and to receive contribution at the time of winding up) shall be transferable (Section 42). However, such transfer shall not by itself cause the disassociation of the partner and a dissolution and winding-up of the Limited Liability Partnership.

Further, such transfer would not make the transferee a 'partner' of the Limited Liability Partnership entitled to participate in its management (Section 42). For becoming a partner of Limited Liability Partnership, unless otherwise provided in the Limited Liability Partnership agreement, consent of all the existing partners is required (Schedule I appended to Limited Liability Partnership Act). But in the case of a public company a shareholder can transfer his shares freely without restriction and the transferee succeeds to all the rights of membership.

6. ***Audit***: The audit of the accounts of a company is a legal necessity but it is not so in the case of a Limited Liability Partnership. If the capital contribution does not exceed Rs.25 lakhs or if the annual turnover does not exceed Rs. 40 lakhs [Rule 24(8) of the Limited Liability Partnership Rules, 2009] audit is not compulsory.

7. ***Meeting:*** Annual General meeting of shareholders of a company is compulsory by law but in Limited Liability Partnership, the annual meeting of partners is not mandatory.

Check Your Progress B

1) What is meant by corporate veil?

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2) List any four circumstances when the corporate veil can be pierced.

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3) Enumerate three main points of difference between a company and a partnership.

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....

4) What are the main points of difference between a company and a limited liability partnership (LLP).

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....

5) Fill in the blanks:

   a) The effect of incorporation is that the company is regarded as a .... person.

b) If an officer of a company, while entering into contract on behalf of the company, fails to disclose his ……………………………… capacity, he becomes personally liable on such contract.

c) When two nations are at war, the corporate veil of the company can be lifted to ascertain the ………………………………….. of the company.

d) The corporate veil can be lifted due to Court's intervention and under …………………………………….

e) The liability of each member of Limited Liability Partnership is ……………………………………

6) State, whether the following statements are true or false:

i) A company comes into existence when the company is registered.

ii) Registration of a company, though desirable, is not compulsory.

iii) After registration, a company ceases to be an association of persons and acquires a juristic status.

iv) For the recovery of his debts, a creditor of a company can proceed against private properties of a member.

v) In case of a company, except a private company, any member may freely transfer his shares to any person.

vi) A shareholder is not an agent of the company.

vii) A person can be a member and a creditor of a company at the same time.

1.9 KINDS OF COMPANIES

Companies can be classified according to various bases. These are:

1) On the basis of incorporation
2) On the basis of liability
3) On the basis of control

See figure 1.1 to have an overall view of the different types of companies:

1.9.1 On the Basis of Incorporation

Depending upon the mode of incorporation, joint stock companies may be divided into the following three categories:

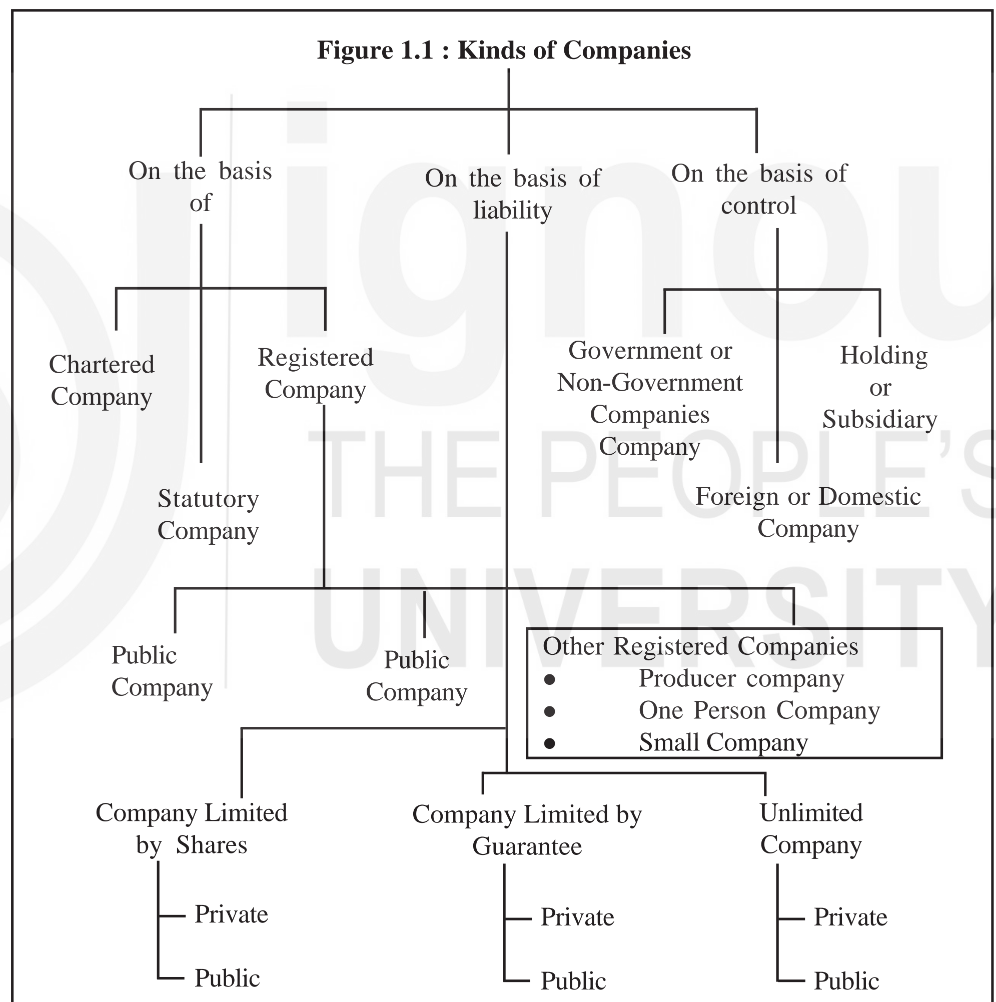
i) **Chartered Company:** A company incorporated under a special charter granted by the King or Queen of England is called 'chartered company'. A chartered company is regulated by its charter and the Companies Act does not apply to it. The charter also prescribes the nature of business and the powers of the company. The familiar examples of chartered companies are the East India Company and the Bank of England. *This type of company cannot now be formed in India.*

ii) **Statutory Company:** A statutory company is one which is created by a special Act of Parliament or a State Legislature. Such companies are usually formed for achieving a purpose related with public utilities. The nature and powers of such companies are laid down in the Special Act under which they are created. However, the provisions of the Companies Act are also applicable

to them in so far as they are consistent with the provisions of the Special Act. A statutory company also has a separate legal entity and it is not required to use the word 'limited' after its name. The audit of such companies is conducted by the Controller and Auditor General of India (C&AG) and the annual report of working is required to be placed before the Parliament or State Legislature, as the case may be. Familiar examples of such companies are Reserve Bank of India, The Life Insurance Corporation of India, The Food Corporation of India, State Bank of India, etc.

iii) **Registered or Incorporated Company:** A registered company is one which is registered in accordance with the provisions of the Companies Act 2013 and also includes companies formed and registered under any of the previous Acts. A registered company comes into existence only when it receives the certificate of incorporation. Registered Companies are governed by the provisions of the Companies Act, 2013.

Figure 1.1 : Kinds of Companies



A registered company may either be a private company or a public company. A ***private company*** is one which by its articles of association (a) restricts the right of transfer of shares; (b) except in case of a one person company limits the number of its members to two hundred (not including members who are the present or past employees); (c) prohibits any invitation to the public to subscribe for any securities of the company [Section 2(68)].

On the other hand, a ***public company*** is one which is not a private company but subsidiary of a public company even where such subsidiary company continues to be a private company in its articles [Section 2 (71].

The minimum number of members required to form a private company is two, while for the public company the minimum number is seven.

1.9.2 On the Basis of Liability

On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee; or (iii) an unlimited company.

1) **Company Limited by Shares**: A company having the liability of its members limited by the memorandum, to the amount, if any, unpaid on the shares respectively held by them is termed "a company limited by shares" [Section 2 (22)]. Such a company is commonly called Limited Liability Company although the liability of the company is never limited; it is the liability of its members which is limited. The liability of members can be enforced at any time during the existence and also during the winding-up of the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. However, there is no liability to pay any balance amount due on the shares, except in pursuance of calls duly made in accordance with law and the articles, while the company is a going concern or of calls made in the event of winding of the company.

2) **Company Limited by Guarantee**: A company limited by guarantee may be defined as a company having liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound-up [Section 2 (21)].

   Such a company may or may not have share capital. If a company limited by a guarantee is formed without any share capital, then the members would be liable to pay only the guaranteed amount and that too when the company goes into liquidation. But if the company limited by guarantee is formed with share capital, then the members are also liable to pay the unpaid amount on their shares. But the guaranteed amount can be called up only at the time of winding-up of the company.

3) **Unlimited Company**: A company having no limit on the liability of its members is an unlimited company [Section 2(92]. Thus, in the case of an unlimited liability company, the liability of each member extends to the whole amount of the company's debts and liabilities. It may be seen that the liability of members of an unlimited company is similar to that of the partners but unlike the liability of partners, the members of the company cannot be directly proceeded against. Company being a separate legal entity, the claims can be enforced only against the company. Thus, creditors shall have to institute proceedings for winding-up of the company for their claims. But the official liquidator may call upon the members to discharge the debts and liabilities without limit.

An unlimited company may or may not have share capital.

Under Section 18, a company registered as an unlimited company may subsequently convert itself into a limited liability company. Any debt, liabilities, applications or contracts in regard to or entered into, by or on behalf of the unlimited liability company before such conversion shall not be affected by such conversion.

1.9.3 On the Basis of Control

Let us study the classification of companies on the basis of control, i.e., who

effectively controls the affairs of the company. On this basis, the companies may be grouped as follows:

i) Holding and Subsidiary Companies

ii) Government Company

iii) Foreign Company

i) **Holding and Subsidiary Companies**

Generally speaking, if one company controls another company, the controlling company may be termed as the 'Holding company' and the company so controlled as a 'Subsidiary'.

According to Section 2 (*87*) "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

i) controls the composition of the Board of Directors; or

ii) exercises or controls more than one-half of the total share capital[1] either at its own or together with one or more of its subsidiary companies:

A company (let's call it Company 'S') shall be deemed to be the subsidiary of another company (let's call it Company 'H') only in the following cases:

a) When the company (Company 'H') controls the composition of Board of directors of other company (Company 'S')

b) When the Company 'H' holds more than half of the total share capital of Company 'S'. Again, where Company 'H' together with Company 'S' holds more than half of the total share capital of company 'Z', then company 'Z' will be subsidiary of Company 'H'.

c) When Company 'S' is a subsidiary of a Company 'T' which itself is a subsidiary of Company 'H'.

Only in any of the above cases, would the Company 'S' be deemed a subsidiary of Company 'H'.

As you have just learnt from the above discussion, a holding company is usually a very major shareholder of its subsidiary but both continue to enjoy separate legal entities in the eyes of the law. Unless there is a specific contract between the two companies, one cannot be said to be the agent of another. A subsidiary company also cannot be said to be a part of the holding company.

ii) **Government Company**

Section 2 (45) of the Companies Act,2013 defines a Government company to mean any company (registered under the Companies Act) in which not less than 51% of the paid- up share capital is held by:-

i) the Central Government; or

ii) any State Government or Governments; or

iii) partly by the Central Government and partly by one or more State Governments.

A subsidiary of a Government company shall also be treated as a Government company.

Engineers India Ltd. (EIL), BHEL, and Hindustan Aeronautics Ltd. (HAL), are examples of Government companies. A statutory corporation formed under special

Act of Parliament of State Legislature, like Life Insurance Corporation of India, is not a 'company' under the Companies Act, and as such is not a Government company. These are corporations as distinguished from Government companies and are incorporated as well as governed by respective separate Acts.

A government company registered under this Act is not an agent of the government. It enjoys, like any other company registered under the Companies Act, an entity distinct from its members. Employees of such a company cannot be said to be the employees of the Government. Again, like any other company, it may be registered as a private company or a public company. Further, like any other company, it is governed by the provisions of the Companies Act 2013.

iii) **Foreign Company**

As per Section 2 (*42*) "foreign company" means any company or body corporate incorporated outside India which—

a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

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

However, *as per Section* 386(C), *having a share transfer office or share registration office will constitute a place of business.*

Section 380 requires the following documents to be filed with the Registrar of Companies within thirty days of the establishment of place of business in India by a Foreign Company:

a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;

b) the full address of the registered or principal office of the company;

c) a list of the directors and secretary of the company containing such particulars as may be prescribed;

d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company any notices or other documents required to be served on the company;

e) the full address of the office of the company in India which is deemed to be its principal place of business in India;

f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;

g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

h) any other information as may be prescribed.

Where any alteration is made or occurs in the documents delivered to the Registrar under this section, the foreign company shall, within thirty days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form.

Again, as per Section 382, a foreign company is obliged to conspicuously exhibit on the outside of every office or place, where it carries on business in India as well as in every prospectus issued by it:

ignou THE PEOPLE'S UNIVERSITY

i) the name of the company,

ii) the country in which it is incorporated,

iii) the fact that liability of its members is limited.

The aforesaid should also be stated on all business letters, bill heads, letter paper, all notices and other official publications of the company in legible English and also in a language in general use in the locality in which the office or place is situated.

Section 381 requires that every foreign company, except a foreign company or such class of foreign companies which have been exempted by the Central Government, shall, in every calendar year:

a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having annexed or attached thereto such documents as may be prescribed; and

b) deliver a copy of those documents to the Registrar.

Provisions of Section 92 of the Act relating to the filing of the annual return with the Registrar of Companies are also applicable to a foreign company.

1.10 OTHER KINDS OF REGISTERED COMPANIES

Other kinds of registered companies include:

i) Producer Company

ii) One Person Company

iii) Small Company

1.10.1 Producer Company*

Based on the recommendations of Dr. Alagh Committee, the following is the summary of important provisions relating to Producer Companies:

1. **Meaning of Producer Company:** A producer company means a body corporate engaged in any activity connected with or related to any primary produce. 'Primary *produce*' means (*i*) produce of farmers, arising from agriculture (including animal husbandry, bee farming, etc.); *OR* (*ii)* from any other primary activity which promotes the interest of farmers or consumers; *OR* (*iii*) produce of persons engaged in handloom, handicraft and other cottage industries; *OR* (*iv*) by-products or ancillary of the aforesaid activities.

2. **Minimum and Maximum Number of Members:** Any ten or more producers** who are individuals or any two or more producer institutions*** or a combination of ten or more individuals and producer institutions may form and incorporate a company as a Producer Company. However, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company.

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* It may be noted that vide Section 465 of the Companies Act, 2013, producer companies shall continue to be governed by the existing provisions of the Companies Act, 1956 until a special Act is enacted.

** **Producer**' means any person engaged in any activity connected with any primary produce. [Section 581A(k).

*** **Producer Institution** means a producer company or any other institution having only producer(s)/producer company(ies) as its members whether incorporated or not having any of the objects referred to in Section 581B and which agrees to make use of the services of the producer company(ies) as provided in its articles.

There is no ceiling on maximum membership.

3. **Share Capital:** The share capital of a producer company shall consist of equity shares only.

4. **Transferability and Transmission of Shares:** Shares of a member of a producer company shall not be transferable except to an active member with the previous approval of the Board. Shares, if allowed to be transferred, shall be at par value only.

   However, in the event of death of a member, shares will be registered in the name of his nominee who must be a producer.

5. **Liability of Members:** Liability of members of a Producer Company shall be limited to the amount, if any, unpaid on the shares held by them.

6. **Promoters' Remuneration:** The Producer Company may, with the approval of its members at its first general meeting, reimburse to its promoters all direct costs associated with the promotion and registration of the company including registration, legal fees, printing of a memorandum and articles.

7. **Status of a Private Company:** On registration, the Producer Company shall become a body corporate as if it is a private limited company without, however, any limit to the number of members thereof and without use of the word private as part of its name. As per Section 581F, name of a producer company shall end with the words 'Producer Company Limited'.

8. **Voting Rights of Members:**

   a) Where the membership consists (i) solely of individual members; or (ii) of individuals and producer institutions, the voting rights shall be based on a single vote for every Member, irrespective of his shareholding or patronage of the Producer Company.

   b) In a case the membership consists of Producer institutions only, the voting rights of such Producer institutions shall be determined on the basis of their participation in the business of the Producer Company in the previous year, as may be specified by Articles. However, during the first year of registration of a Producer Company, the voting rights shall be determined on the basis of the shareholding by such Producer institutions.

9. **Cessation of Membership:**

   Whereas, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company, a member, who acquires any business interest which is in conflict with the business of the Producer Company, shall, cease to be a member of that Company and be removed as a member in accordance with articles. Again, a person will cease to be a member, where he ceases to be a primary producer. He will, however, be paid par value of his shares or any other value that may be determined by the Board.

10. **Benefits to Members:**

    a) Members shall not receive full value of the produce pooled or supplied. 'Withheld price' shall be paid later in cash or equity shares, as per the decision of the Board.

    b) Every member shall receive a limited return on the capital contributed by the members.

c) Members may be allotted bonus shares.

d) Surplus, if any, after making (i) provision for limited return and reserves (as required under Section 581(ZI) (ii) providing for the development of the business of the Producer Company; (iii) providing for common facilities; may be distributed to members as bonus in proportion to their respective participation in business. This may be given in cash or by way of equity shares.

11. **General Meetings:**

i) **First AGM:** The first annual general meeting (AGM) of a producer company shall be held within 90 days of incorporation to discuss appointment of directors, and adoption of articles of association. *No extension of time is permissible.*

ii) **Subsequent AGMs:** Gap between two AGMs must not be more than 15 months. Registrar of Companies may extend this period for a maximum period of 3 months.

iii) **Time and Place of AGM:** Provisions in this regard are same as applicable to other companies. Thus, AGMs should be held at the registered office, on a day which is not a public holiday and during business hours.

iv) **EGM (Extraordinary general Meeting):** An EGM shall be called by the directors on a requisition duly signed by 1/3rd or more of the members who are entitled to vote thereat. *No requirement for quorum has been prescribed for EGM.*

v) **Notice:** Notice of every general meeting shall be sent to : (a) every member; and (b) the auditor.

vi) **Quorum:** Quorum for AGM shall be 1/4th of total number of members. Articles may however fix higher quorum.

1.10.2 One Person Company (OPC)

Section 2 (62) of the Companies Act, 2013 defines 'One Person Company' to mean a company with only one person as its member. Section 3 (1) (c) provides that a company may be formed for any lawful purpose by one person, where the company to be formed is to be One Person Company, that is to say, a private company by subscribing his name to a memorandum and complying with the requirements of the Act in respect of registration.

An One Person Company may be registered as 'limited by shares' or 'limited by guarantee'.

However, the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form (Form No. INC.3), who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Such other person may withdraw his consent in such manner as may be prescribed.

On the death of the promoter member of an OPC, the person nominated by

such promoter member shall be the person recognised by the company as having title to all the shares of the member and shall be entitled to the same dividend and other rights and liabilities to which such sole promoter member of the company was entitled or liable.

The member of One Person Company may at any time change the name of such other person by giving notice and shall intimate the Registrar any such change within such time and in such manner as may be prescribed.

The words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

Relaxations available to One Person Company

Relaxations given to an OPC include:

1. There is no need to prepare a cash-flow statement [Section 2(40)].
2. The annual return can be signed by the Director and not necessarily a Company Secretary (Section 92).
3. There is no necessity for an Annual General Meeting (AGM) to be held (Section 96).
4. Specific provisions related to general meetings and extraordinary general meetings would not apply (Sections 100 to 111).
5. Compliance can be said to have been done if the resolutions are entered in the minutes' book of the company (Section 122).
6. It would suffice if one director signs the audited financial statements (Section 134).
7. Financial statements can be filed within six months from the close of the financial year as against 30 days (Section 137).
8. An OPC need to hold only one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days (Section 173).

Special Provisions applicable to One Person Companies

Where the OPC limited by shares or by guarantee enters into a contract with the sole member of the company who is also the director of the company, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract (Section 193). This will not apply to contracts entered into by Company in the ordinary course of its business.

As per the Rules framed by the Central Government:

1. Only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a One Person Company or be appointed as a nominee for the sole member of a One Person Company. The term "resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding financial year (**Rule No. 3.1**).
2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company (Rule No. 3.2).
3. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest (Rule No 3. 4).

4. Such Company cannot be incorporated or converted into a company under section 8 of the Act (Rule No 3.5) or carry out Non-Banking Financial Investment activities including investment in securities of any body corporate (Rule No 3.6).

5. Where the paid up share capital of a One Person Company exceeds 50 lakh rupees and its average annual turnover during the relevant period exceeds 2 crore rupees, it shall cease to be entitled to continue as a One Person Company. ***(Rule No 3.7). It may convert itself into a private or public company within a period of 6 months from the date its paid up capital exceeds Rs. 50 lakh and turnover exceeds Rs. 2 crore (Rule No. 6).***

6. **Conversion of One Person Company into a private company or a public company:** *One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to 2 or minimum of 7 members and 3 directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion i.e. Conversion of companies already registered* ***(Rule No 6)***. **However, such a company cannot convert voluntarily into any kind of company unless two years is expired from the date of its incorporation *(Rule No. 3. 7)*.**

1.10.3 Small Company

The concept of Small Company has also been introduced for the first time in the Companies Act, 2013. According to Section 2 (85) of the Companies Act, 2013 as amended by the (Amendment) 2017 "small company" means a company, other than a public company —

i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

However, the expression 'small company' shall not include:

a) a holding company or a subsidiary company;

b) non-profit association (i.e, companies registered under Section 8 of the Companies Act, 2013);

c) a company or body corporate governed by any special Act.

In such company there is no need to prepare cash flow statement, annual return can be signed by the Director or Secretary and to hold only one meeting in one half of calendar year and gap between two meetings should not be more than 90 days.

1.11 ASSOCIATIONS NOT FOR PROFIT (SECTION 8)

An "Association not for profit" (companies with charitable objects) is an association which is formed not for making profits but for the promotion of commerce, art,

science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object. Such an association may or may not be registered as a company under the Companies Act. When such an association is registered as a company with limited liability, it may be given a licence by the Central Government.

The Central Government may grant such a licence if it is proved to the satisfaction of the Central Government that a person* or an association of persons proposed to be registered under this Act as a limited company:

i) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

ii) intends to apply its profits, if any, or other income in promoting its objects; and

iii) intends to prohibit payment of any dividend to its members.

When the above conditions are fulfilled, the Central Government may, by licence, direct that the person or association may be registered as a company with limited liability without the addition to its name of the word "Limited" or the words "Private Limited".

Examples of such companies registered under Section 8 include Mohan Bagan Club, Gymkhana Club, Delhi District Cricket Association (D.D.C.A.) etc.

- **Alteration of Memorandum and Articles of Association**

  Such an association shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

- **Partnership Firm may become Member**

  It may be noted that a partnership firm may become a member of such a company. However, on dissolution of the firm, its membership will come to an end [Section 8(3)]. Moreover, one person company can not be formed or converted into a company under Section 8 [Rule 3 (5)] Companies (Incorporation) Rules, 2014.

- **Conversion of a company formed under Section 8 into any other kind**

  A company registered under section 8 which intends to convert itself into a company of any other kind may do so by passing a special resolution at a general meeting for approving such conversion and also complying with the prescribed procedure (Rule 21 of the Companies (Incorporation) Rules, 2014).

1.12 ILLEGAL ASSOCIATIONS

1.12.1 Meaning

Section 464 of the Companies Act, 2013 read along with Rule 10 of the Companies (Miscellaneous) Rules, 2014 provides that no association or partnership consisting of more than 50 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or

* You may note that under Section 8, the use of the word 'person' appears to allow even a single person to form a company for the objects specified.

partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. Thus, if such an association is formed and not registered under either the Companies Act or any other law, it will be regarded as an 'Illegal Association' although none of the objects for which it may have been formed is illegal.

1.12.2 Exceptions

a) **A Hindu undivided family (HUF) carrying on any business,** that is, a joint Hindu family may carry on any business, even for earning profits and with any number of members without being registered or formed in pursuance of any Indian Laws as required by Section 464 of the Act, and yet it will not be illegal association. But, where two joint Hindu families join hands to carry on business, the provisions of Section 464 become applicable. However, in such a case, in reckoning the number of members of such an association, the minor members shall be excluded. As regards adult members, both male and female members shall be taken into account.

b) **An association or partnership, if it is formed by professionals who are governed by special Acts.**

1.12.3 Consequences

Following are the effects of an association being illegal:

1. Every member of such an association or partnership carrying on business shall be punishable with fine which may extend to one lakh rupees.
2. Every member is personally liable for all liabilities incurred in the business.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to him because it cannot contract any debt.
6. It cannot be wound-up even under the provisions relating to winding-up of unregistered companies.
7. *Can a member sue for partition or dissolution or accounts of an illegal association?* The question was brought before the High Court of Allahabad in ***Mewa Ram* v. *Ram Gopal* (1926)**. It was held that where an association was illegal and the business had been carried for some years, none of its members could sue for partition because partition would involve realisation of the assets of the company and payment of its debts, the very things which would be done in a suit for dissolution of partnership or winding-up of a company.

   It should be noted that while an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognise its very existence.
8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members **(Kumar Swami Chettiar v. M.S.M. Chinnathambi Chettiar).**
9. The profits made by an illegal association are, however, liable to assessment to income-tax **(Gopalji Co. v. CITA).**

Check Your Progress C

1) What is a statutory company?

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2) What is meant by a registered company?

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3) What is meant by a company limited by guarantee?

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4) What is a Government Company?

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5) What do you mean by 'Illegal Association'?

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6) Fill in the blanks:

   a) An incorporated company can come into existence as a chartered company, as a statutory company and as .... company.

   b) In a company limited by guarantee, a member is required to pay the guaranteed sum only if the company is ....

   c) A government company is one in which not less than .... per cent of the paid up share capital is held by the Central Government.

   d) An auditor for a government company is appointed by the ....

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e) A foreign company which establishes a place of business in India after the commencement of the Companies Act, 2013, shall deliver to the Registrar of Companies, necessary documents for registration within .... days of establishing the place of business in India.

f) Under Section .... of the Act, any association created not for profit may be exempted by the Central Government and be registered with limited liability without using the word 'limited' as its last word.

7) State, whether the following statements are true or false:

i) Once a company has been registered as an unlimited company, it cannot be converted into a limited company without dissolving the company.

ii) A Government company is not governed by the provisions of the Companies Act, 2013.

iii) In a Government company, company's paid up share capital can be held partly by the Central Government and partly by one or more State Governments.

iv) A foreign company may carry on business in India even without establishing place of business in India.

v) A foreign company is a company registered in India and carries on its business in a foreign company.

vi) In case of a holding company and a subsidiary company both companies continue to enjoy separate legal status.

vii) A private company which is a subsidiary of a public company is a public company.

viii) A partnership firm can be a member of an association not for profit.

ix) An illegal association has no independent personality.

8) State which of the following alternative is correct:

a) A private company

i) must have at least 7 members, ii) cannot have more than 50 members, iii) must prohibit any invitation to public to subscribe for its shares, iv) must file a statement in lieu of prospectus

b) An illegal association is

i) a partnership formed for illegal activities, ii) a partnership with more than 100 partners, iii) a partnership dissolved by a court of law, iv) a HUF with more than 100 members

1.13 LET US SUM UP

A Company implies an association of persons for some common object or objects. A 'company' under the Act is defined to mean a "company formed and registered under the Companies Act, 2013 or under any of the previous Company laws.

A company is characterised by the following features: (1) It is an incorporated association registered under the Act. (2) On registration, it becomes a body corporate and thus acquires an entity distinct from the members constituting it. (3)

Although, a company is recognised as a person enjoying the rights and obligations thereof, it is an artificial person and exists only in contemplation of law. (4) The liability of members of a limited liability company is limited to the extent of the amount unpaid on the shares held by him or the amount guaranteed by him. (5) A company being a distinct entity, the property of the company is also separate. Shareholders are not the part owners of the undertakings. A member does not even have an insurable interest in the property of the company. (6) The shares of a company are movable property, transferable in the manner provided by the articles of the company. (7) A company being an artificial person cannot be incapacitate by illness or otherwise. Members may come and go but the company can go on forever. (8) A company has to work through the agency of human beings. It may have a common seal.

A company is an entity distinct from the members but is an artificial person. The persons who are engaged to manage its affairs may commit certain illegal acts or frauds in its name. It may, therefore, become necessary to identify and hold these individuals personally liable for their deeds. In other words, the veil of corporate personality may be pierced or lifted. The circumstances under which the corporate veil can be lifted as follows:

a) Under Express Statutory Provisions

b) Under judiciary interpretation

Under express statutory provisions corporate veil is lifted in the following circumstances:

(1) Misrepresentations in prospectus; (2) Failure to return application money; (3 Mis-description of name; (4) For investigating the affairs of the company; (5) For investigation of ownership of company; (6) Where the business of the company is found to have been carried for fraudulent purpose; (7) For ultra vires acts; (8) For violations of the provisions of other statutes;

Under judiciary interpretations the corporate veil is lifted in the following cases:

(a) Where the medium of body corporate is used to evade taxes; (b) Where body corporate is used to commit fraud or improper conduct; (c) For determination of the enemy character of the company; (d) Where subsidiaries are formed to act as mere agents of the holding company; (e) Where a company acts as an agent for its shareholders; (f) Where company is used to avoid welfare legislation; (g) Where company is used for some illegal or improper purpose; (h) Punishment for contempt of Court ; (i) For determination of technical competence of the company; (j) Where company is a mere sham or cloak.

A 'company' should, however, be distinguished from a 'body corporate'. The expression body corporate is a wider expression than company. Body corporate includes, besides a company, a company incorporated outside India, public financial institutions, nationalised banks and any other association of persons declared as a body corporate by the Central Government.

A company is a person in the eyes of law. It also has a domicile and nationality. The courts have held that company is not a citizen and therefore cannot be said to have the fundamental rights expressly conferred upon citizens, only. However, those fundamental rights which are available to all persons, whether citizens or not, like the right to own property are available to the company.

A 'company' differs from a 'partnership' on the following grounds viz., mode of creation, number of minimum and maximum member, legal status, liability of

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members, transfer of shares, agency of members, management, perpetual succession, powers, dissolution and legal obligations.

Companies may be classified into the following categories (i) Chartered companies; (ii) Statutory companies; and (iii) Registered Companies. A registered company may be either a company limited by shares or a company limited by guarantee or an unlimited company. Such company may, either be a private company or a public company. Foreign companies are those which are incorporated outside India, but have a place of business in India.

A company is deemed to be the holding company of another, if that other is its subsidiary. A company is deemed to be a subsidiary of another company only if:

i) the other company controls the composition of its board of directors;

ii) the other company holds more than half of the nominal value of its equity share capital; or

iii) it is subsidiary of any other company which, in turn, is the subsidiary of holding company.

Producer companies have been added to Companies Act 1956 by the Companies (Amendment) Act 2002. These are companies in which any ten or more producers who are individuals or any two or more producer institutions may form and incorporate a company as a Producer Company.

One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

"Small Company" means a company, other than a public company (*i*) paid-up share capital of which does not exceed fifty lakh rupees; and (*ii*) turnover of which as per its last profit and loss account does not exceed two crore rupees

An association or partnership which is formed with more than fifty persons according to Section 464, Companies Act 2013 must be regarded as an illegal association. However, a joint Hindu family carrying on a business, a stock exchange and associations not for profit-making are not illegal associations. Every member of an illegal association shall be personally liable for all liabilities incurred in such business.

1.14 KEY WORDS

Company: An association of persons registered under the Companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

Chartered Company: A company which is incorporated under a special Royal Charter granted by the King or Queen of England.

Statutory Company: A company which is created by a special Act of Parliament or State Legislature.

Company limited by shares: A company having the liability of its members limited to the value of shares held by them.

Company limited by guarantee : A company having the liability of its members limited to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound-up.

Government Company: A company in which not less than 51 per cent of the paid up capital is held by the Government.

Private Company: A private company is one which by its articles of association (a) restricts the right of transfer of shares; (b) limits the number of its members to 200 (not including the present or past employee members); (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company and (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives. The minimum number of members required to form a private company is 2.

Public Company: A public company is one which is not a private company is a private company but subsidiary of a public company. The minimum number of members required to form a public company is seven.

Unlimited company: A company in which the liability of the members is unlimited.

Perpetual Succession: Continued existence irrespective of the life or sanity of its members.

Foreign Company: A company incorporated outside India but having a place of business in India.

Corporate Veil: A line of demarcation or a veil is drawn between the company and its members.

Producer Company: A company formed by any ten or more individuals, each of them being a producer or any two or more producer institutions or a combination of ten or more individuals and producer institutions.

One person Company: One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

Small Company: "Small Company" means a company, other than a public company:

i) paid-up share capital of which does not exceed fifty lakh rupees; and

ii) turnover of which as per its last profit and loss account does not exceed two crore rupees.

1.15 ANSWERS TO CHECK YOUR PROGRESS

A 3) i) True; ii) True; iii) False; iv) False;
v) True; vi) True

B 5) a) separate legal
b) representative
c) enemy character
d) express statutory provisions
e) unlimited
6) i) True; ii) False; iii) False; iv) False;
v) True; vi) True; vii) True

C 6) a) registered
b) wound up
c) fifty one

d) Comptroller and Auditor General of India

e) Thirty

f) 8

7) i) False; ii) False; iii) True; iv) True; v) False; vi) True; vii) True; viii) True; ix) True

8) a) (iii); b) (ii)

1.16 TERMINAL QUESTIONS

1) Company is an artificial person by law with a perpetual succession and is different from the members constituting it. Comment.
2) Describe the main characteristics of a company.
3) Discuss the concept of corporate veil. Under what circumstances can this veil be lifted?
4) Distinguish between a company and a partnership.
5) Distinguish between 'company' and 'body corporate'.
6) Write a note on government company
7) Briefly discuss different types of companies.
8) What is a foreign company? Describe special provisions relating to a foreign company.
9) Define a holding company and a subsidiary company. When can a company be called a subsidiary of another company? Explain.
10) What do you mean by an illegal association? What are the consequences of forming such an association?
11) Briefly discuss 'One Person Company' and 'Small Company'.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

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UNIT 2 PUBLIC AND PRIVATE COMPANIES

Structure

2.0 Objectives
2.1 Introduction
2.2 Private Company
2.3 Public Company
2.4 Distinction between a Private Company and a Public Company
2.5 Privileges and Exemptions Available to a Private company
2.6 Conversion of a Private Company into a Public Company
2.7 Conversion of a Public Company into a Private Company
2.8 Let Us Sum Up
2.9 Key Words
2.10 Answers to Check Your Progress
2.11 Terminal Questions

2.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a private and a public company;
- distinguish between private and public companies;
- explain the privileges and exemptions available to private company; and
- describe how a private company is converted into a public company and vice-versa.

2.1 INTRODUCTION

You have learnt in Unit 1 that the Companies Act, 2013 provides for a variety of companies that may be promoted and registered under the Act. The two common types of companies which may be registered under the Act are:

a) **Private companies.**

b) **Public companies.**

These companies may be incorporated either as limited liability companies or as unlimited liability companies.

2.2 PRIVATE COMPANY

By virtue of section 2 (68) as amended by the Companies (Amendment) Act, 2015, a private company means a company having a minimum paid up share capital as may be prescribed and which by its articles of association:

a) restricts the right of members to transfer their shares;

b) Except in case of a one person company limits the number of its members to two hundred.

c) Prohibits any invitation to the public to subscribe for any securities of company.

a) **Restrictions on the Right of Members to Transfer their Shares**. The articles of association of a private company must specifically have a provision restricting the right of the members to transfer their shares, if any. It means that the shares of private company are not as freely transferable as those of the public companies. But it does not mean that the shares of a private company cannot be transferred at all. One of the restrictions generally contained is that whenever a member of a private company desires to transfer his shares, he must first offer them to the existing members at a price to be determined by the directors. This restriction is placed so as to preserve the private character of its shareholding. That is why, a private company is sometimes called a 'closed' corporation. The Act, however, does not specify the manner in which this restriction is to be imposed. You should note that a private company having no share capital need not contain this restriction in its articles.

b) **Restriction on Maximum number of Members :**Except in case of a one person company it limits the number of its members to two hundred. Where two or more persons hold one or more shares jointly, they shall for the purposes of this clause be treated as a single member.

   Again, (*i*) persons who are in the employment of the company; and

   (*ii*) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members;

c) **Prohibition on Invitation to Public:** This restriction implies that a private limited company must not issue a prospectus or any other public invitation, directly or indirectly to the general public so as to invite them to invest in its shares or debentures. The question arises as to how would one ascertain whether an invitation made by the company is in the nature of public invitation or not. The public may include any section of the public whether selected as members or the debenture holders of the company or as customers of the person issuing the prospectus, or in any other manner. The invitation cannot be treated as one made to the public when it can, under all circumstances, be properly regarded as a domestic or private concern of the persons making the invitation and those receiving it. However, an invitation to 200 or more persons will constitute an invitation to public. You will study this aspect in more details in the unit relating to Prospectus.

In view of the aforesaid definition, a private company must, in its articles, incorporate the said restrictions, limitations and prohibitions.

A private company may be (a) a company limited by shares or (b) a company limited by guarantee or (c) an unlimited company.

Number of Debenture holders may exceed 200

It may be noted that it is only the number of members that is limited to two hundred. Private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures cannot be made.

Other requirements relating to a private company

1. ***Minimum number of members*** - As per section 3, for forming a private company, two or more persons are required to subscribe their names to a Memorandum of Association.

   Any person who is competent to contract can be a subscriber. A company being a legal person can subscribe but a partnership firm cannot do so. Similarly, minor cannot be a signatory to the Memorandum since he is not competent to contract.

2. ***Use of words 'Private Limited'*** - Section 4 requires that the words 'Private Limited' or any acceptable abbreviation thereof, such as 'Pvt. Ltd.' must be added at the end of the name of a private limited company.

2.3 PUBLIC COMPANY

Section 2 (71) of the Companies Act, 2013 as amended by the Companies (Amendment) Act 2017 defines a *public company* to mean a company which:

a) is not a private company,

b) has a minimum paid-up share capital, as may be prescribed;

c) further, a company which is subsidiary of a company, not being a private company shall be deemed to a public company for the purpose of this Act even where such subsidiary company continues to be a private company in its articles.

Minimum number of members required to form a public company, as per Section 3, is seven.

A public company, like a private company, can also be (a) a company limited by shares or (b) a company limited by guarantee, or (c) an unlimited company.

2.4 DISTINCTION BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

Following are the main points of distinction between a private company and a public company:

1. ***Minimum Number of Members*** **[Section 3]:** In the case of a private company minimum number of persons to form a company is two while it is seven in the case of a public company.

2. ***Maximum Number of Members*****:** In case of private company the maximum number must not exceed two hundred whereas there is no such restriction on the maximum number of members in the case of a public company.

3. ***Transferability of Shares*** **[Sections 44]**: As per Section 44, the shares of any member in a company shall be movable property transferable in the manner provided by the articles of the company. In a private company, by its very definition, articles of a private company have to contain restrictions on transferability of shares.

4. ***Prospectus*** **[Section 2 (68)]:** A private company cannot issue a prospectus, while a public company may, through prospectus; invite the general public to subscribe for its securities.

5. ***Minimum number of Directors*** **[Section 149]**: A private company must

have at least two directors, whereas a public company must have at least three directors.

6. ***Retirement of Directors*** **[Section 152]**: Directors of a private company are not required to retire by rotation, but in case of a public company at least 2/3rds of the directors must be such whose period of office is subject to retirement by rotation.

7. ***Quorum for General Meetings*** **[Section 103]**: Unless the articles of the company provide for a larger number, ***in case of a public company***, the quorum shall be —

   i) five members personally present if the number of members as on the date of meeting is not more than one thousand;

   ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;

   iii) thirty members personally present if the number of members as on the date of the meeting exceeds five thousand;

   ***In the case of a private company*, unless Articles provide for a higher numbe**r, two members personally present, shall be the quorum for a meeting of the company.

8. ***Managerial Remuneration*** **[Section 197]**: In a private company, there are no restrictions on managerial remuneration, but in the case of a public company total managerial remuneration cannot exceed 11 per cent of the net profits. The remuneration payable to each managing/whole time director or manager cannot exceed 5 per cent of the net profits unless approval of the Central Government has been taken. Likewise, there are restrictions on the remuneration payable to ordinary directors also.

9. ***Public Deposits*:** A public company is free to accept deposits from the public (subject, however, to the provisions of sections 76). A private company cannot accept deposits from the public.

Check Your Progress A

1) Define a private company.

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2) What is a public company?

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3) Give four important distinctions between a public and a private company.

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4) Fill in the blanks:

   a) A private company must have at least ……………………… members and at the most ……………………… members.

   b) At least ……………………… directors of public company must retire by rotation.

   c) A private company cannot invite ………………….. from public.

5) State whether the following statements are true or false:

   i) The minimum number of members in a public company is seven.

   ii) A public company need not issue a prospectus before issue of its shares.

   iii) The memorandum of association of a private company needs to be signed by only two members.

   iv) A company is called a private company because it restricts the transfer of shares.

   v) A public company must have at least five directors.

2.5 PRIVILEGES AND EXEMPTIONS AVAILABLE TO PRIVATE LIMITED COMPANIES

A private company enjoys certain privileges and exemptions from certain provisions of the Companies Act. The basic reason for granting these privileges and exemptions is that the private companies by restricting their membership to not more than 200 and because of prohibition on public subscription to shares or debentures or deposits do not involve the public money. Hence less public accountability and as such it need not be subject to such rigorous surveillance as a public company is required to be. However, a private company shall lose these privileges and exemptions, where it fails to abide by the restrictive clauses of Section 2 (68), whether directly or indirectly.

The privileges and exemptions available to a private company include:

1. **Minimum number of members** - A minimum of two persons (as against seven persons in the case of public company) may form a private company [Section 3].

2. **Minimum number of Directors** - A private company need not have more than two directors as against minimum three in the case of a public company [Section 149].

3. **Quorum for general meetings** - Unless Articles provide for a higher number, quorum required for the general meeting of the shareholders in the case of a private company is 2 members personally present as against 5, 15 or 30 members personally present depending upon the number of members as on the date of meeting being up to 1000, 5000 or more than 5000; in case of a public company (Section 103).

4. **Managerial Remuneration** - A private company is exempted from the

provisions of section 197 which fixes the overall limit to the managerial remuneration at 11 per cent of net profits. Thus, a private company may remunerate its managerial personnel by such higher percentage of profits, or in any manner, as it may deem fit [Section 197].

5. **Rotational Retirement of Directors** - All directors of a private company can be non-rotational directors [Section 152].
6. **Filling casual vacancies** - The provisions relating to manner of filling of casual vacancies among directors and the duration of the period of office of those so appointed do not apply to a private company [Section 161].
7. **Special disqualifications for appointment as directors** - A private company may, by its articles of association, provide special disqualifications for appointment of directors in addition to those contained in section 164 (1 & 2) [Section 164 (3)].
8. **Restrictions on number of directorships** - No person can be a director in more than 10 public companies whereas he can become a director in maximum 20 private companies provided none of those companies is a public company or a holding or subsidiary of a public company [Section 165].
9. **Independent directors** - **A** private company is exempted from the requirement of appointment of independent director(s) [Section 149].
10. **Audit Committee** - A private company is not required to constitute audit committee of the Board [Section 177].
11. **Kinds of shares** - Under section 43, a private company may issue shares other than equity or preference shares, if so provided in its Memorandum or Articles of Association - Vide MCA Notification dated 5.6.2015.
12. **Rights Issue** - In case of rights issue under section 62, as against minimum period of 15 days, a private company may close its offer of rights issue before that. In other words, it need not keep its rights issue open for minimum period of 15 days - Vide MCA Notification dated 5.6.2015.
13. **ESOPs :** For issue of shares to its employees under Employee's Stock Option Scheme, a private company may pass an ordinary resolution as against special resolution - Vide MCA Notification dated 5.6.2015.
14. **Loan for purchase of its own securities :** A private company may provide loans for purchase of its own shares provided the following conditions are satisfied:

    a) No other body corporate should have invested any money;

    b) Borrowing from banks, FIIs or bodies corporate should be less than double of its paid up capital or Rs. 50 crore, whichever is lower;

    c) The private company should not have defaulted in repayment of borrowings as may be existing on the date of the transaction.
15. **Exemption from filing Board resolutions :** A private company has been exempted from filing resolutions of the Board of directors with the Registrar of Companies.
16. **Participation of interested director in Board meeting :** Under section 184**,** an interested director of a private company can participate in the Board meeting after declaring his interest.

Check Your Progress B

1) State whether the following statements are true or false:

   i) A private company must have at least three directors.

   ii) The prospectus of a private company must be filed with the Registrar of Companies five weeks before the allotment of shares.

   iii) A private company can start business immediately after incorporation.

   iv) A private company is not required to observe any restrictions on the amount of managerial remuneration payable to its directors.

   v) A private company may allot shares without issuing a prospectus.

2.6 CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

As per Section 14, the following steps shall be necessary for conversion of a private company into a public company:

1. **Special Resolution:** A private company may convert itself into a public company by amending its Articles of association. Section 14 of the Companies Act, 2013, in this regard, provides that a private company can amend its Articles for the purpose by passing a special resolution. Thus, where a special resolution is passed thereby deleting the statutory requirements as laid down in Section 2 (68) of the Act which make a company a private company, a private company can become a public company. So, where Articles of a private company are amended to raise its membership beyond 200; or permitting free transferability of shares; or to extend invitation to public to subscribe to its shares or debentures or any other security, it becomes a public company with effect from the date of such alteration. As a consequence, the company shall cease to enjoy the privileges and exemptions conferred on a private company and the provisions of the Companies Act shall apply to it as if it were a public company.

2. **Increase in membership**: If the number of members is less than seven, it must be raised to not less than seven [Section 3].

3. **Increase in number of directors:** If the number of directors is less than three, it must be raised to not less than three [Section 149].

4. **Dropping word 'Private":** The word 'private' will be dropped from the name (Sec. 13).

5. **Filling of Altered Articles:** Every alteration of the articles under this section shall be filed with the Registrar in *Form No. INC. 27*, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

6. **Alteration to be noted in every copy:** Every alteration made in the articles of a company shall be noted in every copy of the articles [Section 15 (1)].

If default is made in complying with the aforesaid provision, the company, and every officer of the company who is in default, shall be punishable with fine, which may extend to one thousand rupees for every copy of the articles issued without such alteration [Section 15 (2)].

Where by passing resolutions a final decision had been taken by the company to convert itself into a public company with immediate effect; prescribed Form had been filed along with said resolutions, Supreme Court held that it was sufficient for the purpose of arriving at a *prima facie* conclusion that the company had altered its status and had become a public company even though the necessary alterations had not been effected in the records of the Registrar of Companies – ***Ram Purshotam Mittal* v. *Hillcrest Realty Sdn. Bhd.* [2009]** 94 SCL 120 (SC).

2.7 CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

For conversion of a public company into a private company, Section 14 of the Companies Act, 2013 provides as follows:

i) **Passing of a Special Resolution:** Special resolution at a general meeting of shareholders should be passed authorising the conversion of public company into a private company and altering the articles so as to contain the matters specified in Section 2 (68), namely the three restrictive clauses providing for limiting the total number of members to 200; restricting free transferability of shares and prohibiting invitation to public for subscription of its shares, debentures or any other security.

ii) **Changing the name of the company**: Company's name ought to be changed by, adding the word 'Private' before the word Limited. As per section 13, it does not require special resolution to be passed.

iii) **Obtaining the approval of the Central Government**: Second Proviso to section 14(1) as amended by the Companies (Second Amendment) Ordinance 2019, provides that no alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government which shall make such order as it may deem fit.

iv) **Filing with the Registrar:** Every alteration of the articles and a copy of the order of the Central Government approving the alteration as per sub-section (*1*) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of 15 days in the prescribed manner and the Registrar shall register the same. [(Section 14(2))].

Check Your Progress C

1) Choose the most appropriate answer to the following questions:

   a) In case of conversion of a private company into a public company, the company:

      i) can continue with two directors and less than seven members.

      ii) must increase the number of members to at least seven but can continue with two directors.

      iii) must increase the number of directors to three and members to at least seven

   b) In case of conversion of a public company into a private company, the company:

      i) must pass a special resolution in general body meeting

ii) must obtain approval of the Central Government

iii) must pass a special resolution in general body meeting as well as obtain approval of the Central Government.

2) State whether the following statements are True or False:

i) The special resolution altering the articles so that a private company is converted into a public company, can be passed only at a general meeting.

ii) A copy of the altered articles must be filed with the Registrar within one month of passing the resolution.

iii) As soon as a private company becomes a public company it will have to raise the number of its members to at least seven.

iv) Conversion of a private company to public and vice-versa, does not affect the legal identity of the company.

2.8 LET US SUM UP

The Companies Act 2013 provides for a variety of companies that may be promoted and registered under the Act. However, two basic types of companies which may be registered under the Act are 'private' and 'public' companies. However, Companies Act, 2013 has provided for formation of 'One Person Company' and 'Small Company'. Though these companies have certain distinctive features but are to be treated as private companies. Companies may further be incorporated as limited liability companies or as unlimited liability companies.

A private company is defined to mean a company by its articles: (i) restricts the right to transfer its shares, if any; (ii) prohibits invitations to the public to subscribe for any shares in, or debentures of or any other security of , the company; (iii) limits the total number of members to 200.

A public company is defined under section 2 (71) of the Companies Act, 2013 to mean a company which: (a) is not a private company; (b) has a minimum paid share capital as may be prescribed.

A company which is a subsidiary of a company not being a private company shall be deemed to be a public company for the purpose of the Act, even where such subsidiary company continues to be a private company in its articles.

A private company enjoys certain privileges and exemptions from the provisions of the Companies Act, for instance, it can be formed with just 2 members; it can have only two directors; it can pay its managerial personnel any amount as remuneration.

A private company may be converted into a public company by passing a special resolution and meeting the minimum requirements of a public company like 7 members, 3 directors, etc. Similarly, a public company can also be converted into a private company by passing a special resolution and the approval of the Central Government.

2.9 KEY WORDS

Private Company: A private company is one which (a) restricts the right of transfer of shares; (b) limits the number of its members to two hundred

(not including the present or past employees); (c) prohibits any invitation to the public to subscribe for any shares, debentures or any other security of the company.

Public Company: A public company is one which is not a private company and has a minimum paid share capital as may be prescribed.

Share: Unit in which the total capital of the company is divided.

Quorum: Minimum number of persons required to constitute a valid meeting.

2.10 ANSWERS TO CHECK YOUR PROGRESS

A 4) a) two, two hundred

b) two thirds

c) subscription for shares, debentures or any other security

5) i) True; ii) True; iii) True; iv) True; v) False

B 1) i) False; ii) False; iii) False; iv) True v) True

C 1) a) iii b) iii

2) i) True; ii) False; iii) True iv) True

2.11 TERMINAL QUESTIONS

1) Define a private company. Distinguish between a private company and a public company.
2) Enumerate privileges enjoyed by a private company.
3) Describe the procedure for converting a private company into a public company.
4) Define a public company. Describe the procedure for converting a public company into a private company.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 3 PROMOTER

Structure

3.0 Objectives
3.1 Introduction
3.2 Promoter: Meaning and Importance
3.3 Functions of a Promoter
3.4 Legal Position of Promoters
3.5 Duties of a Promoter
3.6 Liabilities of a Promoter
3.7 Remuneration of a Promoter
3.8 Position of Preliminary or Pre-incorporation Contracts
  3.8.1 Liability of Promoters vis-à-vis Pre-incorporation Contracts
3.9 Let Us Sum Up
3.10 Key Words
3.11 Answers to Check Your Progress
3.12 Terminal Questions

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3.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and importance of promoter;
- describe the functions of a promoter;
- enumerate duties and liabilities of a promoter;
- describe remuneration payable to a promoter; and
- explain the position of preliminary or pre-incorporation contracts.

3.1 INTRODUCTION

In Unit 1 you learnt about the various types of companies that can be formed. The formation of a company is a lengthy process, involving different stages. The first stage in the process of formation of a company is the 'promotion'. At this stage the idea of carrying on a business is conceived by a person or by a group of persons called promoter(s). For incorporating a company various formalities are required to be carried out. The promoters perform these functions and bring the company into existence. In this Unit, you will learn about the meaning and functions of promoters, their legal position and their duties. You will also learn about the legal position of pre-incorporation contracts entered by promoter.

3.2 PROMOTER: MEANING AND IMPORTANCE

You learnt that a company is an artificial person created by law. A company is born only when it is duly incorporated. For incorporating a company various

documents are to be prepared and other formalities are to be completed. All this work is done by promoters. Gerstenberg has defined promotion *as the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.* After the idea is conceived, the promoters make detailed investigation to find out the weakness and strong points of the idea, determine the amount of capital required and estimate the operating expenses and probable income. On being satisfied about the economic viability of the idea, the promoters take all the necessary steps for incorporating the company.

According to **L. J. Bowen**, *the term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence.*

Justice C. Cockburn described a promoter as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose".

Section 2 (69) of the Companies Act, 2013 defines the term promoter as a person:

a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

However, a person who is acting merely in a professional capacity shall not be treated as a promoter.

The following description of promoter brings out the nature of activities that a promoter is usually associated with.

These are:

1) He undertakes to form a company and see it going.
2) He undertakes a number of operations necessary to form a company.
3) He advices, directs and instructs the Board of Directors.
4) He has a control over the affairs of the Company, directly or indirectly.

A company may have more than one promoter. The promoter may be individual, firm, an association of persons or a body corporate. Even if a person has taken a very minor part in the promotion activities, he may still be a promoter. But a person cannot be held as promoter merely because he is a signatory to the memorandum or that he has provided money for the payment of formation expenses or has worked in a professional capacity, for example, in preparation of the documents to be filed for registration of the company or even securing certificate of incorporation of the company. Thus, a solicitor who drafts the articles, or the accountant who values assets of a business to be purchased are merely giving professional assistance to the promoter. However, where he goes further than this, *for example*, by introducing his clients to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter.

A person cannot, however, become a promoter merely because he signs the memorandum as a subscriber for one or more shares **[Official Liquidator v. Velu Mudaliar].**

From the above, it should be clear that *a promoter is one who performs the preliminary duties necessary to bring a company into existence*. Thus, the true test to describe a person as a promoter lies in finding out whether he is keen to form a company and takes steps to give it a concrete shape.

The promoters, in fact, render very useful services in the formation of a company. They render a very useful service to society and they play an important role in the industrial development of a country. A promoter has been described as a creator of wealth and an economic prophet. The promoters carry considerable risk because if the idea goes wrong then the time and money spent by them will be a waste.

3.3 FUNCTIONS OF A PROMOTER

You learnt that a promoter plays a very important role in the formation of a company. You have also noted that a promoter may be an individual, an association or a company. In their capacity as promoters, they perform the following functions in order to incorporate a company and to set it going:

i) **To originate the scheme for formation of the company**: Promoters are generally the first persons who conceive the idea of business. They carry out the necessary investigation to find out whether the formation of a company is possible and profitable. Thereafter, they organize the resources to convert the idea into a reality by forming a company. In this sense, the promoters are the originators of the plan for the formation of a company.

ii) **To secure the co-operation of the required number of persons willing to associate themselves with the project**: The promoters, in accordance with whether they want to incorporate a private or public company, try to secure the co-operation of persons needed to form the company. Minimum number of members required to form a public company is seven and that for a private company the minimum number is two. Depending upon the form chosen, the promoters may decide upon the number of primary members.

iii) **To seek and obtain the consent of the persons willing to act as first directors of the company**: In Unit 1, you learnt that the company has a system of representative management and is managed by individuals appointed as directors. The first directors of the company are, however, are either the promoters themselves or are appointed by them. The promoters seek the consent of some individuals whom they consider appropriate so that they agree to be the first directors of the proposed company. Many a time, promoters themselves become the first directors of the company.

iv) **To settle about the name of the company**: The promoters have to seek the permission of the Registrar of Companies for selecting the name of the company. The promoters usually give three to four names in order of preference. The promoters should ensure that the names selected are not identical with or too closely resemble the name of another existing company. They should also ensure that the suggested names also conform

to the draft rules and other guidelines issued by the Ministry of Corporate Affairs in this regard. We shall discuss the provisions with respect to the name of the company in detail in Unit 6.

v) **To get the documents of the proposed company prepared**: You will study that certain documents like the Memorandum of Association and the Article of association are required to be filed with the Registrar of Companies before the company is registered and brought into existence. As the company itself does not exist before incorporation, this work of preparation of these documents has to be undertaken by the promoters. The promoters, on the advice of legal experts get the Memorandum and Articles of Association prepared and arrange for their printing. In case the proposed company is a public limited company, intending to issue shares to the public after incorporation, the promoters must also arrange to get the prospectus prepared and printed.

vi) **To appoint bankers, brokers and legal advisers for the company**: The incorporation of a company involves a lot of legal formalities. The promoters may need to consult the legal experts on several of these matters. They, therefore, appoint solicitors to assist them in the process of formation of the company. The company is formed for the purpose of carrying on business and as such deals with funds and their management. The promoters must, therefore, also appoint bankers for the company who will receive share application moneys. If the proposed company is a public limited company and proposes to raise funds from the public, the promoters must also ensure the success of the first capital issue made by the company by appointing underwriters and brokers.

vii) **To settle preliminary agreements for acquisition of assets**: The promoters may be required to acquire a suitable site for the factory, make arrangements for plant and machinery and may even make tentative arrangements for key personnel. Sometimes, in order to run the business, the company may be required to take over property of a running business. Promoters fulfill the function of seeing that such property and business is acquired by the proposed company on justifiable terms.

viii) **To enter into preliminary contracts with the vendors**: In respect of the properties and assets mentioned above, the promoters would need to settle the terms of contracts with the third parties from whom these properties are to be bought. These contracts are called preliminary contracts.

ix) **To arrange for filing of the necessary documents with the Registrar**: The promoters are required to pay the stamp duty, filing fee and other charges for registration of the company. The promoters are to see that the various legal formalities for incorporating the company are duly complied with.

3.4 LEGAL POSITION OF PROMOTERS

You learnt that promoters are responsible for the formation of a company. The promoters occupy an important position and have wide powers relating to the formation of a company. It is, however, interesting to note that so far as the legal position is concerned, *a promoter is neither an agent nor a trustee of the proposed company*. He is not the agent because there is no company

yet in existence and he is not a trustee because there is no trust in existence. But it does not mean that the promoter does not have any legal relationship with the proposed company. *The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed*. Lord Cairns has correctly stated the position of promoter in **Erlanger v. New Sombrero Phosphate Co. as follows:**

"the promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begin to act as a trading corporation".

Similarly, it was observed in **Lagunas Nitrate Co. v. Lagunas Syndicate (1899)**, that : "The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become share-holders in it." Lord Justice Lindley in **Lidney & Wigpool Iron Ore Company v. Bird [1866]** described the position of a promoter as follows:

"Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is perfectly well settled that a promoter of a company is accountable to it for all monies secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained."

You would recall from what you have studied in the contract of agency and partnership that a fiduciary relationship means a relationship of utmost trust and confidence and implies disclosure of all material facts. Being in a fiduciary position, the promoter must not make, either directly or indirectly, any profits at the expense of the company that he promotes, without the knowledge and consent of the company.

Check Your Progress A

1) Who is a promoter?

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2) List the four most important functions of a promoter.

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3) What is meant by 'fiduciary relation'?

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4) State in three lines the legal position of promoters.

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5) State, whether the following statements are true or false:

   i) A promoter can be an individual, a group of persons or a company.

   ii) Promotion is the first step for the formation of the company.

   iii) All the persons associated with the formation of the company are promoters of the company.

   iv) The promoter is a person who brings the company into existence.

   v) A promoter cannot be allowed to make any secret profits.

   vi) A promoter stands in a fiduciary relationship towards the company he promotes.

   vii) The promoters in fact act as agent of the company which is being promoted.

3.5 DUTIES OF A PROMOTER

In the above Section, you have just learnt that the promoter occupies a position of total confidence and trust in relation to the company promoted by him. The promoter in this fiduciary capacity has the following important duties:

1) **Not to make any secret profit:** A promoter cannot make any direct or indirect profits out of the promotion of the company. Since, he occupies a position of trust, it is his duty to be honest and uphold the trust of his position.

   In this connection, you must clearly understand that the law does not forbid the promoter from making a profit. The law prohibits only the making of secret profits i.e. the profits which the promoter has not disclosed to the company.

   What may constitute secret profit was best illustrated in the case of **Gluckstein v. Barnes (1900),** In *this case,* a syndicate of persons was formed to buy a property called 'Olympia' and re-sell this 'Olympia' to a company to be formed for the purpose. The syndicate first bought the debentures of the old Olympia Company at a discount. Then they bought the company itself for £ 1,40,000. Out of this money provided by themselves, the debentures were repaid in full and a profit of £ 20,000 made thereon.

   They promoted a new company and sold Olympia to it for £ 1,80,000. The profit of £ 40,000 was revealed in the prospectus but not the profit of £ 20,000.

   Held, profit of £ 20,000 was a secret profit and the promoters of the company would be bound to pay it to the company because the disclosure of the profit by themselves in the capacity of directors of the purchasing company was not sufficient.

   Disclosure to be made to whom?: You have learnt that a promoter is allowed to make a profit out of promotion but with the consent of the company. But, the company being an artificial person, the problem is to discover as to who may consent on behalf of the company.

In **Lagunas Nitrate Co. *v*. Lagunas Syndicate Ltd. [1899]** it was held that the initial shareholders' consent may either be obtained individually or by way of an ordinary resolution to that effect. If the company issues a prospectus, disclosure to shareholders may be made in it, and each shareholder's subscription for shares on the basis of the prospectus would then be deemed to indicate his consent to the retention of profit disclosed by the promoter.

Thus, the promoters have to ensure that the real truth is disclosed to those who are induced by the promoters to join the company.

When a promoter makes a secret profit, the company has the following remedies against him:

a) *Rescission of the contract* – The company may on learning of the secret profit, rescind the contract entered into by the promoter to make the said profit.

b) *Order for refund* – The company may require the promoter to refund the amount of secret profit.

c) *Suit for breach of duty* – The company may sue the promoter for misfeasance, as the promoter, by making the secret profit, has defaulted in his duty towards the company.

2) **To make full disclosure to the company of all relevant facts:** In keeping with his fiduciary capacity, a promoter is bound to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with the company. You should bear in mind that while making a disclosure the promoter must make the full and complete disclosure. If he contracts to sell his own property to the company without making a full disclosure, the company may either repudiate the contract or affirm the contract and recover the profits made by the promoter. Let us explain these fiduciary duties of the promoter with the help of an example.

   'A' was the owner of some arid land. He and some of his friends, decided to form a company to manufacture microchips. They appointed the first directors of the company and 'A' sold his own land to the company at a price higher than the actual valuation of the land. When the company was formed, the purchase agreement of land was approved at the meeting of the shareholders but the fact of A's ownership and the profit made by him were not disclosed at the meeting. Subsequently, when the company went into liquidation, the liquidator filed a suit against 'A' to recover the profits made by him in the sale of land. You would observe that in this case 'A' had defaulted in his duty to make full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure by the promoters of the profit they were making, the company is entitled to rescind the contact. 'A' could have retained the profits made by him if he had made a full disclosure to the directors of the company, all the relevant facts of the transaction including his personal interest and the profit made

3) **To give the benefit of negotiations to the company:** The promoter must pass on to the company, the benefit of any negotiation or agreement that he carried in his capacity of a promoter. *For example*, when he has

negotiated a certain price for some land for the company, he must sell the property to the company at the negotiated price. If he charges a price higher than the negotiated price, the company may rescind the contract on discovering the truth of the matter. If, due to some reason, the contract could not be rescinded, the company is entitled to claim damages from the promoters and the amount of damages shall be equal to the amount of profits made by promoters. However, it should be remembered that secret profits on the sale of property can be recovered from the promoter only when the property was bought and sold to the company while he was acting as a promoter. The promoter must act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.

4) **Duty of promoter towards future allottees:** The promoters stand in a fiduciary position towards the company. It does not mean that they stand in such relation only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at his instance contains all material facts and particulars and does not contain any misstatements.

Termination of promoters' duties: A promoter's duties do not come to an end on the incorporation of the company, or even when a Board of directors is appointed. They continue until the company has acquired the property or business which it was formed to manage and has raised its initial share capital - **[Lagunas Nitrate Co. v. Lagunas Syndicate Ltd. (supra)]**, and the Board of directors has taken over the management of the company's affairs from the promoters - **[Twycross v. Grant (1877)]**.

3.6 LIABILITIES OF A PROMOTER

You have just gone through the duties of a promoter in his fiduciary capacity and learnt that in the event of any breach, the promoter can be made liable to hand over to the company, any secret profit made by him. The company can also file a suit for rescission of the contract of sale made by the promoter, if the promoter has not made a disclosure of his interest to the company.

The liability of the promoter, under the Companies Act, is discussed below:

i) Section 26 enumerates the *matters that should be stated and the reports that should be set out in the prospectus.* If this provision is not complied with, the promoters may be held liable under Section 35 to compensate the shareholders.

ii) Section 35 provides for *civil liabilities for any misstatements made in the prospectus.* Under this section a promoter can be held liable for any false statements in the prospectus, by a person who has subscribed for the shares and debentures of the company acting on the faith of the prospectus. The promoter may be held liable to pay compensation to every person who subscribes for shares or debentures for any loss or damage sustained by him on account of the untrue statements made in the prospectus. However, Section 35 enumerates certain grounds on which the promoter can avoid his liability. These remedies are common to all persons who can be held liable for misstatement in the prospectus. You will study more about these remedies in Unit 8 of this course.

iii) Section 34 contains provisions relating to *criminal liabilities for issuing a prospectus which contains untrue statements.* It is clearly provided

that in addition to the civil liability mentioned in the above two cases, the promoters can be held criminally liable if the prospectus issued by them contained misstatements. The criminal liability for the purpose is contained in Section 447 of the Companies Act, 2013 which provides for imprisonment for a term which shall not be less than six months but which may extend to ten years. Besides, the promoter shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Further, the Section provides that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

The promoter may have to bear this criminal liability for misstatements unless he can prove that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

iv) Section 300 states *the power of the Tribunal to order examination of all the promoters held guilty of fraud in promotion, formation, business or conduct of affair of a company. The Section provides that i*f in the event of winding-up of the company, the Company Liquidator's report alleges a fraud in the promotion or formation of the company, the Tribunal may order the examination of the promoter(s).

v) Section 340 of the Act provides for the *liability for misfeasance or breach of trust for misapplication of funds* during the formation of the company. Like any other director or officer of the company, a promoter can also be held liable if he had misapplied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

vi) The promoters are *personally liable for pre-incorporation contracts.* Even the death of the promoter does not relieve him from this liability. You shall learn about pre-incorporation contracts in Section 3.8 of this Unit.

Check Your Progress B

1) List the duties of promoters.

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2) Fill in the blanks:

a) A promoter plays a very important role in the ………………………… of a company.

b) Besides an individual even an ………………………… may be a promoter.

c) Promoter ………………………… the idea of setting up a business and then organise ………………………… to convert this idea.

d) ………………………… directors of the company are generally appointed by the promoters.

e) The promoters enter into ………………………… for acquisition of assets for the company.

f) A promoter can be made liable to hand over to the company any ……………………… made by him.

g) A promoter stands in a ……………………… relationship towards the company.

3.7 REMUNERATION OF PROMOTERS

You have noted through the above paragraphs that the promoter occupies a unique position in relation to the company. Before the company is brought into existence he has to complete all the formalities, spend considerable skill and effort and organise necessary resources so that the company can be formed. He has to incur preliminary expenses as well. For all these important activities and his considerable effort he should be suitably remunerated. But, he cannot claim as a matter of right any remuneration from the company. He, therefore, is not entitled to recover any remuneration for his services unless the company after getting formed enters into a specific contract with the promoter for this purpose. You must note that even if the promoter has entered into a contract with the prospective directors before the incorporation, he has no valid claim against the company for remuneration. This is so because the directors cannot enter into any contract on behalf of a company that is not yet in existence. **There are also cases where** the articles of a company **may** specifically provide that a specified sum may be paid to the promoters as remuneration for their services. **While this provision gives the director an authority to make such payment,** it does not give the promoters a right to claim remuneration or to sue the company, for the same. In actual practice, therefore, the company, once it is registered, usually agrees to pay some remuneration for the valuable service rendered by the promoters. This remuneration may be paid to the promoters in any of the following ways:

i) He may sell his own property to the company for cash or against fully paid shares in the company at an overvaluation after making full disclosure to an independent Board of directors or to the intended shareholders.

ii) He may take commission on the shares sold.

iii) He may be paid a lump sum by the company.

iv) He may be allotted fully paid-up shares of the company either for free or at a heavy discount.

Whatever be the nature of remuneration or benefit, it must be disclosed in the prospectus.

3.8 POSITION OF PRELIMINARY OR PRE-INCORPORATION CONTRACTS

In order to fulfill the necessary formalities and organise the required resources for the formation of the company, the promoters of a company enter into contracts for a company which is yet to be incorporated. These contacts are generally entered into by the promoters in order to acquire some property or some rights of the company that they are interested in promoting. *All such contracts entered into by the promoters with the third parties for the proposed company (before incorporation) are called 'preliminary contacts'.*

You must note that such preliminary or pre-incorporation contacts are not legally

binding on the company even after its incorporation. The reason for this is that before incorporation the company cannot enter into contracts as it has no legal entity. Not only this, the company cannot ratify such contracts after incorporation because, for valid ratification, the principal must have been in existence at the time when the promoters entered into such contracts. A company can neither sue nor be sued on such contracts since a company before incorporation is a non-entity. The position of these contracts can be explained as follows:

i) **On registration, the company is not bound by the preliminary contracts –** A company is not bound by the preliminary contracts even if the company has taken the benefit of the work on its behalf under the contract. For example, a solicitor was appointed by the promoters of the company and was instructed by them to prepare the articles and the memorandum of the company. The solicitor also paid the necessary registration fee of the company These promoters later became the directors of the company. The solicitor sued for his expenses and the fees paid by him. It was held that since the company was not in existence when these expenses were incurred, the company is not bound to pay.

ii) **The company cannot enforce preliminary contracts** – You must note that just as the company cannot be held liable for the preliminary contracts, it also cannot enforce such contracts made before incorporation, by the promoters. This means that on account of a preliminary contract the company does not get a right to sue the third party for fulfillment of the contract. For example, 'X' the owner of a piece of land in Assam agreed to lease it to a company to be formed by promoters A, B and C. The promoters later on formed a company called M. Pvt. Ltd. On some prospecting of the land, it was discovered that there was a definite possibility of striking oil in that land. Subsequently 'X' refused to grant the lease to the company M. Pvt. Ltd. It was held that the company cannot sue 'X' and cannot claim specific performance as it was not even in existence when the lease was signed.

iii) **The company cannot ratify the preliminary contracts** – After incorporation the Company cannot ratify the contracts formed before its existence. You will recall from your study of the Unit on agency that for valid ratification of a contract, it is essential that the principal must exist of the date when the contract is originally entered into. And as the company does not exist on the date of contract, it cannot ratify a preliminary contract on being incorporated. In the case of **Kelner v. Baxter,** it was held as the company was not in existence when the preliminary contracts were made, it could not be bound by any purported ratification. What the company can do is to enter into a new contract with the vendors after incorporation to give effect to the terms of the contract made before incorporation.

In relation to the above principles, important provisions have been made in out country in the Specific Relief Act, 1963. These provisions provide an important exception to the above principles. According to Section 15 and 19 of the Specific Relief Act "where the promoter of the company have before its incorporation, entered into contract for the purpose of the company and such contracts are warranted by terms of incorporation, specific performance may be obtained by or against the company, if the company has accepted the contract after the incorporation and has communicated such acceptance to the other party.

In the above paragraph the term "contracts for the purposes of the company" means contracts which are necessary for the incorporation and working of the company. **For example,** contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the production work in the company are contracts for the purposes of the company. It should be clear to you now that in order to be enforceable, it is necessary that the company after its incorporation accepts the contract and communicates its acceptance to the other contracting company.

3.8.1 Liability of Promoters vis-à-vis Pre-incorporation Contracts

The promoters are personally liable for contracts made for a company which is not yet in existence. You have already learnt that the company is neither bound nor entitled on account of a preliminary contract. Therefore, it is the promoters alone who remain personally liable for the preliminary contracts. The reason for this is that the preliminary contract is made for a company which, as known to both the contracting parties, is as yet non-existent. The contract, therefore, is deemed to be personally entered into by the promoters and they will be held personally liable for the performance of these contracts.

The preliminary contracts made by the promoters generally contain a provision that if the company adopts the agreements on incorporation, the liability of the promoters shall come to an end and if the company does not adopt the preliminary contract within a specified period either party may rescind the contract. In such a case liability of the promoter will cease on the expiry of the specified period.

In **Phonogram Limited v. Lane** [1982], it was observed that although a contract made before a company's incorporation cannot bind the company, it is not wholly devoid of legal effect, even if all the persons who negotiated the contract are aware that the company has not yet been incorporated. In the referred case, a person attempting to incorporate a Pop Group had obtained financial assistance from a recording company. He was held personally liable to refund the amount on his project failing to materialise.

The contract takes effect as a personal contract with the persons who purport to contract on the company's behalf - **Kelner v. Baxter (supra).** Promoters shall be liable to pay damages for failure to perform the promises made in the company's name. **This shall be so, even where the contract expressly provides that only the company's paid up capital shall be answerable for performance - *Scot* v. *Lord Ebury* [1867].**

Check Your Progress C

1) List the ways in which the promoter can be remunerated.

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....

....

....

2) What is a pre-incorporation contract?

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3) State, whether the following statements are true or false:

   i) A promoter is entitled to be suitably remunerated for the services rendered during formation of the company.

   ii) In the absence of a contract with the company, the promoter cannot recover the payments he has made in connection with the formation of the company.

   iii) If the promoter has made the necessary disclosures, he can sell his own property to the company at a higher price.

   iv) The liability of the promoter for the preliminary contracts ceases as soon as the company is formed.

   v) Upon registration the company is not bound by the preliminary contracts.

   vi) If all the members of the company agree, the company can ratify the preliminary contracts.

   vii) A preliminary contract cannot be enforced by the company against the third parties.

   viii) Promoters are personally liable for preliminary contracts.

3.9 LET US SUM UP

Promotion denotes preliminary steps taken for the purpose of registration and floatation of the company. The persons who undertake these steps are called promoters. However, the persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves. The status of a promoter is generally terminated when the Board of directors has been formed and they start governing the company.

The Act contains no provisions regarding the duties of promoters, it merely imposes liability on promoters for untrue statements in prospectus, they are parties to, and for fraudulent trading. The Courts have, however, charged them with two fiduciary duties, namely, (i) not to make any secret profit out of promotion; and (ii) to disclose to the company any interest which he has in a transaction entered into by it.

A promoter is not entitled to any remuneration for his services from the company unless there is a valid contract, enabling him to do so, between him and the company. Alternatively, Articles may authorise the directors to pay them.

A pre-incorporation contract is void *ab initio* unless the company adopts the same procedure after incorporation and the contract is warranted by the terms of incorporation.

3.10 KEY WORDS

Promoter: The person who performs various functions in relation to the formation of a company.

Fiduciary relation: The relationship based on mutual trust and confidence.

Preliminary contracts: The contracts made before the incorporation of the company.

Ratification: To approve of an act already done.

Secret Profits: Profits made without making a full disclosure of all relevant facts.

Prospectus: A document issued by the company inviting public to subscribe for its shares, debentures or deposits.

3.11 ANSWERS TO CHECK YOUR PROGRESS

A 5) i) True ii) True iii) False iv) True
v) True vi) True vii) True

B 2) a) formation
b) association or a company
c) conceives, resources
d) first
e) preliminary contracts
f) secret profits
g) fiduciary

C 3) i) False ii) True iii) True iv) False
v) True vi) False vii) True viii) True

3.12 TERMINAL QUESTIONS

1) Define the term 'promoter' and explain the functions performed by him.
2) Discuss the legal position of a promoter.
3) "Promoter is not a trustee or an agent of the company but he stands in fiduciary position towards it." Comment.
4) What are the duties of a promoter towards a company promoted by him?
5) Discuss the liabilities of a promoter.
6) Is a promoter entitled to remuneration for the services rendered by him during the formation of the company? Explain.
7) What do you understand by preliminary contracts? Discuss (a) the position of the company in relation to the preliminary contracts, and (b) the liability of the promoter for preliminary contracts.
8) Why pre-incorporation contracts are not binding on the company?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 4 FORMATION OF A COMPANY

Structure

4.0 Objectives
4.1 Introduction
4.2 Stages in the Formation of a Company
4.3 Promotion
4.4 Documents to be Filed with the Registrar
  4.4.1 E-Filing of Documents
4.5 Incorporation
  4.5.1 Conclusiveness of Certificate of Incorporation
  4.5.2 Effects of Registration
4.6 Commencement of Business
4.7 Let Us Sum Up
4.8 Key Words
4.9 Answers to Check Your Progress
4.10 Terminal Questions

4.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the stages in the formation of a company;
- enumerate the documents to the filed with the Registrar of Companies;
- explain the effects of registration;
- describe the procedure for obtaining the certificate of commencement of business; and
- discuss the commencement of business.

4.1 INTRODUCTION

In Unit 1 you learnt that a company is an artificial person created by law and has a distinct separate legal entity of its own. You have also learnt in Unit 3 that before a company is actually formed, certain persons known as 'promoters', make a detailed investigation and, after satisfying themselves about the viability of the business, take certain steps to form the company. In this unit, you will learn about the various stages involved in the formation of a company and the documents which are required to be filed with the Registrar of Companies and E-filing of documents. You will also learn about the commencement of business.

4.2 STAGES IN THE FORMATION OF A COMPANY

The formation of a company is a lengthy process. It involves the following three stages:

1) Promotion
2) Registration or incorporation, and
3) Commencement of business

Each of the above stages comprises specific activities to be undertaken.

4.3 PROMOTION

You have already learnt in Unit 3 about the activities carried out by promoters to bring a company into existence. After discovery of the business idea and judging its soundness, the promoters organise the necessary resources for giving shape to their business idea. They negotiate for, and obtain the required property, the necessary plant and machinery and arrange for the capital necessary for the company. The promoters will also talk to persons who are willing to take the responsibility of becoming the first directors of the company.

It should be noted that a company can be formed only for a lawful purpose. The purpose of the company may be unlawful if it is (a) against any provisions of the company law, or (b) against the provisions of any other law, applicable in India.

You would recall from Unit 2 that promoters may form the company with limited liability or with unlimited liability. In case of a company with limited liability, the liability of members may be limited either by shares or by guarantee.

The promoters then obtain the approval of the proposed name from the Registrar of Companies. Application can now be made online also. Normally, the promoters are supposed to have about 3 to 4 proposed names, so that there is a possibility that at least one of these will be approved.

Section 4 (2) of the Companies Act, 2013 provides that no company shall be registered by a name which is:

a) identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or
b) be such that its use by the company—
   i) will constitute an offence under any law for the time being in force; or
   ii) is undesirable in the opinion of the Central Government.

You will study in detail about this aspect in Unit 6 dealing with Memorandum of Association.

Before an application for registration is filed with the Registrar of Companies, the promoters shall take the necessary steps for preparing the important documents such as 'memorandum of association' and 'articles of association'. For this, the promoters may seek the help of a legal expert, a solicitor, chartered accountant, cost accountant, or a company secretary. These documents should be duly printed. The memorandum and articles have to be stamped and the value of the stamp differs from State to State as per the respective State stamp laws.

Section 7(a) and the rules framed by the Central Government require that Memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address,

description and occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any. The witness shall also verify his/their ID. However, it is not necessary that the promoters themselves should sign the memorandum and articles. The written consent of directors to act as such is also to be filed. The directors are required to give a written undertaking to take up and pay for their qualification shares, if any, prescribed in the Articles.

Besides, there shall be filed an declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.

A statutory declaration to the effect that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with; is also to be filed. The aforesaid declaration is to be signed by:

i) an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, **and**

ii) a person named in the articles as a director, manager or secretary of the company.

Besides these steps, depending upon the peculiar nature of the company and its objects, the promoters may be asked to comply with certain other requirements. These may include (i) obtaining the licence under the Industries (Development and Regulation) Act, 1951, (ii) obtaining clearance from the Ministry of Environment, (iii) entering into preliminary contracts, and (iv) preparing prospectus.

Check Your Progress A

1) What is meant by promotion of a Company?

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....

....

....

2) Fill in the blanks:

   i) For formation of a company, the promoters have to pass through .... stages.

   ii) The three stages for the formation of a company are promotion, ... and the commencement of the business.

   iii) Promotion of a company begins with the ....

   iv) A company may be formed only for a .... purpose.

v) A company not having any limit on the liability of its members is known as an .... company.

vi) In accordance with Section 5 of the Act, no company shall be registered by a name which is .... in the opinion of the ....

vii) The rules framed for the internal management of the affairs of the company are termed as ....

viii) Before delivering the memorandum and articles to the Registrar for registration of the company, these documents will be .... by the .... of the proposed company.

ix) The subscribers to the memorandum of association shall sign in the presence of at least one ....

4.4 DOCUMENTS TO BE FILED WITH THE REGISTRAR

After the promoters have got the necessary documents prepared, these are required to be filed with the Registrar of Companies. The documents that are necessary for the purpose of registration are as follows:

1) **Memorandum of Association:** The Memorandum of Association is the charter of the company. It needs to be originally prepared for every company. It defines the objectives for which the company is being formed. The memorandum by its clauses, describes the whole character of the company. This includes its objectives, its name, the nature of liability of its members, the State in which its registered office shall be located, the capital which the company is authorised to have. Besides, Memorandum must also state the names, addresses and other prescribed particulars of persons who subscribe their names to the memorandum of association.

   The memorandum defines the powers of a company and its relations with third parties.

   The memorandum of a company has to be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

   For purposes of registration, the promoters have to file with the Registrar of Companies, a duly signed and properly stamped printed Memorandum of Association.

   You should note that in case of a private company the memorandum of association should be signed by at least two persons in contrast to seven in case of a public company.

2) **Articles of Association:** The Articles of Association contain the rules and regulations for managing the internal affairs of the company and, therefore, govern the relationship between the company and its members. All companies are required to have articles of association. However, any company may adopt all or any of the regulations contained in the model articles applicable to the company. Model articles in relation to different kinds of companies are contained in Tables F, G, H, I and J in Schedule I to the Companies Act 2013.

In case of any company, which is registered under the Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall be deemed to be the regulations of that company.

The articles of association should also be signed separately by subscribers and they should also be attested by a witness. Once again, note that in case of a private company the articles of association should be signed by at least two persons as against seven persons in case of a public company.

3) **Declaration by subscribers to the memorandum and first directors:** There shall be filed a declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief. (Section 7(1)(c).

4) **A list of persons who have agreed to become the first directors of the company should also be filed:** There shall be filed the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

   Besides, the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed must also be filed with the Registrar of Companies.

5) **Address for communication:** Address for communication till the company acquires its registered office shall also be supplied.

   However, company must, as per Section 12, acquire its registered office within thirty days of its incorporation for the purpose of receiving and acknowledging all communications and notices as may be addressed to it.

   Section 12 and the rules made in this regard also require the company to furnish to the Registrar verification of its registered office within a period of 30 days of its incorporation in the prescribed Form No.2.25.

6) **Statutory declaration:** Lastly, the promoters must file a statutory declaration to the effect that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.

   The aforesaid declaration is to be signed by:

   i) an advocate, or

   ii) a chartered accountant, or

   iii) cost accountant, or

iv) company secretary, in practice and engaged in the formation of the company;

And by a person named in the articles as a director, manager or secretary of the company.

4.4.1 E-Filing of Documents

Sections 398 to 402 of the Companies Act 2013 contain provisions relating to electronic filing of forms, returns and documents with the Registrar and provisions of value added services.

Filing of applications, documents, inspection etc. in electronic form

Section 398 of the Act empowers the Central Government to make rules for filing, maintenance and inspection of various applications, form etc. through the electronic mode.

Further, Section 400 clarifies that the electronic form shall be exclusive or in alternative or in addition to the physical form. Once again, the Central Government is empowered to make rules in this respect.

Providing value added services through electronic form [Section 401]

The Central Government may provide such value added services through the electronic form and levy such fees as may be pre-scribed.

Application of provision of Information Technology Act, 2000 (Section 402) – You may note that all the provisions of the Information Technology Act, 2000 relating to the electronic records (including the manner and format in which the electronic records shall be filed), insofar as they are not inconsistent with this Act, shall be applicable to the records in electronic form under section 398 [Section 402].

Advantages of e-Filing

Adopting international best practices, MCA-21 application adds immense value to the stakeholders. Advantages of E-Filing include:

- Business shall be enabled to register a company and file statutory documents quickly and easily.
- Public to get easy access to relevant records and get their grievances redressed effectively.
- Professionals to be able to offer efficient services to their client companies.
- Financial institutions to find registration and verification of charges easy.
- Government to ensure proactive and effective compliance of relevant laws and corporate governance.
- MCA employees shall be enabled to deliver best services.

Launch of MCA-21 Programme

The Ministry of Corporate Affairs launched MCA-21, a major E-Governance initiative on 26 July, 2006. MCA-21 envisages e-filing of all documents relating to company matters on the MCA portal.

Salient Features of the MCA-21 include:

- Corporations, professionals and the public at large will no longer need to visit the Registrar of Companies offices and would be able to interact with

the Ministry using the MCA-21 portal from their offices or home or by going to the facilitation centres, which have been set-up.

- The users will have multiple options to make payments in the online mode either through credit cards or the Internet banking facility. Besides this, the traditional payment through demand draft would be accepted against a system-generated challan at the specified bank branches across the country.
- The system would also enable the stakeholder to track the service request through a Service Request Number (SRN)

The statutory filing of forms and returns in the offices of ROCs is now on the basis of new E-forms only; all manual filing of documents has been discontinued.

Permanent documents of existing companies like, Memorandum of Association, Articles of Association, current charge documents, etc. are presently maintained in paper form across various Registrar of Companies (RoC) offices. Almost all of these documents have been converted into electronic format. The scope of E-filing covers only the offices of RoCs, Regional Directors and the Headquarters at New Delhi and it does not include Official Liquidators, Tribunal and Courts.

The present scope of the MCA 21 includes services provided by the Secretariat at New Delhi, the four Regional Directorates (RDs) and the 20 offices of the Registrar of Companies (RoC) located all over the country. The E-filing facility includes:

- Registration and incorporation of new companies
- Filing of Annual Returns and Balance Sheets
- Filing of forms for change of names/address/Director's details
- Registration and verification of charges
- Inspection of documents
- Applications for various statutory services from MCA
- Investor grievance redressal

For the purpose of standardization and better understanding, the e-Forms have been grouped under the following broad categories:

a) **New Company Registration**

b) **Compliance Related Filing**: Whether annually or event based include Annual Return, Balance Sheet and Profit & Loss Account, Return of allotment, Return of buy back of securities, Return of deposits, Return of appointment of managing director, whole-time director, Notice of appointment of auditor, Statutory report, Cost audit report, etc.

c) **Change services:** It covers matters in respect of any change in the capital structure, changes in the registered office or the persons appointed as directors, secretaries and authorized representatives.

d) **Charge Management:** For registration of charge created or modified and satisfaction of charge, to be filed with the ROC. It also includes filing of e-Forms for appointment and cessation of receiver and filing of accounts by receiver. Various Forms have been deleted which includes Form 13, relating to charges.

e) **Investor Services:** E-filing system accepts complaints filed against a company by an investor as part of investor services. There is a specific e-Form for this purpose.

f) **Application for Registrar of Companies approval:** Registrar of Companies (ROC) is having powers to give direction in relation to the matters pertaining to the change of name of an existing company and the conversion of a public company to private company. In addition, ROC approval is required in case of extension of time period for holding AGM, holding AGM at place other than registered address, declaring a company as defunct, extension of the period of annual accounts, amalgamation of companies, forms relating to winding up, etc. The MCA has also prescribed several new e-Forms, for which there were no prescribed Forms available.

g) **Informational Services:** It covers those forms which are to be filed with ROC for informational purposes, in compliance with the provisions of the Companies Act, viz., declaration of solvency in case company decides to buy back its shares, form for filing of resolutions and agreements, form regarding place where books of account are kept, form in case company decides to transfer its shares to another company, etc.

In the e-filing system search facilities are available for viewing public documents, getting certified copies, finding the Corporate Identity Number (CIN), checking company name, finding name availability. The categories of public documents includes incorporation documents, charge documents, annual returns and balance sheets, change in directors and other documents.

Five Step e-Filing Process

Step 1 : Register Yourself

Step 2 : Download e-Form

Step 3 : Complete e-Form

Step 4 : Submit e-Form

Step 5 : Make Payment

Check Your Progress B

1) List the documents which are required to be filed with the Registrar for the purpose of incorporation of the company.

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2) State, whether the following statements are true or false:

   i) The memorandum of association of a company defines the objectives for which a company is formed.

   ii) The articles of association govern the relationship between the company and third parties.

iii) The relations between the company and its members are regulated by its articles of association.

iv) For the registration of a private company it is necessary that the articles of association are filed with the Registrar.

v) The list of directors of a private company alongwith their written consent to act as such must be filed with Registrar.

3) State the salient features of MCA-21.

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4) What are the five steps of e-filing process?

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5) State which of the following statements is correct:

a) A company may file its returns with the ROC:

i) in e-Form or deliver a copy in the physical form.

ii) only in the prescribed e-Forms.

b) The manner and format in which e-records are to be filed shall be governed by:

i) The provisions of the Companies Act, 2013.

ii) The provisions of the Information Technology Act, 2000.

4.5 INCORPORATION

When the necessary documents have been delivered to the Registrar and the requisite fees paid, the Registrar shall scrutinize these documents and if he is satisfied that (a) all the documents are in order; (b) all the requirements of the Companies Act in respect of registration have been complied with, and (c) the object for which the company is to be formed are lawful; he shall enter the name of the company in the Register of Companies maintained by his office. He would then issue a Certificate in the prescribed form, under his signature, certifying that the company is incorporated. The Certificate contains the name of the company, the date of its issue, and the signature of the Registrar with his seal. Certificate of Incorporation constitutes the company's birth Certificate and the company becomes a body corporate, with perpetual succession and may have a common seal. The company comes into existence on the date given in the Certificate of Incorporation.

If the Registrar is of the view that there are some minor defects in any document, he may require that the defects be rectified. But, if there are some material and substantial defects, the Registrar may refuse to register the company.

Allotment of Corporate Identity Number (CIN): As per Section 7(3), on and from the date mentioned in the certificate of incorporation , the Registrar shall allot to the company a corporate identity number (CIN), which shall be a distinct identity for the company and which shall also be included in the certificate.

4.5.1 Conclusiveness of Certificate of Incorporation

As per the Companies Act, 2013, Certificate of incorporation given by the Registrar of Companies in respect of any association shall not be conclusive where the Certificate was obtained by furnishing any false or incorrect particulars of any information or suppression of any material information.

Consequences of incorporating a company by filing false information/ suppression of information.

You should note that sub-sections (5), (6) and (7) of Section 7 make furnishing of any false or incorrect particulars of any information or suppression of any material information punishable with a minimum six months imprisonment which may extend up to ten years **and also** fine which shall not be less than the amount involved in the fraud but which may extend to three times the amount involved in the fraud.

Besides the aforesaid penalty, the Tribunal may, on an application made to it, and on being satisfied that the situation so warrants,—

a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

b) direct that liability of the members shall be unlimited; or

c) direct removal of the name of the company from the register of companies; or

d) pass an order for the winding up of the company; or

e) pass such other orders as it may deem fit.

However, before making any order, as aforesaid,—

i) the company shall be given a reasonable opportunity of being heard in the matter; and

ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

You should also note that the Certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company mentioned in the objects clause of the memorandum of association. As such, if a company has been registered whose objects are illegal, the incorporation does not validate the illegal objects. In such a case the only remedy available is to wind up the company.

4.5.2 Effects of Registration

You have just learnt that the Certificate issued by the Registrar of Companies is called the 'Certificate of incorporation'. This Certificate is a very important

document for the company because the company begins its corporate life from the date of the Certificate.

On filing of documents like memorandum of association, articles of association, the declarations, etc., the Registrar shall issue a Certificate of Incorporation to the company. In this Certificate, he shall certify that the company has been incorporated. If the company is a limited company, the Registrar shall further certify that the company is a limited company.

From the date of incorporation i.e., the date mentioned in the Certificate of incorporation the company becomes a legal person distinct from its members. Section 9 describes the effects of registration in the following words:

"From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name".

Thus, on incorporation, the following effects follow:

i) From the date of incorporation, the original subscribers to the memorandum as well as the other persons who may, from time to time, become members of the company, shall constitute a body corporate by the name contained in the memorandum of association. You would recall from Unit 1 that a company after incorporation becomes a body corporate distinct from its members. It becomes a legal person. The company's life starts from the date of its incorporation.

ii) The company acquires a perpetual succession. The consequences of it may be understood better by an example. If a company had ten shareholders and all of them die at the same time in a train accident, the company's existence will not be affected. In other words, we may say that the members may come and members may go, but the company goes on till it is wound up.

iii) The company can sue and be sued in its own name.

iv) Liability and debts of the company are not the liability of the shareholders/ members. They are, however, liable to contribute to the assets of the company, in the event of its being wound-up, to the extent of the amount remaining unpaid on the shares held by them or amount guaranteed, as the case may be.

v) The company will hold its property in its own name. The property of the company cannot be said to be the joint property of the shareholders.

vi) The memorandum and articles of association become binding on the members and the company. Articles are deemed to be a contract between the company and its members and would, after incorporation, govern the rights (a) of members against the company; (b) of company against the members, and (c) between members inter se, i.e., amongst themselves.

4.6 COMMENCEMENT OF BUSINESS

As per Section 10(A) Company incorporated after the commencement of the companies (Amendment) Act 2019 and having a share capital shall not commence any business or exercise any borrowing power unless (a) a declaration is filed by the director of the company within 180 days of the date of incorporation of the company that every subscribes to the memorandum has paid the value of the shares, and b) the registered office of the company so incorporated has been verified by filing return as provided in subsection (2) of section 12.

Penalty

In case of default in complying with this section the company shall be liable to a penalty of fifty thousand rupees and every officer in default shall be liable to a penalty of one thousand rupees each day during which the default continues but not exceeding an amount of one lakh rupees. This also shall qualify as a ground for striking off the name of the company from the register of the companies by the Registrar.

Further section 12(a) as amended empowers the Registrar to physically verify whether or not the company is carrying on business from its registered office. If the company is found to be not carrying any business, the Registrar may initiate action for removal of the name of the company from the register of company. This is to check the increase and functioning of shell companies.

Check Your Progress C

1) What is meant by Certificate of incorporation?

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2) What are the effects of incorporation?

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3) State, whether the following statements are true or false:

   i) A company comes into existence from the date of incorporation, mentioned on the Certificate of incorporation.

   ii) The Registrar issues the Certificate of Incorporation under his signature.

   iii) Only a public company acquires perpetual succession after incorporation.

   iv) A company incorporated after companies Amendment Act 2019 can commence its business immediately after registration.

4.8 LET US SUM UP

The incorporation of a company consists of three stages, viz., promotion, incorporation and commencement of business. In the promotion stage, the

promoters of the company conceive the business idea and organise all the resources needed for forming the company. They also get the necessary documents prepared, printed and file them in the office of the Registrar of Companies, along with the prescribed fee for registration. On scrutiny of these documents, if the Registrar is satisfied that all the formalities prescribed by the Companies Act have been complied with, he issues to the company, under his signatures, a Certificate of Incorporation. The documents can also be filed online. Ministry of Company Affairs (MCA) launched MCA 21, a major E-Governance initiative on 26 July, 2006. With the launch of MCA-21, the Ministry of Corporate Affairs (MCA) has moved from the traditional paper-based operation to e- governance.

The E-filing facility includes registration and incorporation of new companies, filing of Annual Returns and Balance Sheets, filing of forms for change of names/ address/Director's details, registration and verification of charges, inspection of documents, applications for various statutory services from MCA, investor grievance redressal etc.

In the e-filing system search facilities are available for viewing public documents, getting certified copies, finding the Corporate Identity Number (CIN), checking company name, finding name availability.

A company incorporated after the commencement of companies (Amendment) Act 2019 and having a share capital shall not commence its business or exercise any borrowing power unless a declaration is filed by the director of the company and registered office has been verified by filing return.

4.9 KEY WORDS

Conclusive: Final, which does not require any other evidence.

Debenture: A document or certificate signed by the officer of a company acknowledging indebtedness for money lent and a guaranteeing repayment with interest.

Incorporated: Constituted as a body corporate legally authorised to act as a person.

Inter-se: Between or amongst themselves.

Promoter: Those who undertake the formation of a company.

Statutory declaration: A declaration made in compliance of a written law.

MCA-21: An E-governance initiating of Ministry of Corporate governance. It envisages e-filing of all documents relating to a company on MCA portal.

4.10 ANSWERS TO CHECK YOUR PROGRESS

A. 1) For answer to this question please refer to 4.2 of this Unit.

2) i) three

ii) incorporation

iii) discovery of the business idea

iv) lawful

v) unlimited

vi) Undesirable, Central Government

vii) Articles of association

viii) signed, subscribers or promoters

ix) witness

B. 1) For answer to this question please refer to 4.4 of this Unit.

2) i) True ii) False iii) True iv) True v) True

5) a (ii), b (i)

C. 3) i) True ii) True iii) False iv) False

4.11 TERMINAL QUESTIONS

1) What are the different stages in the formation of a company? Discuss.

2) Discuss the documents that are required to filed with the Registrar of Companies for the purposes of registration.

3) What do you mean by incorporation of a company? What are the effects of registration of a company?

4) "The Certificate of incorporation is a conclusive proof that all the requirements of the Act in respect of formation of the company, have been complied with"? Explain.

5) A private company was incorporated with the object of running lotteries in the State of Tamilnadu. The activities of the company were challenged on the ground that it is illegal to run lotteries. the company stated that once the company has been incorporated, the nature of the business of the company is not open to examination and the Certificate of incorporation is conclusive.

(**Hint:** You have learnt in Section 4.5 above that the Certificate of incorporation is not conclusive with respect to the legality of the objects of the company, mentioned in its object clause and that the incorporation does not validate the illegal objects. Hence, the company may be restrained from operating lotteries.)

6) What are the advantages of E-filing? Explain.

7) Discuss the features of MCA-21.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 5 AUTHORITIES UNDER COMPANIES ACT, 2013

Structure

5.0 Objectives

5.1 Introduction

5.2 National Company Law Tribunal

  5.2.1 Qualifications

  5.2.2 Selection

  5.2.3 Term of Office

  5.2.4 Resignation and Removal of President and Members

  5.2.5 Jurisdiction

  5.2.6 Miscellaneous Provisions

  5.2.7 Powers of National Company Law Tribunal

  5.2.8 Appeal to Appellate Tribunal

5.3 National Company Law Appellate Tribunal

  5.3.1 Qualifications

  5.3.2 Selection

  5.3.3 Term of Office

  5.3.4 Resignation and Removal of Members

  5.3.5 Appeal to Supreme Court

  5.3.6 Mediation and Conciliation Panel

  5.3.7 Powers of National Company Law Appellate Tribunal

5.4 Special Courts

  5.4.1 Jurisdiction

  5.4.2 Appeal and Revision

  5.4.3 Fines

  5.4.4 Cognizance

5.5 Other Authorities

  5.5.1 Registrar

  5.5.2 Regional Directors

  5.5.3 National Financial Reporting Authority

  5.5.4 Serious Fraud Investigation Office

5.6 Let Us Sum Up

5.7 Key Words

5.8 Answers to Check Your Progress

5.9 Terminal Questions

5.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the constitution of National Company Law Tribunal and National Company Law Appellate Tribunal;
- enumerate qualifications, selection and term of office of members of National Company Law Tribunal and National Company Law Appellate Tribunal;
- describe the special courts; and
- discuss about Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office.

5.1 INTRODUCTION

There are three main authorities under the Companies Act, 2013. They are:

1) National Company Law Tribunal (NCLT)
2) National Company Law Appellate Tribunal (NCLAT) and
3) Special Courts

There are other authorities also. These are Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office. The NCLT and NCLAT were established under Companies Act, 2013. The Special Courts were first introduced by Companies Act, 2013. The objective is to provide for a single judicial forum to adjudicate all disputes concerning the affairs of Indian Companies except any criminal prosecution. In this block you will learn about NCLT, NCLAT, Special Courts and other authorities, i.e, Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office.

5.2 NATIONAL COMPANY LAW TRIBUNAL

National Company Law Tribunal (NCLT) is a quasi-judicial body that adjudicates issues relating to Indian companies. This was established under Companies Act 2013 and was constituted on 1st June 2016 by government of India. All the disputes under Companies Act such as arbitration, compromise, arrangements and reconstruction and winding up are disposed off by the NCLT.

The NCLT (Tribunal) consists of a President and such member of two types of members (a) Judicial members (b) Technical members, as the Central Government may deem necessary.

5.2.1 Qualifications

Qualifications of President and Judicial and Technical Members are as follows:

Section 409 prescribes the qualifications for appointment of president and members.

A. **President:** The President shall be a person who is or has been a Judge of a High Court for five years.

B. **a) Judicial Member:**

A Judicial member is not qualified unless he

i) is or has been a Judge of a High Court; or

ii) is or has been a District Judge for at least five years; or

iii) has, for at least ten years been an advocate of a court. Any period during which the person has held Judicial office or office of a member of a Tribunal or any post, under Union or State, requiring special knowledge of law after he becomes an advocate shall also be counted.

b) Technical member:

i) He should have at least fifteen years as a member of Indian Corporate Law Service or Indian Legal Service, and has been holding the rank of secretary or additional secretary to the Government of India or above in that service.

Or

ii) is or has been in practice as a Chartered Accountant or Cost Accountant or Company Secretary for at least fifteen years

Or

iii) is a person of proven ability, integrity and standing having professional experience not less than fifteen years, in law, industrial financial, industrial management or administration, industrial reconstruction, investment and accountancy.

Or

iv) is or has been, for at least five years, a presiding officer of a labour court, or Tribunal, National Tribunal Constituted under Industrial Disputes Act 1947.

5.2.2 Selection (Section 412)

The President of the Tribunal shall be appointed after consultation with the Chief Justice of India.

The members of the Tribunal shall be appointed on the recommendation of the Selection Committee consisting of

a) Chief Justice of India or his nominee - Chairperson

b) A Senior Judge of Supreme court or a Chief Justice of High Court - Member

c) Secretary in the Ministry of Corporate Affairs - Member

d) Secretary in the Ministry of Law and Justice - Member

The Committee shall determine its own procedure for recommending persons under subsection (2). Any vacancy or defect in the constitution of selection committee will not make any appointment invalid. The Chairperson shall have a casting vote if there is a equality of votes on any matter in a meeting of Selection Committee.

5.2.3 Term of Office

The president and every other member of the Tribunal shall hold office for five years from date of appointment and may be reappointed for another term of five years.

A member of the Tribunal shall hold office until he attains:

in case of president, the age of sixty seven years and in case of any other member, the age of sixty five years and shall not be eligible for appointment as member if he has not completed fifty years.

5.2.4 Resignation and Removal of President and Members

The president or any other member can resign by giving a notice in writing under his hand addressed to the Central Government, or until person duly appointed as his successor enters upon his office or until the expiry of his term office, whichever is earliest.

As per Section 417 the Central Government may, after consultation with Chief Justice of India, remove from office of the President or any other member who:

a) has been adjudged an insolvent; **or**

b) has been convicted of an offence which in the opinion of the central government involves moral turpitude; **or**

c) has become physically or mentally incapable of acting as such president or member. **or**

d) has acquired such financial or other interest as is likely to affect predecially his functions as president or member **or**

e) has so abused his position as to render his continuance in office prejudicial to public interest.

The president or member shall be given a reasonable opportunity of being heard, on any grounds from (b) to (e) before removal.

5.2.5 Jurisdiction

The Tribunal has jurisdiction on the matters under companies act 2013 which include :-

1) Cancellation/Variation of shareholder rights (Section 48)
2) Redemption of preference shares (Section 54)
3) Transfer and Transmission of shares (Section 56)
4) Rectification of register of members (Section 59)
5) Reduction of shares capital (Section 66)
6) Petition of Debentures trustee (Section 71)
7) Public Deposits (Section 73)
8) Repayment of Deposits (Section 74)
9) Power to call annual general meeting or meeting of members (Section 97, 98)
10) Disqualification of a Director (Section 164)
11) Protection of employees during investigation (Section 218)
12) Compromise or arrangement with Creditors (Section 230, 231)
13) Merger and Amalgamation (Section 232)
14) Oppression and Mismanagement (Section 241)

15) Removal of name of a company from register of Company

16) Revival and Rehabilitation of Sick Company (Chapter XIX)

17) Winding Up (Section 271)

18) Fraudulent Preferable (Section 238)

19) Deposit of monies in Schedule Bank by Company Liquidator (Sector 350)

5.2.6 Miscellaneous Provisions

1) Any person aggrieved by an order of that Tribunal may prefer an appeal to the Appellate Tribunal (Section 421).

2) The Central Government may specify the number of benches of the Tribunal. The Principal Bench shall be at New Delhi (Section 419).

3) Procedure as laid down in code of Civil Procedures 1908 shall be followed by Tribunal (Section 424).

4) The president and members shall be protected of action taken in good faith (Section 428).

5) Vacancy or defect in constitution of Tribunal shall not invalidate acts or proceedings (Section 431).

6) The Tribunal may, in any proceedings relating to a sick company or winding up may seek assistance of metropolitan magistrate, Chief Judicial Magistrate or District Collector or to take into custody or under its control all property, books of accounts or other documents (Section 429).

5.2.7 Powers of the National Company Law Tribunal

The powers of National Company Law Tribunal are as follows:

a) **The Power as a Civil Court** : The Tribunal shall enjoy the same powers as a civil court under the code of the Civil procedure 1908, on the following matters.

   i) Summoning and enforcing the attendance of any person and examining him on oath;

   ii) requiring the discovery and production of documents ;

   iii) receiving evidence on affidavit;

   iv) subject to provision of sections 123 and 124 of the Indian Evidence Act 1972, requisitioning any public record, document or a copy of such record or document from any offices;

   v) issuing commissions for the examination of witness or documents;

   vi) dismissing a representation for default or deciding it exparte;

   vii) any other matter which may be prescribed, Section 424 (2).

b) **Execution of an order**: An order made by the Tribunal may be enforced in the same manner as a decree made by a court in a suit.

c) **Power to punish for contempt**: The Tribunal shall have the same power and authority to punish for contempt as the high court under the provisions of contempt of Court Act 1970 (Section 425).

d) **Power to seek assistance of Chief Metropolitan Magistrate etc.** : In any proceeding relating to winding up of a company or rehabilitation of a sick company, the Tribunal may seek the help of Chief Metropolitan Magistrate, Chief Judicial Magistrate etc for the purpose of taking into custody property, books of account or other documents.

5.2.8 Appeal to Appellate Tribunal

Any person aggrieved by an order of the Tribunal may, within forty five days from the date on which the copy of the order was made available, file an appeal to the NCLAT. If the person was prevented from filing the appeal within forty five days due to sufficient cause, the NCLAT may extend the period by another 45 days. The NCLAT by order may confirm, modify, or set aside the order of the Tribunal appealed against after giving the parties a reasonable opportunity of being heard. A copy of the order shall be sent to tribunal and parties to appeal. If the order was made by tribunal with the consent of the parties, no appeal to NCLAT is possible.

5.3 NATIONAL COMPANY LAW APPELLATE TRIBUNAL

National Company Law Tribunal has primary jurisdiction whereas National Company Law Appellate Tribunal has appellate jurisdiction. It is a higher forum than National Company Law Tribunal. It was established under Section 410 of Companies Act 2013 and constituted with effect from 1st June 2016.

National Company Law Appellate Tribunal (Appellate Tribunal) hears appeals against order of the NCLT and National Financial Reporting Authority (NERA). It has a chairperson and two types of members (a) Judicial members and (b) Technical members. Such number of both types of members not exceeding eleven, as the Central Government may deem fit, to be appointed by the Central Government notification.

5.3.1 Qualifications

The qualifications of Chairman and Members are as follows:

The **Chairperson** shall be a person who is a or has been a judge of a Supreme Court or Chief Justice of a High Court.

A **Judicial member** shall be a person who is or has been a judge of a High Court or is a Judicial member of NCLT for five years.

A **Technical member** shall be a person of proven ability, integrity and standing having special knowledge and experience of not less than twenty five years, in law, industrial finance, industrial management, industrial reconstruction, investment and accountancy, labour matters or such other disciplines related to management, conduct of affairs, revival, rehabilitation, and winding up of companies.

5.3.2 Selection

The Selection for chairperson and member of NCLAT, is same as for National Company Law Tribunal (Section 5.2.2)

5.3.3 Term of Office

The chairperson or a member shall hold office for a term of five years from the date of taking charge and can be re-appointed for a period of another five years.

Chairperson shall hold office upto the age of seventy years and a member shall hold office upto sixty seven years of age.

A member will be appointed if has not completed the age of fifty years.

5.3.4 Resignation or Removal of Members

For a chairperson and members of a NCLAT – same as discussed in point 5.2.4.

5.3.5 Appeal to Supreme Court

An appeal against the order of the Appellate Tribunal may be filed by the aggrieved person to Supreme Court. An appeal within sixty days must be filed by aggrieved person to Supreme Court against order of NCLAT. It may be extendable by another sixty days if the person was prevented by sufficient cause to file within time.

The Tribunal and Appellate Tribunal shall be guided by the principle of natural justice and therefore have the power of regulate their own procedure. They shall not be bound by the procedure laid down in the code of Civil Procedure, 1908. However, while laying down the procedure they shall consider the other provisions of this act and rules made thereunder. The party to any proceeding or appeal before the Tribunal or Appellate Tribunal, has right either to appear in person or through one or more duly authorised Chartered Accountant, Company Secretary or Cost Accountant or Legal Practitioner or any other person to present his case before the Tribunal or Appellate Tribunal.

5.3.6 Mediation and Conciliation Panel (Section 442)

The Central Government maintains a panel of experts called "Mediation and Conciliation Panel", with prescribed qualifications and such number as it may decide. This panel mediates between parties during the pendency of any proceedings before central government or Tribunal or Appellate Tribunal. The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may suo motu, refer any matter pertaining to such proceeding to such member of experts from mediation and conciliation panel as the Central Government or Tribunal or the Appellate Tribunal, as the case may be, deem fit. The party also can file objections against its recommendations to Central Government or Tribunal or Appellate Tribunal as the case may be.

5.3.7 Powers of National Company Law Appellate Tribunal

The powers of National Company Law Appellate Tribunal are same as given in point 5.2.7

Check Your Progress A

1. What qualifications the President and Judicial members of National Company Law Tribunal should have?

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2. What are the qualifications of a Technical member of National Company Law Appellate Tribunal?

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3. List any five matters on which the National Company Law Tribunal has Jurisdiction?

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4. Fill in the blanks.

   a) National Company Law Tribunal consists of a President __________ and ____________

   b) The President of National Company Law Tribunal is appointed in consultation with ___________

   c) The term of office of President and members of National Company Law Tribunal is __________ years.

   d) The __________________ of National Company Law Tribunal should be either or a Judge of Supreme Court or Chief Justice of a High Court.

   e) Chairperson of National Company Law Appellate Tribunal (NCLAT) shall hold office upto the age of _____

5.4 SPECIAL COURTS

The Central Government, for speedy trial of offences under the Act may establish or designate special courts by notification. The special courts shall consist of :

a) A single judge, holding office as a session judge or additional sessions judge in case of offences punishable under Company Act, 2013 with imprisonment of two years or more and

b) A Metropolitan Magistrate or judicial Magistrate of First class in Case of other offences (Section 435).

They shall be appointed with concurrence of Chief Justice of a High Court.

5.4.1 Jurisdiction

1) The Special Courts have jurisdiction to all those offences under Companies Act 2013 with imprisonment of two years or more.

2) All other offences shall be tried as the case may be by a Metropolitan Magistrate or a Judicial Magistrate of the first class having jurisdiction to try any offence under this act or under any previous Company Law.

3) The special Courts try in a summary way any offence which is punishable with imprisonment not, exceeding three years. However, In summary trial, the sentence of imprisonment be passed not exceeding one year. If in the course of summary trial it appears to the special court that the sentence of imprisonment is likely to be granted is exceeding one year or it is undesirable to try the case summarily, it may proceed with the case as a regular trial.

5.4.3 Appeal and Revision

The High Court can hear the appeal or revision against the order of special court.

5.4.4 Fines

The amount of fines, partly or wholly shall be applied in or towards payment of costs of proceedings, or reward to person who gave information.

5.4.5 Cognizance

The court shall take cognizance of an offence against a company or any officer there off only on complaint in writing by Registrar or a member or by an authorised person.

All offences under the Act shall be deemed to be non-cognizable except in case of investigation by Serious Fraud Investigation Office. Compensation shall be paid if a person is accused without reasonable cause by the special court or court of session.

5.5 OTHER AUTHORITIES

Besides the authorities mentioned in earlier points, the following other authorities also overview and regulate the companies under companies Act. 2013

1) The Registrar of Companies (ROC)
2) Regional Director
3) National Financial Reporting Authority (NFRA)
4) Serious Fraud Investigation office (SFIO)

5.5.1 The Registrar

Registrar means a ‘Registrar’ or an additional, a Joint, or Deputy or an Assistant Registrar, having the duty of registering companies and discharging various functions under the Act, Section 2(75).

Registrar of Companies (ROCs) are the field officers who deal directly with the companies registered or intended to be registered within their territorial jurisdiction. There is a Registrar of Companies for each state. He is full time officer appointed by Central Government and is responsible for administration of Company Law in that state. Certain powers are vested in the Registrar of Companies, under various sections of the Act.

The Registrar of Companies has certain duties after the necessary documents are filed by the companies for registration, record or filing. He is required to examine or cause to be examined the documents. He needs to take a decision within 30 days from the date of filing documents. If such documents are found to be defective or incomplete in any respect, the ROC shall direct the company to rectify it.

5.5.2 Regional Directors

There are seven directorate of Regional Directors. They are at Ahmadabad, New Delhi, Mumbai, Chennai, Kolkata, Shillong and Hyderabad, covering North Western region, North Region, Western region, Southern Region, Eastern Region, North Eastern Region and South Eastern region respectively. The Ministry of

Corporate affairs is empowered to appoint Regional Directors for carrying out various functions under the act. Certain powers and functions of the Central Government have been delegated to the Regional Directors in pursuant of Section 458. The Regional Director shall exercise the power and functions of the Central Government so delegated to it under various sections.

5.5.3 National Financial Reporting Authority (NFRA)

The Central Government may by notification, constitute a National Financial Reporting Authority.

It is an apex body for the purpose of various matters relating to accounting and auditing standards. It would be responsible for matters relating to formulation, monitoring and enforcement of accounting standards. The NFRA shall make (a) recommendations to the Central Government on formation and laying down of accounting and auditing policies and standards to be adopted by companies or class of companies or auditors, as the case may be; (b) monitor and enforce the compliance with accounting standards and auditing standard in such a manner as may be prescribed. (c) Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service and such other related matters as may be prescribed and (d) performs such other functions relating to clauses a, b and c as may be prescribed. It is vested with the powers of a civil court. It can own its own or on a reference made to it by Central Government, investigate any body corporate, or persons or professionals or other misconduct by any member or firm of Chartered Accountants (Section 132).

5.5.4 Serious Fraud Investigation Office (SFIO)

Serious Fraud Investigation Office (SFIO) has been constituted under section 211 and 212 of Companies Act, 2013, is a multi disciplinary organisation having experts from financial sector, capital market, accounting, forensic, audit, taxation, law, information technology, company law, customs and investigation.

This office is empowered to investigate frauds relating to a company. Where Central Government is of the opinion, that it is necessary to investigate the affairs of a company by Serious Fraud Investigation Office, it may assign the investigation to Serious Fraud Investigation Office. The Central Government may make that assignment to this office in following circumstances:

a) On receipt of a report of the Registrar or an inspector;

b) On intimation of a special resolution passed by the Company that its affairs are required to be investigated;

c) In the public interest;

d) On request from any department of Central or State Government.

It has the exclusive jurisdiction and once a case has been assigned to SFIO no other agency shall initiate or proceed with investigation. It has a power to arrest and seek information and explanation from any person involved in the fraud.

Check Your Progress B

1. What are 'Special Courts'?

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2. What is the National Financial Reporting Authority?

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3. What is 'Serious Fraud Investigation Office?

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4. Fill in the blanks

   1) The Central Government maintains the panel of experts called ____________

   2) A single judge holding office as _____________ may be appointed in special courts.

   3) There are _____________ Regional Director's Offices.

   4) The National Financial Reporting Authority is responsible for ________________ standards.

5.6 LET US SUM UP

The Companies Act 2013 has specified certain authorities to overview and regulate the companies. These are : National Company Law Tribunal, National Company Law Appellate Tribunal and Special Courts. Both have President and Judicial as well as technical members. Both President or chairman have term of office of five years. The president of the NCLT is appointed after consultation with Chief Justice of India. The members of the Tribunal are appointed on the recommendations of selection committee. The Selection Committee of NCLAT is same as of NCLT. The Central Government for speedy trail of offences under the act may establish or designate special courts.

There are other authorities as well. They are the Registrar, Regional Directors, National Financial Reporting Authority and Serious Fraud Investigation office.

5.7 KEY WORDS

National Company Law Tribunal: A quasi judicial body that adjudicates issues relating to Indian Companies.

National Company Law Appellate Tribunal: A higher forum than NCLT which generally review decisions of NCLT.

Special Courts: These are set up by Central Government for speedy trials.

Serious Fraud Investigation Office: It empowered to investigate fraud relating to companies.

5.8 ANSWERS TO CHECK YOUR PROGRESS

A) a) Judicial and Technical members

b) Chief Justice of India

c) Five years

d) Chairperson

e) 70 years

B) 1) Medication and conciliation panel

2) Sessions judge

3) Six

4) Accounting and Auditing

5.9 TERMINAL QUESTIONS

1) Discuss the powers of the National Company Law Tribunal. What is its Constitution?

2) What are the Special Courts? Explain.

3) Explain in detail about National Company Law Appellate Tribunal.

4) Write a note on Registrar of Companies.

5) Discuss the role of National Financial Reporting Authority.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

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